

MANNATECH INC
Form 10-Q
August 04, 2015

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

FORM 10-Q
(Mark One)

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

For the quarterly period ended: June 30, 2015

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 No. 000-24657

MANNATECH, INCORPORATED
(Exact Name of Registrant as Specified in its Charter)

Texas 75-2508900
(State or other Jurisdiction of Incorporation or Organization) (I.R.S. Employer Identification No.)

600 S. Royal Lane, Suite 200, Coppell, Texas 75019
(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, including Area Code: (972) 471-7400

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 definitions of "accelerated filer", "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

As of July 31, 2015, the number of shares outstanding of the registrant's sole class of common stock, par value
\$0.0001 per share, was 2,681,078.

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Special Note Regarding Forward-Looking Statements

Certain disclosures and analyses in this Form 10-Q, including information incorporated by reference, may include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and the Private Securities Litigation Reform Act of 1995 that are subject to various risks and uncertainties. Opinions, forecasts, projections, guidance, or other statements other than statements of historical fact are considered forward-looking statements and reflect only current views about future events and financial performance. Some of these forward-looking statements include statements regarding:

§ management’s plans and objectives for future operations;

§ existing cash flows being adequate to fund future operational needs;

§ future plans related to budgets, future capital requirements, market share growth, and anticipated capital projects and obligations;

§ the realization of net deferred tax assets;

§ the ability to curtail operating expenditures;

§ global statutory tax rates remaining unchanged;

§ the impact of future market changes due to exposure to foreign currency translations;

§ the possibility of certain policies, procedures, and internal processes minimizing exposure to market risk;

§ the impact of new accounting pronouncements on financial condition, results of operations, or cash flows;

§ the outcome of new or existing litigation matters;

§ the outcome of new or existing regulatory inquiries or investigations; and

§ other assumptions described in this report underlying such forward-looking statements.

Although we believe that the expectations included in these forward-looking statements are reasonable, these forward-looking statements are subject to certain events, risks, assumptions, and uncertainties, including those discussed below, the “Risk Factors” section in Part I, Item 1A of our Form 10-K for the year ended December 31, 2014, and the “Risk Factors” section in Part II, Item 1A of this Form 10-Q, and elsewhere in this Form 10-Q and the documents incorporated by reference herein. If one or more of these risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results and developments could materially differ from those expressed in or implied by such forward-looking statements. For example, any of the following factors could cause actual results to vary materially from our projections:

§ overall growth or lack of growth in the nutritional supplements industry;

§ plans for expected future product development;

§ changes in manufacturing costs;

§ shifts in the mix of packs and products;

§ the future impact of any changes to global associate career and compensation plans or incentives;

§ the ability to attract and retain independent associates and members;

§ new regulatory changes that may affect operations or products;

§ the competitive nature of our business with respect to products and pricing;

§ publicity related to our products or network-marketing; and

§ the political, social, and economic climate.

Forward-looking statements generally can be identified by use of phrases or terminology such as “may,” “will,” “should,” “could,” “would,” “expects,” “plans,” “intends,” “anticipates,” “believes,” “estimates,” “approximates,” “predicts,” “projects,” “continues” or other similar words or the negative of such terms and other comparable terminology. Similarly, descriptions of Mannatech’s objectives, strategies, plans, goals, or targets contained herein are also considered forward-looking statements. Readers are cautioned when considering these forward-looking statements to keep in mind these risks, assumptions, and uncertainties and any other cautionary statements in this report, as all of the forward-looking statements contained herein speak only as of the date of this report.

Unless stated otherwise, all financial information throughout this report and in the Consolidated Financial Statements and related Notes include Mannatech, Incorporated and all of its subsidiaries on a consolidated basis and may be referred to herein as “Mannatech,” “the Company,” “its,” “we,” “our,” or “their.”

Our products are not intended to diagnose, cure, treat, or prevent any disease, and any statements about our products contained in this report have not been evaluated by the Food and Drug Administration, also referred to herein as the “FDA”.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

MANNATECH, INCORPORATED AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except share amounts)

| | June 30, 2015 (unaudited) | December 31, 2014 |
|---|---------------------------------|-------------------------|
| ASSETS | | |
| Cash and cash equivalents | \$ 30,663 | \$ 27,999 |
| Restricted cash | 1,515 | 1,511 |
| Accounts receivable, net of allowance of \$237 and \$213 in 2015 and 2014, respectively | 336 | 504 |
| Income tax receivable | 15 | 4 |
| Inventories, net | 14,247 | 10,591 |
| Prepaid expenses and other current assets | 2,668 | 3,069 |
| Deferred commissions | 4,152 | 4,544 |
| Deferred tax assets, net | 1,184 | 1,141 |
| Total current assets | 54,780 | 49,363 |
| Property and equipment, net | 4,434 | 2,481 |
| Construction in progress | 439 | 1,622 |
| Long-term restricted cash | 7,297 | 7,045 |
| Other assets | 4,033 | 3,567 |
| Long-term deferred tax assets, net | 3,462 | 3,320 |
| Total assets | \$ 74,445 | \$ 67,398 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current portion of capital leases | \$ 761 | \$ 901 |
| Accounts payable | 6,398 | 4,252 |
| Accrued expenses | 6,699 | 6,356 |
| Commissions and incentives payable | 8,722 | 7,908 |
| Taxes payable | 2,538 | 2,578 |
| Current deferred tax liability | 129 | 123 |
| Deferred revenue | 9,770 | 10,890 |
| Total current liabilities | 35,017 | 33,008 |
| Capital leases, excluding current portion | 1,260 | 852 |
| Long-term deferred tax liabilities | 69 | 26 |
| Other long-term liabilities | 2,167 | 2,136 |
| Total liabilities | 38,513 | 36,022 |
| Commitments and contingencies | | |
| Shareholders' equity: | | |
| Preferred stock, \$0.01 par value, 1,000,000 shares authorized, no shares issued or outstanding | — | — |
| Common stock, \$0.0001 par value, 99,000,000 shares authorized, 2,773,972 shares issued and 2,681,078 shares outstanding as of June 30, 2015 and 2,773,972 shares issued and 2,676,077 shares outstanding as of December 31, 2014 | — | — |
| Additional paid-in capital | 40,408 | 40,672 |
| Retained earnings | 6,992 | 2,750 |
| Accumulated other comprehensive loss | (141 |) (109) |

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| | | |
|--|-----------|-----------|
| Treasury stock, at average cost, 92,894 shares as of June 30, 2015 and 97,895 shares as of December 31, 2014, respectively | (11,327) | (11,937) |
| Total shareholders' equity | 35,932 | 31,376 |
| Total liabilities and shareholders' equity | \$ 74,445 | \$ 67,398 |

See accompanying notes to unaudited consolidated financial statements.

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CONSOLIDATED STATEMENTS OF OPERATIONS – (UNAUDITED)

(in thousands, except per share information)

| | Three months ended | | Six months ended | |
|---|--------------------|-----------|------------------|-----------|
| | June 30, | | June 30, | |
| | 2015 | 2014 | 2015 | 2014 |
| Net sales | \$46,726 | \$46,302 | \$91,096 | \$89,265 |
| Cost of sales | 8,270 | 9,738 | 16,823 | 19,136 |
| Gross profit | 38,456 | 36,564 | 74,273 | 70,129 |
| Operating expenses: | | | | |
| Commissions and incentives | 18,887 | 19,782 | 36,429 | 36,750 |
| Selling and administrative | 8,598 | 8,946 | 17,411 | 16,822 |
| Depreciation and amortization | 495 | 421 | 891 | 807 |
| Other operating costs | 5,866 | 6,815 | 12,421 | 13,771 |
| Total operating expenses | 33,846 | 35,964 | 67,152 | 68,150 |
| Income from operations | 4,610 | 600 | 7,121 | 1,979 |
| Interest income | 31 | 35 | 61 | 36 |
| Other income (expense), net | (452) | 192 | (1,384) | (144) |
| Income before income taxes | 4,189 | 827 | 5,798 | 1,871 |
| Provision for income taxes | (1,046) | (1,519) | (1,556) | (2,335) |
| Net income (loss) | \$3,143 | \$(692) | \$4,242 | \$(464) |
| Earnings (loss) per common share: | | | | |
| Basic | \$1.17 | \$(0.26) | \$1.58 | \$(0.17) |
| Diluted | \$1.15 | \$(0.26) | \$1.55 | \$(0.17) |
| Weighted-average common shares outstanding: | | | | |
| Basic | 2,680 | 2,662 | 2,678 | 2,658 |
| Diluted | 2,729 | 2,662 | 2,730 | 2,658 |

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) – (UNAUDITED)

(in thousands)

| | Three months ended | | Six months ended | |
|-------------------------------|--------------------|---------|------------------|---------|
| | June 30, | | June 30, | |
| | 2015 | 2014 | 2015 | 2014 |
| Net income (loss) | \$3,143 | \$(692) | \$4,242 | \$(464) |
| Foreign currency translations | (274) | 566 | (32) | 628 |
| Comprehensive income (loss) | \$2,869 | \$(126) | \$4,210 | \$164 |

See accompanying notes to unaudited consolidated financial statements.

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CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

– (UNAUDITED)

(in thousands)

| | Common stock Par value | Additional paid in capital | Retained earnings | Accumulated other comprehensive loss | Treasury stock | Total shareholders' equity |
|---|---------------------------------|----------------------------------|----------------------|---|-------------------|----------------------------------|
| Balance at December 31, 2014 | \$ | — \$ 40,672 | \$ 2,750 | \$ (109) | \$(11,937) | \$ 31,376 |
| Net income | | — — | 4,242 | — | — | 4,242 |
| Charge related to stock-based compensation | | — 301 | — | — | — | 301 |
| Stock option exercises | | — (581) | — | — | 610 | 29 |
| Tax benefit from exercise of stock options | | — 16 | — | — | — | 16 |
| Foreign currency translations | | — — | — | (32) | — | (32) |
| Balance at June 30, 2015 | \$ | — \$ 40,408 | 6,992 | (141) | (11,327) | 35,932 |

See accompanying notes to unaudited consolidated financial statements.

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MANNATECH, INCORPORATED AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF CASH FLOWS – (UNAUDITED)
 (in thousands)

| | Six months ended June 30, | |
|--|------------------------------|----------|
| | 2015 | 2014 |
| <u>CASH FLOWS FROM OPERATING ACTIVITIES:</u> | | |
| Net income (loss) | \$4,242 | \$(464) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation and amortization | 891 | 807 |
| Provision for inventory losses | 345 | 1,630 |
| Provision for doubtful accounts | 194 | 186 |
| Loss on disposal of assets | 8 | 37 |
| Accounting charge related to stock-based compensation expense | 301 | 302 |
| Tax benefit from exercise of stock options | (16) | — |
| Deferred income taxes | (139) | 221 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (55) | 16 |
| Income tax receivable | (11) | (16) |
| Inventories | (4,242) | (896) |
| Prepaid expenses and other current assets | 962 | (79) |
| Other assets | (97) | (303) |
| Deferred commissions | 351 | (1,941) |
| Accounts payable | 2,164 | 65 |
| Customer deposits | — | 3,075 |
| Accrued expenses and other liabilities | 177 | 763 |
| Taxes payable | (17) | 1,101 |
| Commissions and incentives payable | 910 | (1,924) |
| Deferred revenue | (1,038) | 4,825 |
| Change in restricted cash | (449) | (18) |
| Net cash provided by operating activities | 4,481 | 7,387 |
| <u>CASH FLOWS FROM INVESTING ACTIVITIES:</u> | | |
| Acquisition of property and equipment | (1,174) | (1,193) |
| Proceeds from sale of assets | — | 8 |
| Net cash used in investing activities | (1,174) | (1,185) |
| <u>CASH FLOWS FROM FINANCING ACTIVITIES:</u> | | |
| Proceeds from stock options exercised | 29 | 70 |
| Tax benefit from exercise of stock options | 16 | — |
| Repayment of capital lease obligations | (981) | (680) |
| Net cash used in financing activities | (936) | (610) |
| Effect of currency exchange rate changes on cash and cash equivalents | 293 | 491 |
| Net increase in cash and cash equivalents | 2,664 | 6,083 |
| Cash and cash equivalents at the beginning of the period | 27,999 | 20,395 |
| Cash and cash equivalents at the end of the period | \$30,663 | \$26,478 |
| <u>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</u> | | |
| Income taxes paid, net | \$3,959 | \$1,259 |
| Interest paid on capital leases | \$47 | \$52 |
| Assets acquired through financing arrangements | \$1,250 | \$1,562 |

See accompanying notes to unaudited consolidated financial statements.

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MANNATECH, INCORPORATED AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Mannatech, Incorporated (together with its subsidiaries, the “Company”), located in Coppell, Texas, was incorporated in the state of Texas on November 4, 1993 and is listed on the NASDAQ Global Select Market (“Nasdaq”) under the symbol “MTEX”. The Company develops, markets, and sells high-quality, proprietary nutritional supplements, topical and skin care products, and weight-management products. We currently sell our products in three regions: (i) North America (the United States, Canada and Mexico); (ii) Europe/Middle East/Africa, (“EMEA”) (Austria, the Czech Republic, Denmark, Estonia, Finland, Germany, the Republic of Ireland, Namibia, the Netherlands, Norway, South Africa, Spain, Sweden, and the United Kingdom); and (iii) Asia/Pacific (Australia, Japan, New Zealand, the Republic of Korea, Singapore, Taiwan and Hong Kong).

Independent associates (“associates”) purchase the Company’s products at published wholesale prices to either sell to retail customers or for personal use. Members purchase the Company’s products at a discount from published retail prices primarily for personal use. The Company cannot distinguish products sold for personal use from other sales because it is not involved with the products after delivery, other than usual and customary product warranties and returns. Only associates are eligible to earn commissions and incentives.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with instructions for Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, the Company’s consolidated financial statements and footnotes contained herein do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America (“GAAP”) to be considered “complete financial statements”. However, in the opinion of the Company’s management, the accompanying unaudited consolidated financial statements and footnotes contain all adjustments, including normal recurring adjustments, considered necessary for a fair presentation of the Company’s consolidated financial information as of, and for, the periods presented. The Company cautions that its consolidated results of operations for an interim period are not necessarily indicative of its consolidated results of operations to be expected for its fiscal year. The December 31, 2014 consolidated balance sheet was included in the audited consolidated financial statements in the Company’s annual report on Form 10-K for the year ended December 31, 2014 and filed with the United States Securities and Exchange Commission (the “SEC”) on March 10, 2015 (the “2014 Annual Report”), which includes all disclosures required by GAAP. Therefore, these unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements of the Company included in the 2014 Annual Report.

Principles of Consolidation

The consolidated financial statements and footnotes include the accounts of the Company and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of the Company’s consolidated financial statements in accordance with generally accepted accounting principles requires the use of estimates that affect the reported value of assets, liabilities, revenues and expenses. These estimates are based on historical experience and various other factors. The Company continually evaluates the information used to make these estimates as the business and economic environment changes. Historically, actual results have not varied materially from the Company’s estimates, and the Company does not currently anticipate a significant change in its assumptions related to these estimates. However, actual results may differ from these estimates under different assumptions or conditions.

The use of estimates is pervasive throughout the consolidated financial statements, but the accounting policies and estimates considered the most significant are described in this note to the consolidated financial statements, Organization and Summary of Significant Accounting Policies.

Cash and Cash Equivalents

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. The Company includes in its cash and cash equivalents credit card receivables due from its credit card processor, as the cash proceeds from credit card receivables are received within 24 to 72 hours of submission to the credit card processor. As of June 30, 2015 and December 31, 2014, credit card receivables were \$2.4 million and \$1.2 million, respectively. As of June 30, 2015 and December 31, 2014, cash and cash equivalents held in bank accounts in foreign countries totaled \$27.9 million and \$24.8 million, respectively. The Company invests cash in liquid instruments, such as money market funds and interest bearing deposits. The Company also holds cash in high quality financial institutions and does not believe it has an excessive exposure to credit concentration risk.

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MANNATECH, INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Restricted Cash

The Company is required to restrict cash for: (i) direct selling insurance premiums and credit card sales in the Republic of Korea; (ii) reserve on credit card sales in the United States and Canada; and (iii) the Australia building lease collateral. As of June 30, 2015 and December 31, 2014, our total restricted cash was \$8.8 million and \$8.6 million, respectively.

Accounts Receivable

Accounts receivable are carried at their estimated collectible amounts. Receivables are created upon shipment of an order if the credit card payment is rejected or does not match the order total. As of June 30, 2015 and December 31, 2014, receivables consisted primarily of amounts due from members and associates. The Company periodically evaluates its receivables for collectability based on historical experience, recent account activities, and the length of time receivables are past due and writes-off receivables when they become uncollectible. For each of June 30, 2015 and December 31, 2014, the Company held an allowance for doubtful accounts of \$0.2 million.

Inventories

Inventories consist of raw materials, finished goods, and promotional materials that are stated at the lower of cost or market (using standard costs that approximate average costs). The Company periodically reviews inventories for obsolescence, and any inventories identified as obsolete are reserved or written off.

Other Assets

As of June 30, 2015 and December 31, 2014, other assets were \$4.0 million and \$3.6 million, respectively, and primarily consisted of deposits for building leases in various locations of \$2.0 million and \$1.5 million, respectively. Additionally, included in the June 30, 2015 and December 31, 2014 balances was \$1.6 million and \$1.7 million, respectively, representing a deposit with Mutual Aid Cooperative and Consumer in the Republic of Korea, an organization established by the Republic of Korea's Fair Trade Commission to protect consumers who participate in network marketing activities. Also included in the June 30, 2015 and December 31, 2014 balances was \$0.2 million of indefinite lived intangible assets relating to the Manapol® powder trademark.

Other Long-Term Liabilities

Other long-term liabilities were \$2.2 million and \$2.1 million as of June 30, 2015 and December 31, 2014, respectively. As of June 30, 2015 and December 31, 2014, the Company recorded \$0.8 million and \$0.7 million, respectively, in other long-term liabilities related to uncertain income tax positions (see Note 8, Income Taxes of the Company's annual report on Form 10-K for the year ended December 31, 2014, filed March 10, 2015). Certain operating leases for the Company's regional office facilities contain a restoration clause that requires the Company to restore the premises to its original condition. Accrued restoration costs related to these leases amounted to \$0.4 million at June 30, 2015 and December 31, 2014. The Company also recorded a long-term liability for estimated defined benefit obligation related to a non-U.S. defined benefit plan for its Japan operations of \$0.6 million at each of June 30, 2015 and December 31, 2014 (See Note 10, Employee Benefit Plans, of the Company's 10-K, filed March 10, 2015).

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MANNATECH, INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Revenue Recognition and Deferred Commissions

The Company's revenue is derived from sales of individual products, sales of its starter and renewal packs, and shipping fees. Substantially all of the Company's product and pack sales are made to associates at published wholesale prices and to members at discounted published retail prices. The Company records revenue net of any sales taxes and records a reserve for expected sales returns based on its historical experience.

The Company recognizes revenue from shipped packs and products upon receipt by the customer. Corporate-sponsored event revenue is recognized when the event is held. The Company defers certain components of its revenue. At June 30, 2015 and December 31, 2014, the Company's deferred revenue was \$9.8 million and \$10.9 million, respectively. When participating in the Company's loyalty program, customers earn loyalty points from qualified automatic orders, which can be applied to future purchases. The Company defers the dollar equivalent in revenue of these points until the points are applied or forfeited or expired, which includes an estimate of the percentage of the unvested loyalty points that are expected to be forfeited or expired. During the third quarter 2014, the Company modified the program to allow loyalty points to vest more quickly. The deferred revenue associated with the loyalty program at June 30, 2015 and December 31, 2014, was \$7.9 million and \$9.7 million, respectively. Deferred revenue consisted primarily of: (i) sales of packs and products shipped but not received by the customers by the end of the respective period; (ii) revenue from the loyalty program; and (iii) prepaid registration fees from customers planning to attend a future corporate-sponsored event. In total current assets, the Company defers commissions on (i) the sales of packs and products shipped but not received by the customers by the end of the respective period and (ii) the loyalty program. Deferred commissions were \$4.2 million and \$4.5 million at June 30, 2015 and December 31, 2014, respectively.

| | |
|--|-------------------|
| | (in thousands) |
| Loyalty program | |
| Loyalty deferred revenue as of January 1, 2014 | \$ 5,456 |
| Loyalty points forfeited or expired | (4,664) |
| Loyalty points used | (12,348) |
| Loyalty points vested | 19,580 |
| Loyalty points unvested | 1,679 |
| Loyalty deferred revenue as of December 31, 2014 | \$ 9,703 |
| Loyalty deferred revenue as of January 1, 2015 | \$9,703 |
| Loyalty points forfeited or expired | (5,310) |
| Loyalty points used | (7,123) |
| Loyalty points vested | 6,432 |
| Loyalty points unvested | 4,167 |
| Loyalty deferred revenue as of June 30, 2015 | \$7,869 |

The Company estimates a sales return reserve for expected sales refunds based on historical experience over a rolling six month period. If actual results differ from our estimated sales return reserve due to various factors, the amount of revenue recorded each period could be materially affected. Historically, sales returns have not materially changed through the years, as the majority of our customers who return their merchandise do so within the first 90 days after the original sale. Sales returns have historically averaged 1.5% or less of our gross sales. For the six months ended June 30, 2015 our sales return reserve consisted of the following (in thousands):

| | |
|-------------------------------------|-------|
| Sales reserve as of January 1, 2015 | \$207 |
|-------------------------------------|-------|

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| | |
|---|-------|
| Provision related to sales made in current period | 828 |
| Adjustment related to sales made in prior periods | (28) |
| Actual returns or credits related to current period | (632) |
| Actual returns or credits related to prior periods | (172) |
| Sales reserve as of June 30, 2015 | \$203 |

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MANNATECH, INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Shipping and Handling Costs

The Company records freight and shipping fees collected from its customers as revenue. The Company records inbound freight as a component of inventory and both inbound and outbound freight as a component of cost of sales.

Commissions and Incentives

Associates earn commissions and incentives based on their direct and indirect commissionable net sales over 13 business periods each year. Each business period equals 28 days. The Company accrues commissions and incentives when earned by associates and pays commissions on product sales three weeks following the business period end and pays commissions on its pack sales five weeks following the business period end.

Comprehensive Income (Loss) and Accumulated Other Comprehensive Income (Loss)

Comprehensive income (loss) is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources and includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. The Company's comprehensive income (loss) consists of the Company's net income (loss), foreign currency translation adjustments from its Japan, Republic of Korea, Taiwan, Norway, Sweden, and Mexico operations, and changes in the pension obligation for its Japanese employees.

NOTE 2: INVENTORIES

Inventories consist of raw materials and finished goods, which also includes promotional materials. The Company provides an allowance for any slow-moving or obsolete inventories. Inventories at June 30, 2015 and December 31, 2014, consisted of the following (in thousands):

| | June 30, 2015 | December 31, 2014 |
|-------------------------------------|------------------|----------------------|
| Raw materials | \$1,578 | \$ 2,118 |
| Finished goods | 14,467 | 10,615 |
| Inventory reserves for obsolescence | (1,798) | (2,142) |
| Total | \$14,247 | \$ 10,591 |

NOTE 3: INCOME TAXES

For the three and six months ended June 30, 2015, the Company's effective tax rate was 25.0% and 26.8% respectively. For the three and six months ended June 30, 2014, the Company's effective income tax rate was 183.7% and 124.8%, respectively. For the three and six months ended June 30, 2015 and 2014, the Company's effective tax rate was determined based on the estimated annual effective tax rate.

The effective tax rates for the three and six months ended June 30, 2015 were lower than what would have been expected if the federal statutory rate were applied to income before taxes. Items decreasing the effective income tax rate include the favorable rate differences from foreign jurisdictions and release of valuation allowances associated with deferred tax assets of net operating loss carryforward.

The effective tax rates for the three and six months ended June 30, 2014 were higher than what would have been expected if the federal statutory rate were applied to income before taxes. Items increasing the effective income tax rate included the change in the valuation allowances associated with certain deferred tax assets and the unfavorable rate differences from foreign jurisdictions. In addition, in the second quarter 2014, it was determined a deemed intercompany dividend had occurred in 2012 and 2013 related to an intercompany working capital loan that originated in 2012; the Company recorded the expense, which is not material to the financial statements for the year. We have not initiated any further intercompany transactions like the 2012 transaction, nor do we anticipate the need for further transactions of this type.

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MANNATECH, INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 4: EARNINGS (LOSS) PER SHARE

The Company calculates basic Earnings Per Share (“EPS”) by dividing net income (loss) by the weighted-average number of common shares outstanding for the period. Diluted EPS also reflects the potential dilution that could occur if common stock were issued for awards outstanding under the 2008 Stock Incentive Plan. In determining the potential dilution effect of outstanding stock options during the three months ended June 30, 2015 and 2014, the Company used the quarter’s average common stock close price of \$20.08 and \$15.13 per share, respectively. In determining the potential dilution effect of outstanding stock options during the six months ended June 30, 2015 and 2014, the Company used the six month average common stock close price of \$20.71 and \$15.93 per share, respectively. The Company reported net income for the three and six months ended June 30, 2015. For the three and six months ended June 30, 2015, approximately 0.1 million shares of the Company’s common stock subject to options were excluded from the diluted EPS calculation, as the effect would have been antidilutive.

NOTE 5: STOCK-BASED COMPENSATION

The Company currently has one active stock-based compensation plan, which was approved by shareholders. The Company grants stock options to employees, consultants, and board members at the fair market value of its common stock, on the date of grant, with a term no greater than ten years. The majority of stock options vest over two or three years. Shareholders who own 10% or more of the Company’s outstanding stock are granted incentive stock options at an exercise price that may not be less than 110% of the fair market value of the Company’s common stock on the date of grant and have a term no greater than five years.

In February 2008, the Company’s Board of Directors approved the Mannatech, Incorporated 2008 Stock Incentive Plan, (the “2008 Plan”), which reserves up to 100,000 shares of common stock for issuance of stock options and restricted stock to our employees, board members, and consultants, plus any shares reserved under the Company’s then-existing, unexpired stock plans for which options had not yet been issued, and any shares underlying outstanding options under the then-existing stock option plans that terminate without having been exercised in full. The 2008 Plan was approved by the Company’s shareholders at the 2008 Annual Shareholders’ Meeting and was amended at the 2012 Annual Shareholders’ Meeting held May 30, 2012 to increase the number of shares of common stock subject to the plan by 100,000. At the 2014 Annual Shareholders’ Meeting, the 2008 Plan was amended again to increase the number of shares of common stock subject to the plan by 130,000. As of June 30, 2015, the 2008 Plan had 134,628 stock options available for grant before the plan expires on February 20, 2018.

The Company records stock-based compensation expense related to granting stock options in selling and administrative expenses. During the three months ended June 30, 2015 and 2014, the Company granted 20,000 and 15,000 stock options, respectively. The fair value of stock options granted during the three months ended June 30, 2015 ranged from \$11.34 to \$12.80 per share. During the six months ended June 30, 2015 and 2014, the Company granted 20,000 and 81,000 stock options, respectively. The fair value of stock options granted during the six months ended June 30, 2015 ranged from \$11.34 to \$12.80 per share. The Company recognized compensation expense as follows for the three and six months ended June 30 (in thousands):

| | Three months ending June 30 | | Six months ending June 30 | |
|----------------------------------|-----------------------------|-------|---------------------------|-------|
| | 2015 | 2014 | 2015 | 2014 |
| Total gross compensation expense | \$161 | \$124 | \$301 | \$302 |

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| | | | | |
|--|-------|------|-------|-------|
| Total tax benefit associated with compensation expense | 43 | 30 | 86 | 90 |
| Total net compensation expense | \$118 | \$94 | \$215 | \$212 |

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MANNATECH, INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

As of June 30, 2015, the Company expects to record compensation expense in the future as follows (in thousands):

| | Six months ending December 31, 2015 | Year ending December 31, | | |
|---|--|-----------------------------|-------|-------|
| | | 2016 | 2017 | 2018 |
| Total gross unrecognized compensation expense | \$ 209 | \$262 | \$ 90 | \$ 23 |
| Tax benefit associated with unrecognized compensation expense | 46 | 40 | 12 | 6 |
| Total net unrecognized compensation expense | \$ 163 | \$222 | \$ 78 | \$ 17 |

NOTE 6: SHAREHOLDERS' EQUITY

Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss, displayed in the Consolidated Statement of Shareholders' Equity and Comprehensive Loss, represents net loss plus the results of certain shareholders' equity changes not reflected in the Consolidated Statements of Operations, such as foreign currency translation and certain pension and post-retirement benefit obligations. The after-tax components of accumulated other comprehensive loss, are as follows (in thousands):

| | Foreign Currency Translation | Pension Postretirement Benefit Obligation | Accumulated Other Comprehensive Loss, Net |
|------------------------------------|------------------------------------|--|--|
| Balance as of December 31, 2014 | \$ (457) | \$ 348 | \$ (109) |
| Current-period change ¹ | (32) | — | (32) |
| Balance as of June 30, 2015 | \$ (489) | \$ 348 | \$ (141) |

¹No amounts reclassified from accumulated other comprehensive loss

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MANNATECH, INCORPORATED AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 7: LITIGATION

Patent Litigation

Mannatech, Incorporated v. Wellness Quest, LLC and Harley Reginald McDaniel, Case No. 3:14-cv-2497, U.S. District Court, for the Northern District of Texas, Dallas Division

On July 11, 2014 the Company filed a patent infringement lawsuit against Wellness Quest, LLC and Dr. H. Reginald McDaniel (“Defendants”) alleging the Defendants infringe United States Patent Nos. 7,157,431 and 7,202,220, both entitled “Compositions of Plant Carbohydrates as Dietary Supplements” (the “Patents”) and seeking to stop the Defendants’ manufacture, offer, and sale of infringing glyconutritional dietary supplement products. On July 16, 2014, the Company filed a Motion for Preliminary Injunction preventing Defendants from infringing the Patents pending a final decision on the merits. On August 29, 2014, the Defendants filed their Response to Plaintiff’s Motion for Preliminary Injunction and Brief in Support along with their Answer and Affirmative Defenses. On November 4, 2014, the Court denied the Company’s Motion for Preliminary Injunction and Motion to Expedite Discovery. On December 15, 2014, the Company deposed Dr. Reginald McDaniel. Each party has submitted its list of claim constructions/definitions and a list of the supporting authority. Each party has filed its opening brief and its respective responsive brief. Defendants have designated an expert and the Company deposed the expert on January 27, 2015 regarding his claim construction opinions while reserving the right to examine him later regarding other matters. Mediation on this matter was held on April 24, 2015. A settlement was not reached.

On May 12, 2015 the Company received notice of an Order of Transfer advising that the case had been reassigned from Judge Ed Kinkeade to Judge David C. Godbey for all further proceedings. On July 20, 2015, the Court issued its Markman ruling adopting the Company’s proposed claim construction for all disputed terms except for “dietary supplement composition” which it found needed no construction. This matter remains open.

Mannatech, Incorporated v. RBC Life Sciences, Inc. and RBC Life Sciences USA, Inc., Case No. 3:15-cv-01321-N, U.S. District Court, for the Northern District of Texas, Dallas Division

On April 28, 2015 the Company filed a patent infringement lawsuit against RBC Life Sciences, Inc. and RBC Life Sciences USA, Inc. (“Defendants”) alleging the Defendants infringe United States Patent Nos. 7,157,431 and 7,202,220, both entitled “Compositions of Plant Carbohydrates as Dietary Supplements” (the “Patents”) and seeking to stop their manufacture, offer, and sale of infringing glyconutritional dietary supplement products. The Defendants filed their answer and have asserted counterclaims alleging, among other things, invalidity and non-infringement. On May 12, 2015 the Company received notice of an Order of Transfer advising that the case had been reassigned from Judge Ed Kinkeade to Judge David C. Godbey for all further proceedings. The parties filed the Case Management Report with the Court on June 24, 2015. The Company filed its answer to Defendants’ counterclaims on June 29, 2015.

On July 28, 2015, the parties filed a Joint Motion for Entry of Final Judgment with the Court seeking the entry of a Final Judgment and Permanent Injunction (“Final Judgment”). Effective immediately under the proposed Final Judgment, the Defendants would be enjoined from making the infringing products in the United States; importing the infringing products into the United States; and marketing products marked with the trademarks VITALOE® and IMMUNE 360® as “glyconutrients.” After October 31, 2015, Defendants would be enjoined from selling the infringing products as currently formulated in the United States for the terms of the Patents. Subject to Defendants performance of the above obligations, the Company will release Defendants of all infringement claims asserted in the lawsuit and the Defendants, subject to the Company’s performance of its obligations under the Agreement will release the Company from all claims asserted in its counterclaims and further agree to not challenge, or cause to be challenged,

the validity or enforceability of the Patents. This matter remains open until the Court issues the final order.

These lawsuits continue the Company's enforcement of its patent rights, and the Company intends to vigorously prosecute these matters. Based on the previous successful patent infringement lawsuits against Country Life, LLC, Glycobiotics International, Inc., Techmedica Health, Inc., IonX Holdings, Inc., Boston Mountain Laboratories, Inc., Green Life, LLC, and Xiong Lo, the Company believes there is a strong likelihood that it will obtain permanent injunctions against the manufacture and sale of any infringing products for the duration of the Company's patents.

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MANNATECH, INCORPORATED AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Breach of Contract


Diana Anselmo and New Day Today Corporation v. Mannatech, Incorporated, Case No. DC-15-01904, 192nd Judicial District Court, Dallas County, Texas

On February 18, 2015 Ms. Diana Anselmo and New Day Today Corporation (collectively, the “Plaintiffs”) filed suit against Mannatech alleging breach of contract pertaining to a portion of proceeds from a Mannatech Associate position once held by Ms. Anselmo’s former husband, Ray Gebauer. Plaintiffs are seeking damages in excess of \$1,000,000 and a declaration that the Company continue to pay Plaintiffs proceeds from Mr. Gebauer’s former account.

The Company filed its answer on March 23, 2015 denying the Plaintiffs’ allegations. The Court set the case for trial on March 7, 2016. The Court has appointed a mediator and has ordered that mediation must be conducted no later than February 7, 2016. The parties remain engaged in the discovery process. It is not possible at this time to predict whether the Company will incur any liability, or to estimate the ranges of damages, if any, which may be incurred in connection with this matter. However, the Company believes it has a valid defense and will vigorously defend this claim.

Trademark Opposition – U.S. Patent and Trademark Office (“USPTO”)

United States Trademark Opposition No. 91221493, Shaklee Corporation v. Mannatech, Incorporated re: UTH

On April 15, 2015 the Company received notice that Shaklee Corporation filed a Notice of Opposition to the Company’s trademark application for UTH (stylized as ) with the USPTO. On May 19, 2015, the Company filed an answer to the opposition and also filed a counterclaim seeking to cancel Shaklee’s registration of its YOUTH mark. Shaklee filed an extension to oppose the UTH mark on June 18, 2015, and the request to extend time to oppose was granted until July 18, 2015. Shaklee filed a second extension on July 17, 2015, and the request to extend time to oppose has been granted until September 16, 2015.

It is not possible at this time to predict the outcome of this USPTO action or whether the Company will incur any liability, or to estimate the ranges of damages, if any, which may be incurred in connection with this matter. However, the Company believes it has a valid defense and will vigorously defend this claim. This matter will remain open until it is resolved.

Administrative Proceedings

On April 12, 2015, Mannatech Korea, Ltd. filed a suit against the Busan Custom Office (“BCO”) to challenge BCO’s method of calculation regarding its assessment notice issued on July 11, 2013. The assessment notice included an audit of the Company’s imported goods covering fiscal years 2008 through 2012 and required the Company to pay \$1.0 million for this assessment, which was paid in January 2014. No court date has been set.

There are other ongoing audits in various international jurisdictions that the Company does not expect will have a material effect on our financial statements.

Arbitration Proceeding

Mannatech v. Samuel L. Caster and Wonder Enterprises, LLC, Demand for Arbitration

On May 29, 2015 the Company initiated arbitration proceedings against Samuel L. Caster and Wonder Enterprises, LLC (“Respondents”) alleging breach of contract by Mr. Caster and his company, Wonder Enterprises, in a series of consulting agreements entered into by the parties. Mannatech seeks to recover actual damages, costs of court and prejudgment interest together with disgorgement of all benefits received by Caster. The Company estimates its damages to be between \$500,000 and \$3,500,000. On June 12, 2015 Respondents contacted the Company’s counsel to request mediation. The parties have agreed to mediate; mediation has been set for August 17, 2015.

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MANNATECH, INCORPORATED AND SUBSIDIARIES
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Litigation in General

The Company is or may become subject to claims in the normal course of business. The Company believes such claims can be resolved without any material adverse effect on its consolidated financial position, results of operations, or cash flows.

The Company maintains certain liability insurance; however, certain costs of defending lawsuits are not covered or are only partially covered by its insurance policies, including claims that are below insurance deductibles. Additionally, insurance carriers could refuse to cover certain claims, in whole or in part. The Company accrues costs to defend itself from litigation as they are incurred or as they become determinable.

The outcome of litigation is uncertain, and despite management’s views of the merits of any litigation, or the reasonableness of the Company’s estimates and reserves, the Company’s financial statements could nonetheless be materially affected by an adverse judgment. The Company believes it has adequately reserved for the contingencies arising from current legal matters where an outcome was deemed to be probable, and the loss amount could be reasonably estimated.

NOTE 8: FAIR VALUE

The Company utilizes fair value measurements to record fair value adjustments to certain financial assets and to determine fair value disclosures.

Fair Value Measurements and Disclosure Topic 820 of the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) establishes a fair value hierarchy that requires the use of observable market data, when available, and prioritizes the inputs to valuation techniques used to measure fair value in the following categories:

- Level 1 – Quoted unadjusted prices for identical instruments in active markets.
- Level 2 – Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-derived valuations in which all observable inputs and significant value drivers are observable in active markets.
- Level 3 – Model-derived valuations in which one or more significant inputs or significant value drivers are unobservable, including assumptions developed by the Company.

The primary objective of the Company’s investment activities is to preserve principal while maximizing yields without significantly increasing risk. The investment instruments held by the Company are money market funds and interest bearing deposits for which quoted market prices are readily available. The Company considers these highly liquid investments to be cash equivalents. These investments are classified within Level 1 of the fair value hierarchy because they are valued based on quoted market prices in active markets. The Company does not have any material financial liabilities that were required to be measured at fair value on a recurring basis at June 30, 2015.

The table below presents the recorded amount of financial assets measured at fair value (in thousands) on a recurring basis as of June 30, 2015 and December 31, 2014.

| | | |
|---------------|---------|-------|
| June 30, 2015 | Level 1 | Total |
|---------------|---------|-------|

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| | | Level | Level | |
|---|----------|-------|-------|----------|
| | | 2 | 3 | |
| Assets | | | | |
| Money Market Funds – Fidelity, US | \$18 | \$ — | \$ — | \$18 |
| Interest bearing deposits – various banks | 20,599 | — | — | 20,599 |
| Total assets | \$20,617 | \$ — | \$ — | \$20,617 |
| Amounts included in: | | | | |
| Cash and cash equivalents | \$13,774 | \$ — | \$ — | \$13,774 |
| Restricted cash | 6,843 | — | — | 6,843 |
| Total | \$20,617 | \$ — | \$ — | \$20,617 |

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MANNATECH, INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

| December 31, 2014 | Level 1 | Level | | Total |
|---|----------|-------|------|----------|
| | | 2 | 3 | |
| Assets | | | | |
| Money Market Funds – Fidelity, US | \$392 | \$ — | \$ — | \$392 |
| Interest bearing deposits – various banks | 12,322 | — | — | 12,322 |
| Total assets | \$12,714 | \$ — | \$ — | \$12,714 |
| Amounts included in: | | | | |
| Cash and cash equivalents | \$6,159 | \$ — | \$ — | \$6,159 |
| Restricted cash | 738 | — | — | 738 |
| Long-term restricted cash | 5,817 | — | — | 5,817 |
| Total | \$12,714 | \$ — | \$ — | \$12,714 |

NOTE 9: SEGMENT INFORMATION

The Company conducts its business as a single operating segment, consolidating all of its business units into a single reportable entity, as a seller of proprietary nutritional supplements, topical and skin care products, and weight-management products through its network marketing distribution channels operating in twenty-four countries. Each of the Company's business units sells similar packs and products and possesses similar economic characteristics, such as selling prices and gross margins. In each country, the Company markets its products and pays commissions and incentives in similar market environments. The Company's management reviews its financial information by country and focuses its internal reporting and analysis of revenues by packs and product sales. The Company sells its products through its independent associates and distributes its products through similar distribution channels in each country. No single independent associate has ever accounted for more than 10% of the Company's consolidated net sales.

The Company operates facilities in twelve countries and sells product in twenty-four countries around the world. These facilities are located in the United States, Canada, Switzerland, Australia, the United Kingdom, Japan, the Republic of Korea (South Korea), Taiwan, South Africa, Mexico, Singapore and Hong Kong. Each facility services different geographic areas. We currently sell our products in three regions: (i) North America (the United States, Canada and Mexico); (ii) EMEA (Austria, the Czech Republic, Denmark, Estonia, Finland, Germany, the Republic of Ireland, Namibia, the Netherlands, Norway, South Africa, Spain, Sweden and the United Kingdom); and (iii) Asia/Pacific (Australia, Japan, New Zealand, the Republic of Korea, Singapore, Taiwan and Hong Kong).

Consolidated net sales shipped to customers in these regions, along with pack and product sales information for the three and six months ended June 30, are as follows (in millions, except percentages):

| Region | Three months | | | Six months | | | | |
|---------------|--------------|--------|--------|------------|--------|--------|--------|--------|
| | 2015 | 2014 | | 2015 | 2014 | | | |
| North America | \$18.8 | 40.3 % | \$20.9 | 45.1 % | \$36.9 | 40.5 % | \$41.2 | 46.1 % |
| Asia/Pacific | 23.6 | 50.5 % | 21.4 | 46.3 % | 46.3 | 50.8 % | 40.4 | 45.3 % |
| EMEA | 4.3 | 9.2 % | 4.0 | 8.6 % | 7.9 | 8.7 % | 7.7 | 8.6 % |
| Totals | \$46.7 | 100.0% | \$46.3 | 100.0% | \$91.1 | 100.0% | \$89.3 | 100.0% |

| | Three months | | Six months | |
|----------------------------|--------------|--------|------------|--------|
| | 2015 | 2014 | 2015 | 2014 |
| Consolidated product sales | \$36.3 | \$37.2 | \$70.5 | \$71.7 |
| Consolidated pack sales | 8.9 | 7.3 | 17.8 | 14.0 |

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| | | | | |
|---------------------------------------|--------|--------|--------|--------|
| Consolidated other, including freight | 1.5 | 1.8 | 2.8 | 3.6 |
| Consolidated total net sales | \$46.7 | \$46.3 | \$91.1 | \$89.3 |

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MANNATECH, INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Long-lived assets, which include property, equipment and construction in progress for the Company and its subsidiaries, reside in the following regions in the following amounts (in millions):

| <u>Region</u> | June 30, 2015 | December 31, 2014 |
|---------------|---------------------|----------------------|
| North America | \$ 3.8 | \$ 3.1 |
| Asia/Pacific | 1.0 | 0.8 |
| EMEA | 0.1 | 0.2 |
| Total | \$ 4.9 | \$ 4.1 |

Inventory balances by region, which consist of raw materials, work in progress, finished goods, and promotional materials, as offset by obsolete inventories, were as follows (in millions):

| <u>Region</u> | June 30, 2015 | December 31, 2014 |
|---------------|---------------------|----------------------|
| North America | \$5.1 | \$ 4.0 |
| Asia/Pacific | 6.5 | 4.3 |
| EMEA | 2.6 | 2.3 |
| Total | \$14.2 | \$ 10.6 |

NOTE 10: RECENT ACCOUNTING PRONOUNCEMENTS

In May 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606), which supersedes the revenue recognition requirements in Topic 605, Revenue Recognition. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of goods to customers in an amount that reflects the consideration to which the entity expects in exchange for those goods. To achieve that core principle, an entity should apply the following steps:

- Step 1: Identify the contract(s) with a customer.
- Step 2: Identify the performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

The standard is effective for the Company for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures.) Early application is not permitted. Management is currently evaluating the impact of the Company's pending adoption of ASU 2014-09 on the Company's consolidated financial statements and has not yet determined the method by which the Company will adopt the standard in 2018.

In January 2015, the FASB issued ASU No. 2015-01, Income Statement—Extraordinary and Unusual Items, which eliminates from GAAP the concept of extraordinary items. The update is effective for fiscal years, and interim periods

within those fiscal years, beginning after December 15, 2015. Because this standard only impacts presentation and disclosure requirements, its adoption is not expected to have a material impact on the Company's consolidated results of operations or financial condition.

In April 2015, the FASB issued ASU No. 2015-05, Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40), which adds guidance to Subtopic 350-40, Intangibles – Goodwill and Other – Internal-Use Software. The amendments in this update provide guidance to customers about whether a cloud computing arrangement includes a software license. The update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015 and early adoption is permitted. Management is currently evaluating the impact of this standard on the Company's consolidated results of operations and financial condition.

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MANNATECH, INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

In July 2015, the FASB issued ASU No. 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory, which provides guidance to more closely align the measurement of inventory in GAAP with the measurement of inventory in International Financial Reporting Standards (IFRS). For Mannatech, the amendments are effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Management is currently evaluating the impact of this standard on the Company's consolidated results of operations and financial condition.

Other recently issued accounting pronouncements did not or are not believed by management to have a material impact on the Company's present or future financial statements.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion is intended to assist in the understanding of our consolidated financial position and results of operations for the three and six months ended June 30, 2015 as compared to the same period in 2014, and should be read in conjunction with Item I "Financial Statements" in Part I of this quarterly report on Form 10-Q. Unless stated otherwise, all financial information presented below, throughout this report, and in the consolidated financial statements and related notes includes Mannatech and all of our subsidiaries on a consolidated basis. Refer to the Non-GAAP Financial Measures section herein for a description of how Constant dollar ("Constant dollar") growth rate (a Non-GAAP financial metric) is determined.

COMPANY OVERVIEW

Since November 1993, we have continued to develop innovative, high-quality, proprietary nutritional supplements, topical and skin care products, and weight-management products that are sold through a global network marketing system. We operate in three regions: (i) North America (the United States, Canada and Mexico); (ii) EMEA (Austria, the Czech Republic, Denmark, Estonia, Finland, Germany, the Republic of Ireland, Namibia, the Netherlands, Norway, South Africa, Spain, Sweden and the United Kingdom); and (iii) Asia/Pacific (Australia, Japan, New Zealand, the Republic of Korea, Singapore, Taiwan and Hong Kong). Our Switzerland office manages certain day-to-day business needs of non-North American markets. By the end of the third quarter of 2015, we plan to operate in Colombia.

We conduct our business as a single operating segment and primarily sell our products through a network of approximately 228,000 active independent associates and members who have purchased our products and/or packs within the last 12 months, who we refer to as active independent associates and members. New recruits and pack sales are leading indicators for the long-term success of our business. New recruits include new independent associates and members purchasing our packs and products for the first time. We operate as a seller of nutritional supplements, topical skin care and anti-aging products, and weight-management products through our network marketing distribution channels operating in twenty-four countries. We review and analyze net sales by geographical location and by packs and products on a consolidated basis. Each of our subsidiaries sells similar products and exhibits similar economic characteristics, such as selling prices and gross margins.

Because we sell our products through network marketing distribution channels, the opportunities and challenges that affect us most are: recruitment of new and retention of active independent associates and members; entry into new markets and growth of existing markets; niche market development; new product introduction; and investment in our infrastructure.

Current Economic Conditions and Recent Developments

Overall net sales increased \$0.4 million, or 0.9% during the three months ended June 30, 2015, as compared to the same period in 2014, and overall net sales increased \$1.8 million, or 2.1% during the six months ended June 30, 2015, as compared to the same period in 2014. For the three and six months ended June 30, 2015, our operations outside of North America accounted for approximately 59.7% and 59.5%, respectively, of our consolidated net sales.

The net sales comparisons for the three- and six-month periods were affected by the loyalty program and the translation of foreign currency into U.S. dollars. The loyalty program increased second quarter 2015 net sales by \$3.2 million and increased net sales for the six months ended June 30, 2015 by \$5.5 million, as compared to the same periods in 2014. These increases were offset by foreign exchange losses. Excluding the effects on net sales of the loyalty program, net sales would have decreased by \$2.8 million, or 6.0% for the three months ended June 30, 2015, and by \$3.7 million, or 4.1%, for the six months ended June 30, 2015, as compared to the same periods in 2014.

Excluding the effects due to the translation of foreign currencies into U.S. dollars, net sales would have increased \$3.5 million and \$6.7 million for the three and six months ended June 30, 2015, respectively. These adjusted net sales expressed in Constant dollars are a non-GAAP financial measure discussed in further detail below.

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RESULTS OF OPERATIONS

The table below summarizes our consolidated operating results in dollars and as a percentage of net sales for the three months ended June 30, 2015 and 2014 (in thousands, except percentages):

| | 2015 | | 2014 | | Change from 2015 to 2014 | | |
|-------------------------------------|----------|-----------|----------|-----------|--------------------------------|------------|----|
| | Total | % of | Total | % of | Dollar | Percentage | |
| | dollars | net sales | dollars | net sales | | | |
| Net sales | \$46,726 | 100.0 % | \$46,302 | 100.0 % | \$424 | 0.9 | % |
| Cost of sales | 8,270 | 17.7 % | 9,738 | 21.0 % | (1,468) | (15.1) |)% |
| Gross profit | 38,456 | 82.3 % | 36,564 | 79.0 % | 1,892 | 5.2 | % |
| Operating expenses: | | | | | | | |
| Commissions and incentives | 18,887 | 40.4 % | 19,782 | 42.7 % | (895) | (4.5 |)% |
| Selling and administrative expenses | 8,598 | 18.4 % | 8,946 | 19.3 % | (348) | (3.9 |)% |
| Depreciation and amortization | 495 | 1.1 % | 421 | 0.9 % | 74 | 17.6 | % |
| Other operating costs | 5,866 | 12.5 % | 6,815 | 14.7 % | (949) | (13.9 |)% |
| Total operating expenses | 33,846 | 72.4 % | 35,964 | 77.6 % | (2,118) | (5.9 |)% |
| Income from operations | 4,610 | 9.9 % | 600 | 1.4 % | 4,010 | 668.3 | % |
| Interest income | 31 | 0.1 % | 35 | 0.1 % | (4) | (11.4 |)% |
| Other income (expense), net | (452) | (1.0)% | 192 | 0.4 % | (644) | (335.4 |)% |
| Income before income taxes | 4,189 | 9.0 % | 827 | 1.9 % | 3,362 | 406.5 | % |
| Provision for income taxes | (1,046) | (2.3)% | (1,519) | (3.3)% | 473 | 31.1 | % |
| Net income (loss) | \$3,143 | 6.7 % | \$(692) | 1.4 % | \$3,835 | 554.2 | % |

The table below summarizes our consolidated operating results in dollars and as a percentage of net sales for the six months ended June 30, 2015 and 2014 (in thousands, except percentages):

| | 2015 | | 2014 | | Change from 2015 to 2014 | | |
|-------------------------------------|----------|-----------|----------|-----------|-----------------------------|------------|----|
| | Total | % of | Total | % of | Dollar | Percentage | |
| | dollars | net sales | dollars | net sales | | | |
| Net sales | \$91,096 | 100.0 % | \$89,265 | 100.0 % | \$1,831 | 2.1 | % |
| Cost of sales | 16,823 | 18.5 % | 19,136 | 21.4 % | (2,313) | (12.1) |)% |
| Gross profit | 74,273 | 81.5 % | 70,129 | 78.6 % | 4,144 | 5.9 | % |
| Operating expenses: | | | | | | | |
| Commissions and incentives | 36,429 | 40.0 % | 36,750 | 41.2 % | (321) | (0.9 |)% |
| Selling and administrative expenses | 17,411 | 19.1 % | 16,822 | 18.8 % | 589 | 3.5 | % |
| Depreciation and amortization | 891 | 1.0 % | 807 | 0.9 % | 84 | 10.4 | % |
| Other operating costs | 12,421 | 13.6 % | 13,771 | 15.4 % | (1,350) | (9.8 |)% |
| Total operating expenses | 67,152 | 73.7 % | 68,150 | 76.3 % | (998) | (1.5 |)% |
| Income from operations | 7,121 | 7.8 % | 1,979 | 2.3 % | 5,142 | 259.8 | % |
| Interest income | 61 | 0.1 % | 36 | 0.0 % | 25 | 69.4 | % |
| Other expense, net | (1,384) | (1.5)% | (144) | (0.2)% | (1,240) | 861.1 | % |

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| | | | | | | | | | |
|----------------------------|---------|-------|----|---------|-------|----|---------|---------|---|
| Income before income taxes | 5,798 | 6.4 | % | 1,871 | 2.1 | % | 3,927 | 209.9 | % |
| Provision for income taxes | (1,556) | (1.7) |)% | (2,335) | (2.6) |)% | 779 | 33.4 | % |
| Net income (loss) | \$4,242 | 4.7 | % | \$(464) | (0.5) |)% | \$4,706 | 1,014.2 | % |

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Non-GAAP Financial Measures

To supplement our financial results presented in accordance with generally accepted accounting principles in the United States ("GAAP"), we disclose operating results that have been adjusted to exclude the impact of changes due to the translation of foreign currencies into U.S. dollars, including changes in: Net Sales, Gross Profit, and Income from Operations. We refer to these adjusted financial measures as Constant dollar items, which are Non-GAAP financial measures. We believe these measures provide investors an additional perspective on trends. To exclude the impact of changes due to the translation of foreign currencies into U.S. dollars, we calculate current year results and prior year results at a constant exchange rate, which is the prior year's rate. Currency impact is determined as the difference between actual growth rates and constant currency growth rates. Dollar amounts set forth below are expressed in millions.

| Three month period ended | June 30, 2015 | | June 30, 2014 | | Change | |
|--------------------------|-----------------------|-------------------------------|------------------------|--------|---------|---|
| | GAAP Measure Total \$ | Non-GAAP Measure: Constant \$ | GAAP Measure: Total \$ | Dollar | Percent | |
| Net Sales | \$46.7 | \$ 49.8 | \$ 46.3 | \$3.5 | 7.6 | % |
| Product | 36.3 | 38.7 | 37.2 | 1.5 | 4.0 | % |
| Pack | 8.9 | 9.6 | 7.3 | 2.3 | 31.5 | % |
| Other | 1.5 | 1.5 | 1.8 | (0.3) | (16.7) | % |
| Gross Profit | 38.5 | 40.9 | 36.6 | 4.3 | 11.7 | % |
| Income from Operations | 4.6 | 5.1 | 0.6 | 4.5 | 750.0 | % |

| Six month period ended | June 30, 2015 | | June 30, 2014 | | Change | |
|------------------------|-----------------------|-------------------------------|------------------------|--------|---------|---|
| | GAAP Measure Total \$ | Non-GAAP Measure: Constant \$ | GAAP Measure: Total \$ | Dollar | Percent | |
| Net Sales | \$91.1 | \$ 96.0 | \$ 89.3 | \$6.7 | 7.5 | % |
| Product | 70.5 | 74.3 | 71.7 | 2.6 | 3.6 | % |
| Pack | 17.8 | 18.8 | 14.0 | 4.8 | 34.3 | % |
| Other | 2.8 | 2.9 | 3.6 | (0.7) | (19.4) | % |
| Gross Profit | 74.3 | 78.2 | 70.1 | 8.1 | 11.6 | % |
| Income from Operations | 7.1 | 7.7 | 2.0 | 5.7 | 285.0 | % |

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Consolidated net sales by region for the three months ended June 30, 2015 and 2014 were as follows (in millions, except percentages):

Net Sales in Dollars and as a Percentage of Consolidated Net Sales

| <u>Region</u> | 2015 | | 2014 | |
|---------------|--------|---------|--------|---------|
| North America | \$18.8 | 40.3 % | \$20.9 | 45.1 % |
| Asia/Pacific | 23.6 | 50.5 % | 21.4 | 46.3 % |
| EMEA | 4.3 | 9.2 % | 4.0 | 8.6 % |
| Total | \$46.7 | 100.0 % | \$46.3 | 100.0 % |

Consolidated net sales by region for the six months ended June 30, 2015 and 2014 were as follows (in millions, except percentages):

Net Sales in Dollars and as a Percentage of Consolidated Net Sales

| <u>Region</u> | 2015 | | 2014 | |
|---------------|--------|---------|--------|---------|
| North America | \$36.9 | 40.5 % | \$41.2 | 46.1 % |
| Asia/Pacific | 46.3 | 50.8 % | 40.4 | 45.3 % |
| EMEA | 7.9 | 8.7 % | 7.7 | 8.6 % |
| Total | \$91.1 | 100.0 % | \$89.3 | 100.0 % |

Net Sales

Consolidated net sales for the three months ended June 30, 2015 increased by \$0.4 million, or 0.9%, to \$46.7 million as compared to the same period in 2014. Consolidated net sales for the six months ended June 30, 2015 increased by \$1.8 million, or 2.1%, to \$91.1 million as compared to the same period in 2014.

North American net sales decreased by \$2.1 million, or 10.0%, to \$18.8 million for the three months ended June 30, 2015 as compared to the same period in 2014. North American net sales decreased by \$4.3 million, or 10.4%, to \$36.9 million for the six months ended June 30, 2015 as compared to the same period in 2014. For the three and six months ended June 30, 2015, revenue per active associate and member increased while the number of associates decreased. Net sales comparisons for the three- and six-month periods were affected by the loyalty program. Excluding the effects on net sales of the loyalty program, net sales in North America would have declined by \$3.6 million, or 17.2%, for the three months ended June 30, 2015, and by \$7.0 million, or 17.0%, for the six months ended June 30, 2015, as compared to the same periods in 2014.

For the three and six months ended June 30, 2015, our operations outside of North America accounted for approximately 59.7% and 59.5%, respectively, of our consolidated net sales, whereas in the same period in 2014, our operations outside of North America accounted for approximately 54.9% and 53.9%, respectively, of our consolidated net sales.

Asia/Pacific net sales increased by \$2.2 million, or 10.3%, to \$23.6 million for the three months ended June 30, 2015. For the three months ended June 30, 2015, compared to the same period in 2014, the number of active members increased and the revenue per active associate and member increased. Net sales comparisons for the second quarter were affected by the loyalty program and the translation of foreign currency into U.S. dollars. Excluding the effects on net sales of the loyalty program, net sales in Asia/Pacific would have increased by \$1.0 million, or 4.7%, for the second quarter 2015 as compared to the same period in 2014. In Constant dollars (a non-GAAP financial measure discussed in more detail above), net sales would have increased to \$25.9 million, or 21.0%. The currency impact was primarily due to depreciation of the Korean Won, the Japanese Yen and the Australian Dollar.

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Asia/Pacific net sales increased by \$5.9 million, or 14.6%, to \$46.3 million for the six months ended June 30, 2015 as compared to the same period in 2014. For the six months ended June 30, 2015, compared to the same period in 2014, the number of active members increased and the revenue per active associate and member increased. Net sales comparisons for the six months ended June 30, 2015 were affected by the loyalty program and the translation of foreign currency into U.S. dollars. Excluding the effects on net sales of the loyalty program, net sales in Asia/Pacific would have increased by \$3.8 million, or 9.4%, for the six months ended June 30, 2015 as compared to the same period in 2014. In Constant dollars (a non-GAAP financial measure discussed in more detail above), net sales would have increased to \$50.0 million, or 23.8%. The currency impact was primarily due to depreciation of the Korean Won, the Japanese Yen and the Australian Dollar.

EMEA net sales increased by \$0.3 million, or 7.5%, to \$4.3 million for the three months ended June 30, 2015 as compared to the same period in 2014. For the three months ended June 30, 2015, compared to the same period in 2014, the number of active associates increased and the revenue per active associate and member decreased. Net sales comparisons for the second quarter were affected by the loyalty program and the translation of foreign currency into U.S. dollars. Excluding the effects on net sales of the loyalty program, net sales in EMEA would have decreased by \$0.2 million, or 5.0%, for the second quarter 2015 as compared to the same period in 2014. In Constant dollars (a non-GAAP financial measure discussed in more detail above), net sales for the three months ended June 30, 2015 would have increased 25.0% to \$5.0 million; the currency impact was primarily due to the depreciation of the South African Rand and the Euro.

EMEA net sales increased by \$0.2 million, or 2.6%, to \$7.9 million for the six months ended June 30, 2015 as compared to the same period in 2014. For the six months ended June 30, 2015, compared to the same period in 2014, the number of active associates increased and the revenue per active associate and member decreased. Net sales comparisons for the six months ended June 30, 2015 were affected by the loyalty program and the translation of foreign currency into U.S. dollars. Excluding the effects on net sales of the loyalty program, net sales in EMEA would have decreased by \$0.5 million, or 6.5%, for the six months ended June 30, 2015 as compared to the same period in 2014. In Constant dollars (a non-GAAP financial measure discussed in more detail above), net sales for the six months ended June 30, 2015 would have increased 16.9% to \$9.0 million; the currency impact was primarily due to the depreciation of the South African Rand and the Euro.

Our total sales and sales mix could be influenced by any of the following:

- changes in our sales prices;
- changes in consumer demand;
- changes in the number of associates and members;
- changes in competitors' products;
- changes in economic conditions;
- changes in regulations;
- announcements of new scientific studies and breakthroughs;
- introduction of new products;
- discontinuation of existing products;

- adverse publicity;
- changes in our commissions and incentives programs;
- direct competition; and
- fluctuations in foreign currency exchange rates.

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Our sales mix for the three and six months ended June 30, was as follows (in millions, except percentages):

| | Three Months | | Change | | |
|---------------------------------------|--------------|--------|---------|------------|----|
| | 2015 | 2014 | Dollar | Percentage | |
| Consolidated product sales | \$36.3 | \$37.2 | \$(0.9) | (2.4) |)% |
| Consolidated pack sales | 8.9 | 7.3 | 1.6 | 21.9 | % |
| Consolidated other, including freight | 1.5 | 1.8 | (0.3) | (16.7) |)% |
| Total consolidated net sales | \$46.7 | \$46.3 | \$0.4 | 0.9 | % |

| | Six Months | | Change | | |
|---------------------------------------|------------|--------|---------|------------|----|
| | 2015 | 2014 | Dollar | Percentage | |
| Consolidated product sales | \$70.5 | \$71.7 | \$(1.2) | (1.7) |)% |
| Consolidated pack sales | 17.8 | 14.0 | 3.8 | 27.1 | % |
| Consolidated other, including freight | 2.8 | 3.6 | (0.8) | (22.2) |)% |
| Total consolidated net sales | \$91.1 | \$89.3 | \$1.8 | 2.1 | % |

Pack sales correlate to new associates who purchase starter packs and to continuing associates who purchase upgrade or renewal packs. However, there is no direct correlation between product sales and the number of new and continuing associates and members because associates and members utilize products at different volumes.

Product Sales

Product sales for the three months ended June 30, 2015 decreased by \$0.9 million or 2.4% as compared to the same period in 2014 impacted by a 3.7% decrease in orders and a decrease in average order value. The average order value for the three months ended June 30, 2015 was \$156 as compared to \$165 for the same period in 2014.

Product sales for the six months ended June 30, 2015 decreased by \$1.2 million, or 1.7%, as compared to the same period in 2014 driven by a 3.5% decrease in orders and a decrease in average order value. The average order value for the six months ended June 30, 2015 was \$155, as compared to \$159 for the same period in 2014.

With respect to our loyalty program, we defer the dollar equivalent in revenue of loyalty points until we recognize the revenue attributable to points that are applied or forfeited or expired (see Revenue Recognition and Deferred Commissions in Note 1). This year, as associates and members are utilizing more loyalty points, we are able to recognize more revenue compared to the same periods last year, resulting in a \$3.2 million increase in revenue for the three months ending June 30, 2015 and a \$5.5 million increase in revenue for the six months ending June 30, 2015.

Pack Sales

Packs may be purchased by our independent associates who wish to build a Mannatech business. These packs contain product which is discounted from both the published retail and Associate price. There are several pack options available to our independent associates. In certain markets, pack sales are completed during the final stages of the registration process and can provide new independent associates with valuable training and promotional materials, as well as products for resale to retail customers, demonstration purposes, and personal consumption. Business-building independent associates can also purchase an upgrade pack, which provides the associate with additional promotional materials, additional products, and eligibility for additional commissions and incentives. Many of our business-building independent associates also choose to purchase renewal packs to satisfy annual renewal requirements to continue to earn various commissions.

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The dollar amount of pack sales associated with new and continuing independent associates was as follows, for the three and six months ended June 30 (in millions, except percentages):

| | Three Months ended June 30 | | Change | | |
|------------|-------------------------------------|-------|--------|------------|---|
| | 2015 | 2014 | Dollar | Percentage | |
| New | \$2.4 | \$2.4 | \$0.0 | 0.0 | % |
| Continuing | 6.5 | 4.9 | 1.6 | 32.7 | % |
| Total | \$8.9 | \$7.3 | \$1.6 | 21.9 | % |

| | Six Months ended June 30 | | Change | | |
|------------|--------------------------------|--------|---------|------------|---|
| | 2015 | 2014 | Dollar | Percentage | |
| New | \$4.3 | \$4.5 | \$(0.2) | (4.4) | % |
| Continuing | 13.5 | 9.5 | 4.0 | 42.1 | % |
| Total | \$17.8 | \$14.0 | \$3.8 | 27.1 | % |

Total pack sales for the three months ended June 30, 2015 increased by \$1.6 million, or 21.9%, to \$8.9 million, as compared to \$7.3 million for the same period in 2014 reflecting a 10.2% increase in new associates, an increase in average pack value and an increase in the total number of packs sold. Average pack value for the three months ended June 30, 2015 was \$249 as compared to \$240 for the same period in 2014. During the three month period ended June 30, 2015, the total number of packs sold increased by 5,500, or 18.1%, to 35,900.

Total pack sales for the six months ended June 30, 2015 increased by \$3.8 million, or 27.1%, to \$17.8 million, as compared to \$14.0 million for the same period in 2014 reflecting a 14.8% increase in new associates and an increase in the total number of packs sold. Average pack value for the six months ended June 30, 2015 was \$242, as compared to \$250 for the same period in 2014. The total number of packs sold increased by 17,700, or 31.7%, to 73,600.

During 2014 and continuing into 2015, we took the following actions to recruit and retain associates and members:

- explored new international markets;
- launched an aggressive marketing and educational campaign;
- continued to strengthen compliance initiatives;
- concentrated on publishing results of research studies and clinical trials related to our products;
- initiated additional incentives;
- explored new advertising and educational tools to broaden name recognition; and
- implemented changes to our global associate career and compensation plan.

The approximate number of new and continuing independent associates and members who purchased our packs or products during the twelve months ended June 30, 2015 and 2014 were as follows:

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| | 2015 | | 2014 | |
|------------|---------|--------|---------|--------|
| New | 102,000 | 44.8 % | 113,000 | 47.3 % |
| Continuing | 126,000 | 55.2 % | 126,000 | 52.7 % |
| Total | 228,000 | 100.0% | 239,000 | 100.0% |

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Recruiting decreased 18.7% in the second quarter of 2015 as compared to the second quarter of 2014 as the increase in new associates was offset by a decrease in new members. The number of new independent associates and members for the second quarter of 2015 was approximately 25,600, as compared to 31,500 in 2014.

Other Sales

Other sales consisted of: (i) freight revenue charged to our independent associates and members; (ii) sales of promotional materials; (iii) monthly fees collected for Success Tracker™ and Navig8™ customized electronic business-building and educational materials, databases and applications; (iv) training and event registration fees; and (v) a reserve for estimated sales refunds and returns. Promotional materials, training, database applications and business management tools support our independent associates, which in turn helps stimulate product sales.

For the three months ended June 30, 2015, other sales decreased by \$0.3 million, or 16.7%, to \$1.5 million, as compared to \$1.8 million for the same period in 2014 due to decreases in freight and shipping, event revenues and Success Tracker sales. Other sales for the six months ended June 30, 2015 decreased by \$0.8 million, or 22.2%, to \$2.8 million, as compared to \$3.6 million for the same period in 2014. The decrease was primarily due to rising sales returns and decreases in freight and shipping, Success Tracker sales and event revenue.

Gross Profit

During the three months ended June 30, 2015, gross profit increased by \$1.9 million, or 5.2%, to \$38.5 million, as compared to \$36.6 million for the same period in 2014 primarily due to a decrease in cost of sales. Cost of sales was \$8.3 million, a decrease of 15.1% as compared to \$9.7 million in the second quarter 2014 due to foreign exchange and a smaller charge for obsolete inventory of \$0.1 million during the second quarter as compared to a charge of \$0.8 million during the same period in 2014. For the three months ended June 30, 2015, gross profit as a percentage of net sales increased to 82.3%, as compared to 79.0% for the same period in 2014.

For the six months ended June 30, 2015 and 2014, gross profit increased by \$4.2 million, or 5.9%, to \$74.3 million, as compared to \$70.1 million for the same period in 2014, primarily due to a decrease in cost of sales. For the six months ended June 30, 2015, gross profit as a percentage of net sales increased to 81.5%, as compared to 78.6% for the same period in 2014.

Commissions and Incentives

Commission costs for the three months ended June 30, 2015 decreased by \$0.6 million, to \$18.2 million, as compared to \$18.8 million for the same period in 2014. The decrease in commissions was due to the decrease in commissionable net sales. For the three months ended June 30, 2015, commissions as a percentage of net sales decreased to 38.9% from 40.6% for the same period in 2014 due to the commission expense in 2014 on the Uth pre-launch and launch activities in certain Asia/Pacific markets. We recognized \$2.8 million in revenue related to these activities during the third quarter of 2014.

Commission costs for the six months ended June 30, 2015 decreased by \$0.2 million to \$35.0 million, compared to \$35.2 million for the same period in 2014. The decrease in commissions was due to the decrease in commissionable net sales. For the six months ended June 30, 2015, commissions as a percentage of net sales decreased to 38.5% from 39.5% for the same period in 2014.

Incentive costs for the three months ended June 30, 2015 decreased by \$0.3 million, to \$0.7 million, as compared to \$1.0 million for the same period in 2014. For the three months ended June 30, 2015, the costs of incentives as a percentage of net sales decreased to 1.5% from 2.2% for the same period in 2014.

Incentive costs for the six months ended June 30, 2015 decreased by \$0.2 million, to \$1.4 million, as compared to \$1.6 million for the same period in 2014. For the six months ended June 30, 2015, the costs of incentives as a percentage of net sales decreased to 1.5%, as compared to 1.7% for the same period in 2014.

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Selling and Administrative Expenses

Selling and administrative expenses include a combination of both fixed and variable expenses. These expenses consist of compensation and benefits for employees, temporary and contract labor, marketing-related expenses, and costs related to hosting our corporate-sponsored events.

For the three months ended June 30, 2015, selling and administrative expenses increased by \$0.3 million, or 3.9%, to \$8.6 million, as compared to \$8.9 million for the same period in 2014 due primarily to decreased warehousing and marketing costs. Selling and administrative expenses as a percentage of net sales for the three months ended June 30, 2015 decreased to 18.4% from 19.3% for the same period in 2014.

For the six months ended June 30, 2015, selling and administrative expenses increased by \$0.6 million, or 3.5%, to \$17.4 million, as compared to \$16.8 million for the same period in 2014 due primarily to increases in marketing costs. Selling and administrative expenses as a percentage of net sales for the six months ended June 30, 2015 increased to 19.1% from 18.8% for the same period in 2014.

Other Operating Costs

Other operating costs include travel, accounting/legal/consulting fees, credit card processing fees, banking fees, off-site storage fees, utilities, and other miscellaneous operating expenses.

For the three months ended June 30, 2015, other operating costs decreased 13.9% to \$5.9 million, due primarily to decreases in travel costs, office expenses and credit card processing fees. For the three months ended June 30, 2015, other operating costs as a percentage of net sales decreased to 12.5% from 14.7% for the same period in 2014 as expenses decreased. For the six months ended June 30, 2015, other operating costs decreased by \$1.4 million to \$12.4 million, compared to \$13.8 million for the same period in 2014, due primarily to decreases in travel, credit card processing fees and legal expenses. For the six months ended June 30, 2015, other operating costs as a percentage of net sales decreased to 13.6% from 15.4% for the same period in 2014 as expenses decreased.

Depreciation and Amortization Expense

Depreciation and amortization expense for the three months ended June 30, 2015 increased to \$0.5 million, as compared to \$0.4 million for the same period in 2014.

Depreciation and amortization expense for the six months ended June 30, 2015 increased to \$0.9 million, as compared to \$0.8 million for the same period in 2014.

Other Expense, Net

Due to foreign exchange losses, other income (expense), net for the three months ended June 30, 2015 was (\$0.5) million, as compared to other income (expense), net of \$0.2 million for the same period in 2014. Other income (expense), net for the six months ended June 30, 2015 was (\$1.4) million, as compared to other income (expense), net of (\$0.1) million for the same period in 2014, due to foreign exchange losses.

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Provision for Income Taxes

Provision for income taxes includes current and deferred income taxes for both our domestic and foreign operations. Our statutory income tax rates by jurisdiction are as follows for the three and six months ended June 30:

| <u>Country</u> | 2015 | 2014 |
|-------------------|-------|-------|
| Australia | 30.0% | 30.0% |
| Canada | 26.5% | 26.5% |
| Denmark | 23.5% | 23.5% |
| Japan | 35.4% | 37.1% |
| Mexico | 30.0% | 30.0% |
| Norway | 27.0% | 27.0% |
| Republic of Korea | 22.0% | 22.0% |
| Singapore | 17.0% | 17.0% |
| South Africa | 28.0% | 28.0% |
| Sweden | 22.0% | 22.0% |
| Switzerland | 16.2% | 16.2% |
| Taiwan | 17.0% | 17.0% |
| United Kingdom | 20.0% | 21.0% |
| United States | 37.5% | 37.5% |
| Cyprus | 12.5% | 12.5% |
| Hong Kong | 16.5% | 16.5% |
| Ukraine | 18.0% | 18.0% |
| Gibraltar | 10.0% | 10.0% |
| Colombia | 34.0% | — % |

Income from our international operations is subject to taxation in the countries in which we operate. Although we may receive foreign income tax credits that would reduce the total amount of income taxes owed in the United States, we may not be able to fully utilize our foreign income tax credits in the United States.

We use the recognition and measurement provisions of FASB ASC Topic 740, Income Taxes (“Topic 740”), to account for income taxes. The provisions of the Tax Topic 740 require a company to record a valuation allowance when the “more likely than not” criterion for realizing net deferred tax assets cannot be met. Furthermore, the weight given to the potential effect of such evidence should be commensurate with the extent to which it can be objectively verified. As a result, we reviewed the operating results, as well as all of the positive and negative evidence related to realization of such deferred tax assets to evaluate the need for a valuation allowance in each tax jurisdiction.

For each of the periods ended June 30, 2015 and December 31, 2014, we maintained the following valuation allowances for deferred tax assets totaling \$9.3 million and \$9.7 million, respectively, as we believe the “more likely than not” criterion for recognition and realization purposes, as defined in Topic 740, cannot be met (in millions):

| | June | December |
|----------------|-------|----------|
| | 30, | 31, |
| <u>Country</u> | 2015 | 2014 |
| Mexico | \$2.7 | \$ 2.7 |
| Norway | 0.1 | 0.1 |
| Sweden | 0.1 | 0.1 |
| Switzerland | 0.8 | 1.2 |
| Taiwan | 1.2 | 1.2 |
| Ukraine | 0.1 | 0.1 |

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| | | |
|---------------|-------|--------|
| United States | 4.3 | 4.3 |
| Total | \$9.3 | \$ 9.7 |

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The dollar amount of the provisions for income taxes is directly related to our profitability and changes in the taxable income among countries. For the three and six months ended June 30, 2015, the Company's effective income tax rate was 25.0% and 26.8% respectively, as compared to 183.7% and 124.8%, respectively, for the same periods in 2014.

The effective tax rates for the three and six months ended June 30, 2015 were lower than what would have been expected if the federal statutory rate were applied to income before taxes. Items decreasing the effective income tax rate include the favorable rate differences from foreign jurisdictions and release of valuation allowances associated with deferred tax assets of net operating loss carryforward.

The effective tax rates for the three and six months ended June 30, 2014 were higher than what would have been expected if the federal statutory rate were applied to income before taxes. Items increasing the effective income tax rate included the change in the valuation allowances associated with certain deferred tax assets and the unfavorable rate differences from foreign jurisdictions. In addition, in the second quarter 2014, it was determined a deemed intercompany dividend had occurred in 2012 and 2013 related to an intercompany working capital loan that originated in 2012; the Company recorded the expense, which is not material to the financial statements for the year. We have not initiated any further intercompany transactions like the 2012 transaction, nor do we anticipate the need for further transactions of this type.

LIQUIDITY AND CAPITAL RESOURCES

Cash and Cash Equivalents

As of June 30, 2015, our cash and cash equivalents increased by 9.5%, or \$2.7 million, to \$30.7 million from \$28.0 million as of December 31, 2014. Our restricted cash balance increased during the six months ended June 30, 2015 by \$0.3 million to \$8.8 million from \$8.6 million. Fluctuations in currency rates produced an increase of \$0.3 million in cash and cash equivalents during the six months ended June 30, 2015.

Our principal use of cash is to pay for operating expenses, including commissions and incentives, capital assets, inventory purchases, and international expansion. The quarterly cash dividend has been suspended since August 2009. Business objectives, operations, and expansion of operations are funded through net cash flows from operations rather than incurring long-term debt.

Working Capital

Working capital represents total current assets less total current liabilities. At June 30, 2015, our working capital increased by \$3.4 million to \$19.8 million from \$16.4 million at December 31, 2014. The increase in working capital is primarily related to an increase in cash and inventories, offset by an increase in accounts payable. Our working capital is also significantly impacted by deferred revenue and deferred costs (see Revenue Recognition and Deferred Commissions in Note 1: Organization and Summary of Significant Accounting Policies of the unaudited consolidated financial statements).

Net Cash Flows

Our net consolidated cash flows consisted of the following, for the six months ended June 30 (in millions):

| | | |
|------------------------|---------|---------|
| Provided by/(used in): | 2015 | 2014 |
| Operating activities | \$4.5 | \$7.4 |
| Investing activities | \$(1.2) | \$(1.2) |
| Financing activities | \$(0.9) | \$(0.6) |

Operating Activities

Cash provided by operating activities was \$4.5 million for the six months ended June 30, 2015, as compared to cash provided by operating activities of \$7.4 million for the same period in 2014. Operating cash flow declined due to the purchases of inventories and decreases in deferred revenue, deferred costs and customer deposits. We defer certain components of our revenue and commission expense as discussed in Revenue Recognition and Deferred Commissions in Note 1 Organization and Summary of Significant Accounting Policies. We defer the recognition of revenue on payments received and related commission expenses on payments made. Payments received related to the revenue deferral were a use of \$1.0 million cash for the six months ended June 30, 2015, as compared to a source of \$4.8 million for the same period in 2014. Commission payments related to the reduced expense deferral was a source of \$0.4 million in cash for the six months ended June 30, 2015, as compared to a use of \$1.9 million for the same period in 2014. Additionally, our June 30, 2014 balance sheet included \$3.1 million in customer deposits from pre-launch activities of the Uth skin care product in certain Asia/Pacific markets. We had no customer deposits at June 30, 2015.

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Investing Activities

For each of the six months ended June 30, 2015 and 2014, we invested cash of \$1.2 million. During the six months ended June 30, 2015, we invested \$0.9 million in back-office software projects and \$0.3 million in leasehold improvements in various international offices and training centers.

Financing Activities

For the six months ended June 30, 2015 and 2014, we used \$1.0 million and \$0.7 million, respectively, in repayment of capital lease obligations which was partially offset by cash provided by the exercise of stock options. We received less than \$0.1 million during the six months ended June 30, 2015 as compared to approximately \$0.1 million during the six months ended June 30, 2014 in proceeds from stock option exercises.

General Liquidity and Cash Flows

Short Term Liquidity

We believe our existing liquidity and cash flows from operations are adequate to fund our normal expected future business operations and possible international expansion costs for the next 12 months. As our primary source of liquidity is our cash flow from operations, this will be dependent on our ability to maintain and increase revenue and/or continue to reduce operational expenses. However, if our existing capital resources or cash flows become insufficient to meet current business plans, projections, and existing capital requirements, we may be required to raise additional funds, which may not be available on favorable terms, if at all.

We are engaged in ongoing audits in various tax jurisdictions and other disputes in the normal course of business. It is impossible at this time to predict whether we will incur any liability, or to estimate the ranges of damages, if any, in connection with these matters. Adverse outcomes on these uncertainties may lead to substantial liability or enforcement actions that could adversely affect our cash position. For more information, see Note 3 Income Taxes and Note 7 Litigation to our consolidated financial statements.

Long Term Liquidity

We believe our positive cash flows from operations should be adequate to fund our normal expected future business operations and possible international expansion costs for the long term. As our primary source of liquidity is from our cash flows from operations, this will be dependent on our ability to maintain and increase revenue and/or continue to reduce operational expenses.

However, if our existing capital resources or cash flows become insufficient to meet anticipated business plans and existing capital requirements, we may be required to raise additional funds, which may not be available on favorable terms, if at all.

Our future access to the capital markets may be adversely impacted if we fail to maintain compliance with the Nasdaq Marketplace Rules for the continued listing of our stock. We continuously monitor our compliance with the Nasdaq continued listing rules.

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CONTRACTUAL OBLIGATIONS

The following summarizes our future commitments and obligations associated with various agreements and contracts as of June 30, 2015, for the years ending December 31 (in thousands):

| | Remaining 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | Thereafter | Total |
|---|-------------------|-------|-------|------|------|------|------------|--------|
| Capital lease obligations and other financing | 529 | 749 | 607 | 242 | 54 | 14 | — | 2,195 |
| Purchase obligations ^{(1) (2)} | 5,261 | 288 | — | — | — | — | — | 5,549 |
| Operating leases | 961 | 1,651 | 1,348 | 698 | 192 | 35 | — | 4,885 |
| Employment agreements | 722 | 738 | — | — | — | — | — | 1,460 |
| Royalty agreement | 24 | — | — | — | — | — | — | 24 |
| Tax liability ⁽³⁾ | 34 | 268 | 497 | — | — | — | — | 799 |
| Other obligations ⁽⁴⁾ | 199 | 247 | 146 | 53 | 49 | 49 | 659 | 1,402 |
| Total commitments and obligations | 7,730 | 3,941 | 2,598 | 993 | 295 | 98 | 659 | 16,314 |

For purposes of the table, a purchase obligation is defined as an agreement to purchase goods or services that is non-cancelable, enforceable and legally binding on the Company that specifies all significant terms, including:

- (1) fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction.
- (2) Excludes approximately \$6.5 million of finished product purchase orders that may be cancelled or delivery dates changed as of June 30, 2015.
- (3) Represents the tax liability associated with uncertain tax positions, see Note 3 "Income Taxes" to our consolidated financial statements.
- (4) Other obligations are composed of pension obligations related to the Company's international operations (approximately \$1.0 million) and lease restoration obligations (approximately \$0.4 million).

We have maintained purchase commitments with certain raw material suppliers to purchase minimum quantities and to ensure exclusivity of our raw materials and the proprietary nature of our products. Currently, we have one supply agreement that requires minimum purchase commitments. We also maintain other supply agreements and manufacturing agreements to protect our products, regulate product costs, and help ensure quality control standards. These agreements do not require us to purchase any set minimums. We have no present commitments or agreements with respect to acquisitions or purchases of any manufacturing facilities; however, management from time to time explores the possible benefits of purchasing a raw material manufacturing facility to help control costs of our raw materials and help ensure quality control standards.

OFF-BALANCE SHEET ARRANGEMENTS

We do not have any special-purpose entity arrangements, nor do we have any off-balance sheet arrangements.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. The application of GAAP requires us to make estimates and assumptions that affect the reported values of assets and liabilities at the date of our financial statements, the reported amounts of revenues and expenses during the reporting period, and the related disclosures of contingent assets and liabilities. We use estimates throughout our financial statements, which are influenced by management's judgment and uncertainties. Our estimates are based on historical trends, industry standards, and various other assumptions that we believe are applicable and reasonable under the circumstances at the time the consolidated financial statements are prepared. Our Audit

Committee reviews our critical accounting policies and estimates. We continually evaluate and review our policies related to the portrayal of our consolidated financial position and consolidated results of operations that require the application of significant judgment by our management. We also analyze the need for certain estimates, including the need for such items as allowance for doubtful accounts, inventory reserves, long-lived fixed assets and capitalization of internal-use software development costs, reserve for uncertain income tax positions and tax valuation allowances, revenue recognition, sales returns, and deferred revenues, accounting for stock-based compensation, and contingencies and litigation. Historically, actual results have not materially deviated from our estimates. However, we caution readers that actual results could differ from our estimates and assumptions applied in the preparation of our consolidated financial statements. If circumstances change relating to the various assumptions or conditions used in our estimates, we could experience an adverse effect on our financial position, results of operations, and cash flows. We have identified the following applicable critical accounting policies and estimates as of June 30, 2015:

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Inventory Reserves

Inventory consists of raw materials, finished goods, and promotional materials that are stated at the lower of cost (using standard costs that approximate average costs) or market. We record the amounts charged by the vendors as the costs of inventory. Typically, the net realizable value of our inventory is higher than the aggregate cost. Determination of net realizable value can be complex and, therefore, requires a high degree of judgment. In order for management to make the appropriate determination of net realizable value, the following items are considered: inventory turnover statistics, current selling prices, seasonality factors, consumer demand, regulatory changes, competitive pricing, and performance of similar products. If we determine the carrying value of inventory is in excess of estimated net realizable value, we write down the value of inventory to the estimated net realizable value.

We also review inventory for obsolescence in a similar manner, and any inventory identified as obsolete is reserved or written off. Our determination of obsolescence is based on assumptions about the demand for our products, product expiration dates, estimated future sales, and general future plans. We monitor actual sales compared to original projections, and if actual sales are less favorable than those originally projected by us, we record an additional inventory reserve or write-down. Historically, our estimates have been close to our actual reported amounts. However, if our estimates regarding inventory obsolescence are inaccurate or consumer demand for our products changes in an unforeseen manner, we may be exposed to additional material losses or gains in excess of our established estimated inventory reserves.

Long Lived Fixed Assets and Capitalization of Software Development Costs

In addition to capitalizing long lived fixed asset costs, we also capitalize costs associated with internally-developed software projects (collectively “fixed assets”) and amortize such costs over the estimated useful lives of such fixed assets. Fixed assets are carried at cost, less accumulated depreciation computed using the straight-line method over the assets’ estimated useful lives. Leasehold improvements are amortized over the shorter of the remaining lease terms or the estimated useful lives of the improvements. Expenditures for maintenance and repairs are charged to operations as incurred. If a fixed asset is sold or otherwise retired or disposed of, the cost of the fixed asset and the related accumulated depreciation or amortization is written off and any resulting gain or loss is recorded in other operating costs in our consolidated statement of operations.

We review our fixed assets for impairment whenever an event or change in circumstances indicates the carrying amount of an asset or group of assets may not be recoverable, such as plans to dispose of an asset before the end of its previously estimated useful life. Our impairment review includes a comparison of future projected cash flows generated by the asset, or group of assets, with its associated net carrying value. If the net carrying value of the asset or group of assets exceeds expected cash flows (undiscounted and without interest charges), an impairment loss is recognized to the extent the carrying amount exceeds the fair value. The fair value is determined by calculating the discounted expected future cash flows using an estimated risk-free rate of interest. Any identified impairment losses are recorded in the period in which the impairment occurs. The carrying value of the fixed asset is adjusted to the new carrying value, and any subsequent increases in fair value of the fixed asset are not recorded. In addition, if we determine the estimated remaining useful life of the asset should be reduced from our original estimate; the periodic depreciation expense is adjusted prospectively, based on the new remaining useful life of the fixed asset.

The impairment calculation requires us to apply judgment and estimates concerning future cash flows, strategic plans, useful lives, and discount rates. If actual results are not consistent with our estimates and assumptions, we may be exposed to an additional impairment charge, which could be material to our results of operations. In addition, if accounting standards change, or if fixed assets become obsolete, we may be required to write off any unamortized costs of fixed assets, or if estimated useful lives change, we would be required to accelerate depreciation or amortization periods and recognize additional depreciation expense in our consolidated statement of operations.

Historically, our estimates and assumptions related to the carrying value and the estimated useful lives of our fixed assets have not materially deviated from actual results. As of June 30, 2015 and December 31, 2014, the estimated useful lives and net carrying values of fixed assets were as follows:

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| | Estimated useful life | Net carrying value at June 30, 2015 |
|---|------------------------------|-------------------------------------|
| Computer hardware and software | 3 to 5 years | \$2.5 million |
| Leasehold improvements | 2 to 10 years ⁽¹⁾ | 1.3 million |
| Office furniture and equipment | 5 to 7 years | 0.6 million |
| Automobiles | 3 to 5 years | — million |
| Total net carrying value at June 30, 2015 | | \$4.4 million |

| | Estimated useful life | Net carrying value at December 31, 2014 |
|---|------------------------------|---|
| Computer hardware and software | 3 to 5 years | \$0.6 million |
| Leasehold improvements | 2 to 10 years ⁽¹⁾ | 1.4 million |
| Office furniture and equipment | 5 to 7 years | 0.4 million |
| Automobiles | 3 to 5 years | 0.1 million |
| Total net carrying value at December 31, 2014 | | \$2.5 million |

(1) We amortize leasehold improvements over the shorter of the useful estimated life of the leased asset or the lease term.

The net carrying costs of fixed assets and construction in progress are exposed to impairment losses if our assumptions and estimates of their carrying values change, there is a change in estimated future cash flow, or there is a change in the estimated useful life of the fixed asset. Based on management's analysis, no impairment indicators existed for the six months ended June 30, 2015.

Uncertain Income Tax Positions and Tax Valuation Allowances

As of June 30, 2015, we recorded \$0.8 million in other long-term liabilities and \$0.1 million in taxes payable on our consolidated balance sheet related to uncertain income tax positions. As required by FASB ASC Topic 740, Income Taxes, we use judgments and make estimates and assumptions related to evaluating the probability of uncertain income tax positions. We base our estimates and assumptions on the potential liability related to an assessment of whether the income tax position will "more likely than not" be sustained in an income tax audit. We are also subject to periodic audits from multiple domestic and foreign tax authorities related to income tax and other forms of taxation. These audits examine our tax positions, timing of income and deductions, and allocation procedures across multiple jurisdictions. As part of our evaluation of these tax issues, we establish reserves in our consolidated financial statements based on our estimate of current probable tax exposures. Depending on the nature of the tax issue, we could be subject to audit over several years. Therefore, our estimated reserve balances and liability related to uncertain income tax positions may exist for multiple years before the applicable statute of limitations expires or before an issue is resolved by the taxing authority. Additionally, we may be requested to extend the statute of limitations for tax years under audit, which may cause the classification between current and long-term to change. We believe our tax liabilities related to uncertain tax positions are based upon reasonable judgment and estimates; however, if actual results materially differ, our effective income tax rate and cash flows could be affected in the period of discovery or resolution.

We also review the estimates and assumptions used in evaluating the probability of realizing the future benefits of our deferred tax assets and record a valuation allowance when we believe that a portion or all of the deferred tax assets

may not be realized. If we are unable to realize the expected future benefits of our deferred tax assets, we are required to provide a valuation allowance. We use our past history and experience, overall profitability, future management plans, and current economic information to evaluate the amount of valuation allowance to record. As of June 30, 2015, we maintained a valuation allowance for deferred tax assets arising from our operations of \$9.3 million because they did not meet the “more likely than not” criteria as defined by the recognition and measurement provisions of FASB ASC Topic 740, Income Taxes. In addition, as of June 30, 2015 and December 31, 2014, we had deferred tax assets, after valuation allowance, totaling \$5.8 million and \$4.3 million, respectively, which may not be realized if our assumptions and estimates change, which would affect our effective income tax rate and cash flows in the period of discovery or resolution.

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Revenue Recognition and Deferred Commissions

Our revenue is derived from sales of individual products, sales of starter and renewal packs, and shipping fees. Substantially all of our product and pack sales are made to associates at published wholesale prices and to members at discounted published retail prices. We record revenue net of any sales taxes and record a reserve for expected sales returns based on historical experience.

We recognize revenue from shipped packs and products upon receipt by the customer. Corporate-sponsored event revenue is recognized when the event is held. We defer certain components of revenue. At June 30, 2015 and December 31, 2014, deferred revenue was \$9.8 million and \$10.9 million, respectively. When participating in the Company's loyalty program, customers earn loyalty points from qualified automatic orders, which can be applied to future purchases. We defer the dollar equivalent in revenue of these points until the points are applied, forfeited, or expired, which includes an estimate of the percentage of the unvested loyalty points that are expected to be forfeited or expired. During the third quarter 2014, we modified the program to allow loyalty points to vest more quickly. The deferred revenue associated with the loyalty program at June 30, 2015 and December 31, 2014 was \$7.9 million and \$9.7 million, respectively. Deferred revenue consisted primarily of: (i) sales of packs and products shipped but not received by the customers by the end of the respective period; (ii) revenue from the loyalty program; and (iii) prepaid registration fees from customers planning to attend a future corporate-sponsored event. In total current assets, we defer commissions on (i) the sales of packs and products shipped but not received by the customers by the end of the respective period and (ii) the loyalty program. Deferred commissions were \$4.2 million and \$4.5 million at June 30, 2015 and December 31, 2014, respectively.

Product Return Policy

We stand behind our products and believe we offer a reasonable and industry-standard product return policy to all of our customers. We do not resell returned products. Refunds are not processed until proper approval is obtained. All refunds must be processed and returned in the same form of payment that was originally used in the sale. Each country in which we operate has specific product return guidelines. However, we allow our associates and members to exchange products as long as the products are unopened and in good condition. Our return policies for our retail customers and our associates and members are as follows:

Retail Customer Product Return Policy. This policy allows a retail customer to return any of our products to the original associate who sold the product and receive a full cash refund from the associate for the first 180 days following the product's purchase if located in the United States and Canada, and for the first 90 days following the product's purchase in the remaining countries. The associate may then return or exchange the product based on the associate product return policy.

Associate and Member Product Return Policy. This policy allows the associate or member to return an order within one year of the purchase date upon terminating his/her account. If an associate or member returns a product unopened and in good condition, he/she may receive a full refund minus a 10% restocking fee. We may also allow the associate or member to receive a full satisfaction guarantee refund if they have tried the product and are not satisfied for any reason, excluding promotional materials. This satisfaction guarantee refund applies in the United States and Canada, only for the first 180 days following the product's purchase, and applies in the remaining countries for the first 90 days following the product's purchase; however, any commissions earned by an associate will be deducted from the refund. If we discover abuse of the refund policy, we may terminate the associate's or member's account.

Historically, sales returns estimates have not materially deviated from actual sales returns, as the majority of our customers who return merchandise do so within the first 90 days after the original sale. Based upon our return policies and historical experience, we estimate a sales return reserve for expected sales refunds over a rolling six month period. If actual results differ from our estimated sales returns reserves due to various factors, the amount of revenue recorded

each period could be materially affected. Historically, our sales returns have not materially changed through the years and have averaged 1.5% or less of our gross sales.

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Accounting for Stock-Based Compensation

We grant stock options to our employees, board members, and consultants. At the date of grant, we determine the fair value of a stock option award and recognize compensation expense over the requisite service period, or the vesting period of such stock option award, which is two to three years. The fair value of the stock option award is calculated using the Black-Scholes option-pricing model (“calculated fair value”). The Black-Scholes option-pricing model requires us to apply judgment and use highly subjective assumptions, including expected stock option life, expected volatility, expected average risk-free interest rates, and expected forfeiture rates. For the six months ended June 30, 2015, our assumptions and estimates used for the calculated fair value of stock options granted in 2015 were as follows:

| | April 2015 Grant | May 2015 Grant |
|--|------------------------|----------------------|
| Estimated fair value per share of options granted: | \$ 11.34 | \$ 12.80 |
| Assumptions: | | |
| Annualized dividend yield | — % | — % |
| Risk-free rate of return | 1.2 % | 1.4 % |
| Common stock price volatility | 79.4 % | 79.1 % |
| Expected average life of stock options (in years) | 4.5 | 4.5 |

The assumptions we use are based on our best estimates and involve inherent uncertainties related to market conditions that are outside of our control. If actual results are not consistent with the assumptions we use, the stock-based compensation expense reported in our consolidated financial statements may not be representative of the actual economic cost of stock-based compensation. For example, if actual employee forfeitures significantly differ from our estimated forfeitures, we may be required to make an adjustment to our consolidated financial statements in future periods. As of June 30, 2015, using our current assumptions and estimates, we anticipate recognizing \$0.5 million in gross compensation expense through 2018 related to unvested stock options outstanding.

If we grant additional stock options in the future, we would be required to recognize additional compensation expense over the vesting period of such stock options in our consolidated statement of operations. As of June 30, 2015, we had 134,628 shares available for grant in the future.

Contingencies and Litigation

Each quarter, we evaluate the need to establish a reserve for any legal claims or assessments. We base our evaluation on our best estimates of the potential liability in such matters. The legal reserve includes an estimated amount for any damages and the probability of losing any threatened legal claims or assessments. We consult with our general and outside counsel to determine the legal reserve, which is based upon a combination of litigation and settlement strategies. Although we believe that our legal reserve and accruals are based on reasonable judgments and estimates, actual results could differ, which may expose us to material gains or losses in future periods. If actual results differ, if circumstances change, or if we experience an unanticipated adverse outcome of any legal action, including any claim or assessment, we would be required to recognize the estimated amount which could reduce net income, earnings per share, and cash flows.

RECENT ACCOUNTING PRONOUNCEMENTS

See Note 10, Recent Accounting Pronouncements in the Notes to our Unaudited Consolidated Financial Statements.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

We do not engage in trading market risk sensitive instruments and do not purchase investments as hedges or for purposes “other than trading” that are likely to expose us to certain types of market risk, including interest rate, commodity price, or equity price risk. Although we have investments, we believe there has been no material change in our exposure to interest rate risk. We have not issued any debt instruments, entered into any forward or futures contracts, purchased any options, or entered into any swap agreements.

We are exposed, however, to other market risks, including changes in currency exchange rates as measured against the United States dollar. Because the change in value of the United States dollar measured against foreign currency may affect our consolidated financial results, changes in foreign currency exchange rates could positively or negatively affect our results as expressed in United States dollars. For example, when the United States dollar strengthens against foreign currencies in which our products are sold or weakens against foreign currencies in which we may incur costs, our consolidated net sales or related costs and expenses could be adversely affected. We translate our revenues and expenses in foreign markets using an average rate. We believe inflation has not had a material impact on our consolidated operations or profitability.

We maintain policies, procedures, and internal processes in an effort to help monitor any significant market risks and we do not use any financial instruments to manage our exposure to such risks. We assess the anticipated foreign currency working capital requirements of our foreign operations and maintain a portion of our cash and cash equivalents denominated in foreign currencies sufficient to satisfy most of these anticipated requirements.

We caution that we cannot predict with any certainty our future exposure to such currency exchange rate fluctuations or the impact, if any, such fluctuations may have on our future business, product pricing, operating expenses, and on our consolidated financial position, results of operations, or cash flows. However, to combat such market risk, we closely monitor our exposure to currency fluctuations. The regions and countries in which we currently have exposure to foreign currency exchange rate risk include: (i) North America (Canada and Mexico); (ii) EMEA (Austria, the Czech Republic, Denmark, Estonia, Finland, Germany, the Republic of Ireland, the Netherlands, Norway, South Africa, Spain, Sweden, Switzerland and the United Kingdom); and (iii) Asia/Pacific (Australia, Japan, New Zealand, the Republic of Korea, Singapore, Taiwan and Hong Kong). The current (spot) rate, average currency exchange rates, and the low and high of such currency exchange rates as compared to the United States dollar, for each of these countries as of and for the six months ended June 30, 2015 were as follows:

| Country (foreign currency name) | Six months ended June 30, 2015 | | | As of June 30, 2015 |
|---|--------------------------------|---------|---------|---------------------|
| | Low | High | Average | Spot |
| Australia (Australian Dollar) | .75815 | .82330 | .78277 | .76575 |
| Various countries ⁽¹⁾ (Euro) | 1.04993 | 1.21430 | 1.11738 | 1.10965 |
| Canada (Canadian Dollar) | .78230 | .86220 | .81075 | .80945 |
| Czech Republic (Koruna) | .03840 | .04380 | .04065 | .04070 |
| Denmark (Kroner) | .14069 | .16310 | .14989 | .14874 |
| Hong Kong (Hong Kong Dollar) | .12875 | .12904 | .12898 | .12900 |
| Japan (Yen) | .00797 | .00857 | .00832 | .00815 |
| Mexico (Peso) | .06357 | .06885 | .06613 | .06389 |
| New Zealand (New Zealand Dollar) | .68402 | .78430 | .74313 | .68402 |
| Norway (Krone) | .12034 | .13702 | .12921 | .12670 |
| Republic of Korea (Won) | .00088 | .00094 | .00091 | .00089 |
| Singapore (Singapore Dollar) | .71835 | .75781 | .74134 | .74063 |
| South Africa (Rand) | .07957 | .08805 | .08404 | .08145 |

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| | | | | |
|--------------------------------|---------|---------|---------|---------|
| Sweden (Krona) | .11330 | .12900 | .11957 | .12027 |
| Switzerland (Franc) | .98100 | 1.17090 | 1.05737 | 1.07066 |
| Taiwan (New Taiwan Dollar) | .03122 | .03298 | .03209 | .03234 |
| United Kingdom (British Pound) | 1.46339 | 1.58880 | 1.52393 | 1.57205 |

(1) Austria, Germany, the Netherlands, Estonia, Finland, the Republic of Ireland and Spain

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Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer (principal executive officer) and our Chief Accounting Officer (principal financial officer), have concluded, based on their evaluation as of the end of the period covered by this report, that our disclosure controls and procedures (as defined in Rule 13a-15(e) or Rule 15d – 15(e) under the Exchange Act) are effective to ensure that information required to be disclosed by us in reports filed or submitted under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms and include controls and procedures designed to ensure that information required to be disclosed by us in such reports is accumulated and communicated to our management, including our principal executive and financial officers, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

During the quarter ended June 30, 2015, there were no changes in our internal control over our financial reporting that we believe materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings

See “Litigation” in Note 7 of the Notes to our Unaudited Consolidated Financial Statements, which is incorporated herein by reference.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2014, which could materially affect our business or our consolidated financial position, results of operations, and cash flows. The risks described in our Annual Report on Form 10-K are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be insignificant also may become materially adverse or may affect our business in the future or our consolidated financial position, results of operations, or cash flows.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not Applicable.

Item 5. Other Information

None.

Item 6. Exhibits

See Index to Exhibits following the signature page of this Quarterly Report on Form 10-Q.

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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.

MANNATECH, INCORPORATED

Dated: August 4, 2015 By: /s/ Robert A. Sinnott

Robert A. Sinnott
Chief Executive Officer and Chief Science Officer
(principal executive officer)

Dated: August 4, 2015 By: /s/ David A. Johnson

David A. Johnson
Chief Accounting Officer
(principal financial officer)

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| Exhibit Number | Exhibit Description | Incorporated by Reference | | |
|----------------|---|---------------------------|--------------|-------------------------|
| | | Form | File No. | Exhibit (s) Filing Date |
| 3.1 | Amended and Restated Articles of Incorporation of Mannatech, dated May 19, 1998. | S-1 | 333-631333.1 | October 28, 1998 |
| 3.2 | Certificate of Amendment to the Amended and Restated Articles of Incorporation of Mannatech, dated January 13, 2012. | 8-K | 000-246573.1 | January 17, 2012 |
| 3.3 | Fifth Amended and Restated Bylaws of Mannatech, dated August 25, 2014. | 8-K | 000-246573.1 | August 27, 2014 |
| 4.1 | Specimen Certificate representing Mannatech's common stock, par value \$0.0001 per share. | S-1 | 333-631334.1 | October 28, 1998 |
| <u>31.1*</u> | Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, of the Chief Executive Officer of Mannatech. | * | * | * |
| <u>31.2*</u> | Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, of the Chief Financial Officer of Mannatech. | * | * | * |
| <u>32.1*</u> | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of the Chief Executive Officer of Mannatech. | * | * | * |
| <u>32.2*</u> | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of the Chief Financial Officer of Mannatech. | * | * | * |
| 101.INS** | XBRL Instance Document | ** | ** | ** |
| 101.SCH** | XBRL Taxonomy Extension Schema Document | ** | ** | ** |
| 101.CAL** | XBRL Taxonomy Extension Calculation Linkbase Document | ** | ** | ** |
| 101.LAB** | XBRL Taxonomy Extension Label Linkbase Document | ** | ** | ** |
| 101.PRE** | XBRL Taxonomy Extension Presentation Linkbase Document | ** | ** | ** |
| 101.DEF** | XBRL Taxonomy Extension Definition Linkbase Document | ** | ** | ** |

*Filed herewith.

Furnished herewith. In accordance with Rule 406T of Regulation S-T, the information in these exhibits shall not be deemed to be "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to

**liability under that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, except as expressly set forth by specific reference in such filing.
