

NU SKIN ENTERPRISES INC

Form 10-Q

August 03, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _____ TO _____

Commission File Number: 001-12421

	NU SKIN ENTERPRISES, INC. (Exact name of registrant as specified in its charter)	
Delaware		87-0565309
(State or other jurisdiction of incorporation or organization)	75 WEST CENTER STREET PROVO, UTAH 84601 (Address of principal executive offices, including zip code)	(IRS Employer Identification No.)
	(801) 345-1000 (Registrant's telephone number, including area code)	

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was

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required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for 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, smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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, 2017, 52,942,178 shares of the registrant's Class A common stock, \$.001 par value per share, were outstanding.

NU SKIN ENTERPRISES, INC.

QUARTERLY REPORT ON FORM 10-Q – SECOND QUARTER 2017

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In this Quarterly Report on Form 10-Q, references to "dollars" and "\$" are to United States ("U.S.") dollars.

Nu Skin, Pharmanex, and ageLOC are our trademarks. The italicized product names used in this Quarterly Report on Form 10-Q are product names and also, in certain cases, our trademarks.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

NU SKIN ENTERPRISES, INC.

Consolidated Balance Sheets (Unaudited)

(U.S. dollars in thousands)

	June 30, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	\$345,102	\$357,246
Current investments	7,982	10,880
Accounts receivable	35,010	31,199
Inventories, net	246,658	249,936
Prepaid expenses and other	85,547	65,076
	720,299	714,337
Property and equipment, net	450,707	444,732
Goodwill	114,954	114,954
Other intangible assets, net	59,802	63,553
Other assets	161,383	136,469
Total assets	\$1,507,145	\$1,474,045
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$37,846	\$41,261
Accrued expenses	262,123	275,023
Current portion of long-term debt	100,533	82,727
	400,502	399,011
Long-term debt	324,059	334,165
Other liabilities	83,014	76,799
Total liabilities	807,575	809,975
Commitments and contingencies (Note 11)		
Stockholders' equity:		
Class A common stock – 500 million shares authorized, \$.001 par value, 90.6 million shares issued	91	91
Additional paid-in capital	448,928	439,635
Treasury stock, at cost – 37.6 million and 38.0 million shares	(1,261,983)	(1,250,123)
Accumulated other comprehensive loss	(74,743)	(84,122)
Retained earnings	1,587,277	1,558,589
	699,570	664,070
Total liabilities and stockholders' equity	\$1,507,145	\$1,474,045

The accompanying notes are an integral part of these consolidated financial statements.

NU SKIN ENTERPRISES, INC.

Consolidated Statements of Income (Unaudited)

(U.S. dollars in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Revenue	\$550,101	\$600,475	\$1,049,200	\$1,072,306
Cost of sales	121,521	128,205	232,787	266,074
Gross profit	428,580	472,270	816,413	806,232
Operating expenses:				
Selling expenses	228,353	248,363	437,361	443,922
General and administrative expenses	135,488	144,109	268,051	274,363
Total operating expenses	363,841	392,472	705,412	718,285
Operating income	64,739	79,798	111,001	87,947
Other income (expense), net	(2,731)	(11,060)	(7,298)	(13,923)
Income before provision for income taxes	62,008	68,738	103,703	74,024
Provision for income taxes	19,967	24,025	34,173	25,995
Net income	\$42,041	\$44,713	\$69,530	\$48,029
Net income per share (Note 2):				
Basic	\$0.79	\$0.80	\$1.32	\$0.86
Diluted	\$0.77	\$0.79	\$1.28	\$0.85
Weighted-average common shares outstanding (000s):				
Basic	52,929	55,952	52,804	55,953
Diluted	54,839	56,356	54,466	56,388

The accompanying notes are an integral part of these consolidated financial statements.

NU SKIN ENTERPRISES, INC.

Consolidated Statements of Comprehensive Income (Unaudited)
(U.S. dollars in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net income	\$42,041	\$44,713	\$69,530	\$48,029
Other comprehensive income, net of tax:				
Foreign currency translation adjustment, net of taxes of \$1,901 and \$886 for the three months ended June 30, 2017 and 2016, respectively, and \$(1,679) and \$(1,565) for the six months ended June 30, 2017 and 2016, respectively	81	(3,639)	9,776	1,950
Net unrealized gains/(losses) on foreign currency cash flow hedges, net of taxes of \$(114) and \$645 for the three months ended June 30, 2017 and 2016, respectively, and \$99 and \$1,575 for the six months ended June 30, 2017 and 2016, respectively	207	(1,170)	(180)	(2,860)
Reclassification adjustment for realized losses/(gains) in current earnings, net of taxes of \$143 and \$(329) for the three months ended June 30, 2017 and 2016, respectively, and \$120 and \$(395) for the six months ended June 30, 2017 and 2016, respectively	(260)	597	(217)	716
	28	(4,212)	9,379	(194)
Comprehensive income	\$42,069	\$40,501	\$78,909	\$47,835

The accompanying notes are an integral part of these consolidated financial statements.

NU SKIN ENTERPRISES, INC.

Consolidated Statements of Cash Flows (Unaudited)

(U.S. dollars in thousands)

	Six Months Ended June 30,	
	2017	2016
Cash flows from operating activities:		
Net income	\$69,530	\$48,029
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	35,080	34,684
Equity method earnings	(358)	—
Japan customs expense	—	31,355
Foreign currency losses	(256)	13,519
Stock-based compensation	7,581	7,586
Deferred taxes	5,390	2,463
Changes in operating assets and liabilities:		
Accounts receivable	(2,812)	4,595
Inventories, net	8,706	6,871
Prepaid expenses and other	(15,140)	(62,091)
Other assets	(2,567)	12
Accounts payable	(4,357)	14,353
Accrued expenses	(21,607)	36,486
Other liabilities	4,839	(2,037)
Net cash provided by operating activities	84,029	135,825
Cash flows from investing activities:		
Purchases of property and equipment	(27,751)	(24,714)
Proceeds of investment sales	7,741	10,881
Purchases of investments	(4,716)	(9,869)
Acquisition and investment in equity investee	(25,095)	(4,400)
Net cash used in investing activities	(49,821)	(28,102)
Cash flows from financing activities:		
Exercise of employee stock options and taxes paid related to the net shares settlement of stock awards	7,795	2,777
Payments on long-term debt	(64,495)	(18,978)
Payment of cash dividends	(38,042)	(39,698)
Income tax benefit of equity awards	—	3,520
Proceeds from long-term debt	67,000	233,721
Payment of debt issuance costs	—	(6,596)
Repurchases of shares of common stock	(22,135)	(24,296)
Net cash provided by (used in) financing activities	(49,877)	150,450
Effect of exchange rate changes on cash	3,525	(2,679)

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Net increase (decrease) in cash and cash equivalents	(12,144)	255,494
Cash and cash equivalents, beginning of period	357,246	289,354
Cash and cash equivalents, end of period	\$ 345,102	\$ 544,848

The accompanying notes are an integral part of these consolidated financial statements.

NU SKIN ENTERPRISES, INC.
Notes to Consolidated Financial Statements

1. THE COMPANY

Nu Skin Enterprises, Inc. (the "Company") is a leading, global direct selling company that develops and distributes premium-quality, innovative personal care products and nutritional supplements that are sold worldwide under the Nu Skin and Pharmanex brands and a small number of other products and services. Over the last several years, the Company has introduced new Pharmanex nutritional supplements and Nu Skin personal care products under its ageLOC anti-aging brand. The Company reports revenue from seven segments: Mainland China; South Korea; South Asia/Pacific, which consists of Australia, Brunei, French Polynesia, Indonesia, Malaysia, New Caledonia, New Zealand, the Philippines, Singapore, Thailand and Vietnam; Americas, which consists of the United States, Canada and Latin America; Japan; Hong Kong/Taiwan; and Europe, Middle East and Africa ("EMEA"), which consists of several markets in Europe as well as Israel, Russia, Ukraine and South Africa (the Company's subsidiaries operating in these countries in each segment are collectively referred to as the "Subsidiaries").

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 the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. The unaudited consolidated financial statements include the accounts of the Company and its Subsidiaries. All significant intercompany accounts and transactions are eliminated in consolidation. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments, consisting of normal recurring adjustments, considered necessary for a fair statement of the Company's financial information as of June 30, 2017, and for the three- and six-month periods ended June 30, 2017 and 2016. The results of operations of any interim period are not necessarily indicative of the results of operations to be expected for the fiscal year. The consolidated balance sheet as of December 31, 2016 has been prepared using information from the audited financial statements at that date. For further information, refer to the consolidated financial statements and accompanying footnotes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

2. NET INCOME PER SHARE

Net income per share is computed based on the weighted-average number of common shares outstanding during the periods presented. Additionally, diluted earnings per share data gives effect to all potentially dilutive common shares that were outstanding during the periods presented. For the three-month periods ended June 30, 2017 and 2016, stock options of 0.2 million and 2.8 million, respectively, and for the six-month periods ended June 30, 2017 and 2016, stock options of 0.6 million and 3.1 million, respectively, were excluded from the calculation of diluted earnings per share because they were anti-dilutive.

3. DIVIDENDS PER SHARE

In February and May 2017, the Company's board of directors declared a quarterly cash dividend of \$0.36 per share. These quarterly cash dividends of \$19.0 million and \$19.1 million were paid on March 15, 2017 and June 14, 2017 to stockholders of record on February 27, 2017 and May 26, 2017. In July 2017, the Company's board of directors declared a quarterly cash dividend of \$0.36 per share to be paid on September 13, 2017 to stockholders of record on August 25, 2017.

4. DERIVATIVE FINANCIAL INSTRUMENTS

The Company enters into non-designated foreign currency derivatives, primarily comprised of foreign currency forward contracts, for which hedge accounting does not apply. The changes in the fair market value of these non-designated derivatives are included in other income/expense in the Company's consolidated statements of income. The Company uses non-designated foreign currency derivatives to hedge foreign-currency-denominated intercompany transactions and to partially mitigate the impact of foreign-currency fluctuations. The fair value of the non-designated foreign currency derivatives is based on third-party quotes.

As of June 30, 2017, the Company did not hold any non-designated derivative contracts. As of June 30, 2016, the Company held non-designated derivative contracts with notional amounts of 500 million Japanese yen (\$4.8 million), 11.5 billion Korean won (\$10.0 million), 3.9 million Canadian dollars (\$3.0 million) and 16.0 million South African rand (\$1.1 million). Gains and losses related to non-designated derivative contracts are recorded as part of Other Income (Expense).

The following table summarizes gains (losses) related to derivative instruments not designated as hedging instruments during the three- and six-month periods ended June 30, 2017 and 2016 (U.S. dollars in thousands):

Derivatives not designated as hedging instruments:	Location of Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income			
		Three Months Ended		Six Months Ended	
		June 30, 2017	2016	June 30, 2017	2016
Foreign currency contracts	Other income (expense)	\$	\$ (474)	\$ (485)	\$ (478)

The Company designates as cash-flow hedges those foreign currency forward contracts it enters to hedge forecasted intercompany transactions that are subject to foreign currency exposures. Changes in the fair value of these forward contracts designated as cash-flow hedges are recorded as a component of accumulated other comprehensive income (loss) within shareholders' equity (deficit), and are recognized in the consolidated statement of income during the period which approximates the time the hedged transaction is settled.

As of June 30, 2017, the Company held forward contracts designated as foreign currency cash flow hedges with notional amounts totaling 2.2 billion Japanese yen and 1.0 million Euros (\$19.6 million and \$1.1 million, respectively), compared to 2.9 billion Japanese yen and 9.0 million euros (\$28.1 million and \$10.0 million, respectively) as of June 30, 2016, to hedge forecasted foreign-currency-denominated intercompany transactions. The fair value of these hedges were \$0.3 million and \$(2.9) million as of June 30, 2017 and 2016, respectively. The contracts held at June 30, 2017 have maturities through June 2018, and accordingly, all unrealized gains and losses on foreign currency cash flow hedges included in accumulated other comprehensive loss will be recognized in current earnings over the next 12 months.

The following table summarizes gains (losses) related to derivative instruments recorded in other comprehensive income (loss) during the three-month periods ended June 30, 2017 and 2016 (U.S. dollars in thousands):

Derivatives designated as hedging instruments:	Amount of Gain (Loss) Recognized in Other Comprehensive Loss			
	Three Months Ended		Six Months Ended	
	June 30, 2017	2016	June 30, 2017	2016
Foreign currency forward contracts related to intercompany license fee, product sales, and selling expense hedges	\$ 207	\$ (1,170)	\$ (180)	\$ (2,860)

The following table summarizes gains (losses) relating to derivative instruments reclassified from accumulated other comprehensive loss into income during the three- and six-month periods ended June 30, 2017 and 2016 (U.S. dollars in thousands):

Derivatives designated as hedging instruments:	Location of Gain (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income	Amount of Gain (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income			
		Three Months Ended June 30,		Six Months Ended June 30,	
		2017	2016	2017	2016
Foreign currency forward contracts related to intercompany license fees and product sales hedges	Revenue	\$ 134	\$ (401)	\$ 109	\$ (479)
Foreign currency forward contracts related to intercompany selling expense hedges	Selling expenses	\$ 269	\$ (525)	\$ 228	\$ (632)

As of June 30, 2017 and December 31, 2016, there were \$0.2 million and \$0.6 million, respectively, of unrealized gains/(losses) included in accumulated other comprehensive loss related to foreign currency cash flow hedges. The remaining \$74.9 million and \$84.7 million as of June 30, 2017 and December 31, 2016, respectively, in accumulated other comprehensive loss are related to cumulative translation adjustments. The Company assesses hedge effectiveness at least quarterly. During the three- and six- month periods ended June 30, 2017 and 2016, all hedges were determined to be effective.

The Company reports its derivatives at fair value as either other current assets or accrued expenses within its consolidated balance sheet. See Note 13 Fair Value.

5. REPURCHASES OF COMMON STOCK

During the three-month periods ended June 30, 2017 and 2016, the Company repurchased 0.3 million and 0.1 million shares of its Class A common stock under its open market stock repurchase plan for \$15.3 million and \$4.3 million, respectively. As of June 30, 2017, \$177.6 million was available for repurchases under the Company's open market stock repurchase plan.

6. SEGMENT INFORMATION

As a result of the Company's management changes in the first quarter of 2017, the Company concluded that the Chief Operating Decision Maker, as defined in ASC 280, is now comprised of the CEO, President and CFO. This change required the Company to reevaluate its determination of operating segments. The Company's operating segments are based on geographic regions that generate revenue and hold its long-lived assets. The Company sells and distributes its products through a global network of customers and sales leaders in approximately 50 markets. The Company has divided these markets into seven operating segments, which are the Company's reportable segments: Mainland China, Hong Kong/Taiwan, South Korea, Japan, South Asia/Pacific, Americas and EMEA. The seven reportable segments generate revenue from the sale of personal care products and nutritional supplements under the Nu Skin and Pharmanex brands, have similar business characteristics and align with how the CODM function began assessing

performance and allocating resources in the first quarter of 2017.

Profitability by segment as reported under US GAAP is driven primarily by the Company's international taxation policies. Segment contribution, which is the Company's segment profitability metric presented in the table below, excludes certain intercompany charges, specifically royalties, license fees, transfer pricing, discrete charges and other miscellaneous items. These charges have been included in Corporate and other expenses. Corporate and other expenses also include costs related to the Company's executive and administrative offices, information technology, research and development, marketing and supply chain functions not recorded at the segment level.

The accounting policies of the segments are the same as those described in Note 1 – The Company. The Company evaluates the performance of its segments based on revenue and segment contribution. Each segment records direct expenses related to its employees and its operations.

Summarized financial information for the Company's reportable segments is shown in the following tables. Asset information is not reviewed or included with the Company's internal management reporting. Therefore, the Company has not disclosed asset information for each reportable segment.

Revenue by Segment

	Three Months Ended June 30,		Six Months Ended June 30,	
(U.S. dollars in thousands)	2017	2016	2017	2016
Mainland China	\$172,098	\$184,344	\$322,102	\$302,999
South Korea	86,917	93,036	169,388	179,154
Americas	77,096	67,884	142,754	133,632
South Asia/Pacific	67,935	92,297	137,733	155,875
Japan	64,796	72,849	125,952	137,940
Hong Kong/Taiwan	43,071	52,372	79,019	92,428
EMEA	38,188	37,693	72,252	70,278
Total	\$550,101	\$600,475	\$1,049,200	\$1,072,306

Segment Contribution

	Three Months Ended June 30,		Six Months Ended June 30,	
(U.S. dollars in thousands)	2017	2016	2017	2016
Mainland China	\$52,283	\$56,709	\$87,710	\$75,010
South Korea	22,278	24,195	46,790	48,252
Americas	11,646	12,177	21,742	22,649
South Asia/Pacific	14,439	24,348	28,419	36,801
Japan	10,922	15,933	23,348	27,980
Hong Kong/Taiwan	7,766	7,070	12,849	15,428
EMEA	3,617	2,833	5,408	3,180
Total segment contribution	122,951	143,265	226,266	229,300
Corporate and other	(58,212)	(63,467)	(115,265)	(141,353)
Operating income	64,739	79,798	111,001	87,947
Other income (expense)	(2,731)	(11,060)	(7,298)	(13,923)
Income before provision for income taxes	\$62,008	\$68,738	\$103,703	\$74,024

Depreciation and Amortization

(U.S. dollars in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Mainland China	\$3,681	\$4,117	\$7,652	\$8,144
South Korea	1,654	1,723	3,286	3,364
Americas	448	679	978	1,338
South Asia/Pacific	585	597	1,148	1,160
Japan	899	953	1,779	1,846
Hong Kong/Taiwan	344	547	646	1,111
EMEA	322	367	594	671
Corporate and other	9,522	8,756	18,997	17,050
Total	\$17,455	\$17,739	\$35,080	\$34,684

Capital Expenditures

(U.S. dollars in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Mainland China	\$760	\$2,098	\$1,663	\$6,998
South Korea	16	109	464	379
Americas	313	211	564	489
South Asia/Pacific	347	1,466	530	1,743
Japan	21	128	97	867
Hong Kong/Taiwan	511	37	1,117	265
EMEA	118	202	311	667
Corporate and other	9,737	9,521	23,005	13,306
Total	\$11,823	\$13,772	\$27,751	\$24,714

Revenue by Major Market

A major market is defined as one with total revenue greater than 10% of consolidated total revenue. Based on this criteria, the Company has identified three major markets: Mainland China, South Korea and Japan. There are approximately 50 other markets, each of which individually is less than 10%. No single customer accounted for 10% or more of net sales for the periods presented. Sales are recorded in the jurisdiction in which the transactions occurred.

Revenue by Product Line

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Nu Skin	\$345,287	\$365,266	\$647,160	\$655,255
Pharmanex	202,912	234,014	399,015	414,728

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Other	1,902	1,195	3,025	2,323
Totals	\$550,101	\$600,475	\$1,049,200	\$1,072,306

Long-Lived Assets by Major Market

A major market is defined as a market with long-lived assets greater than 10% of consolidated long-lived assets and also includes the Company's country of domicile (the U.S.). Long-lived assets in Mainland China consist primarily of property, plant and equipment related to manufacturing, distribution facilities and the Mainland China headquarters. Long-lived assets in the U.S. consist primarily of property, plant and equipment, including the Company's corporate offices and distribution facilities. Long-lived assets by major markets are set forth below for the periods ended June 30, 2017 and December 31, 2016 (U.S. dollars in thousands):

	June 30, 2017	December 31, 2016
United States	\$291,906	\$283,868
Mainland China	93,855	97,867
South Korea	41,748	41,545
Japan	10,261	11,517
All others	12,937	9,935
Total	\$450,707	\$444,732

7. GOODWILL

During the first quarter of 2017, the Company realigned its operational segments and reporting structure to reflect how the business will be managed going forward. As part of this realignment, the Company divided its single operating segment into seven geographical reporting segments. The Company's reporting units for goodwill are its operating segments, which are also its reportable segments. As a result of the segment changes, the historical goodwill of \$115.0 million was allocated to the seven reportable segments.

The following table presents goodwill allocated to the Company's reportable segments for the periods ended June 30, 2017 and December 31, 2016 (U.S. dollars in thousands):

	June 30, 2017	December 31, 2016 ⁽¹⁾
Mainland China	\$32,179	\$32,179
South Korea	29,261	29,261
Americas	9,449	9,449
South Asia/Pacific	18,537	18,537
Japan	16,019	16,019
Hong Kong/Taiwan	6,634	6,634
EMEA	2,875	2,875
Total	\$114,954	\$114,954

⁽¹⁾Goodwill was recast to reflect current period presentation by geographic region at December 31, 2016.

8. INVENTORY

Inventories consist of the following (U.S. dollars in thousands):

	June 30, 2017	December 31, 2016
Raw materials	\$ 104,050	\$ 108,276
Finished goods	142,608	141,660
	\$246,658	\$249,936

9. DEFERRED TAX ASSETS AND LIABILITIES

The Company accounts for income taxes in accordance with the Income Taxes Topic of the Financial Accounting Standards Codification. These standards establish financial accounting and reporting standards for the effects of income taxes that result from an enterprise's activities during the current and preceding years. The Company takes an asset and liability approach for financial accounting and reporting of income taxes. The Company pays income taxes in many foreign jurisdictions based on the profits realized in those jurisdictions, which can be significantly impacted by terms of intercompany transactions between the Company and its foreign affiliates. Deferred tax assets and liabilities are created in this process. The Company has netted these deferred tax assets and deferred tax liabilities by jurisdiction. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be ultimately realized. As of June 30, 2017 and December 31, 2016, the Company had net deferred tax assets of \$30.8 million and \$35.1 million, respectively.

The Company evaluates its indefinite reinvestment assertions with respect to foreign earnings for each quarter. Other than earnings the Company intends to reinvest indefinitely, the Company accrues for the U.S. federal and state income taxes applicable to the earnings. For all foreign earnings, the Company accrues the applicable foreign income taxes. The Company intends to utilize the offshore earnings to fund foreign investments, specifically capital expenditures. Undistributed earnings that the Company has indefinitely reinvested, for which no federal or state income taxes in the U.S. have been provided, aggregate to \$70.0 million as of December 31, 2016. If the amount designated as indefinitely reinvested as of December 31, 2016 was repatriated to the United States, the amount of incremental taxes would be approximately \$7.6 million.

10. UNCERTAIN TAX POSITIONS

The Company files income tax returns in the U.S. federal jurisdiction, and in various state and foreign jurisdictions. The Company is no longer subject to tax examinations from the IRS for all years for which tax returns have been filed before 2011. With a few exceptions, the Company is no longer subject to state and local income tax examination by tax authorities for the years before 2011. In 2009, the Company entered into a voluntary program with the IRS called Compliance Assurance Process ("CAP"). The objective of CAP is to contemporaneously work with the IRS to achieve federal tax compliance and resolve all or most of the issues prior to filing of the tax return. The Company has elected to participate in the CAP program for 2017 and may elect to continue participating in CAP for future tax years; the Company may withdraw from the program at any time. In major foreign jurisdictions, the Company is generally no longer subject to income tax examinations for years before 2010. However, statutes in certain countries may be as long as ten years for transfer pricing related issues. Along with the IRS examination of 2011, the Company is currently under examination in certain foreign jurisdictions; however, the outcomes of those reviews are not yet determinable.

The Company's unrecognized tax benefits relate to multiple foreign and domestic jurisdictions. There are potential changes in unrecognized tax benefits from the multiple jurisdictions in which the Company operates, as well as the

expiration of various statutes of limitation and possible completion of tax examinations; however, the Company does not anticipate that total unrecognized tax benefits will significantly change over the next 12 months.

11. COMMITMENTS AND CONTINGENCIES

The Company is subject to government regulations pertaining to product formulation, labeling and packaging, product claims and advertising, and the Company's direct selling system. The Company is also subject to the jurisdiction of numerous foreign tax and customs authorities. Any assertions or determination that either the Company or the Company's sales force is not in compliance with existing statutes, laws, rules or regulations could have a material adverse effect on the Company's operations. In addition, in any country or jurisdiction, the adoption of new statutes, laws, rules or regulations or changes in the interpretation of existing statutes, laws, rules or regulations could have a material adverse effect on the Company and its operations. No assurance can be given that the Company's compliance with applicable statutes, laws, rules and regulations will not be challenged by foreign authorities or that such challenges will not have a material adverse effect on the Company's financial position, results of operations or cash flows. The Company and its Subsidiaries are defendants in litigation, investigations and other proceedings involving various matters. In the opinion of the Company's management, based upon advice of its counsel handling such litigation, investigations and other proceedings, adverse outcomes, if any, will not likely result in a material effect on the Company's consolidated financial condition, results of operations or cash flows.

The Company is subject to regular audits by federal, state and foreign tax authorities. These audits may result in additional tax liabilities. The Company believes it has appropriately provided for income taxes for all years. Several factors drive the calculation of its tax reserves. Some of these factors include: (i) the expiration of various statutes of limitations; (ii) changes in tax law and regulations; (iii) issuance of tax rulings; and (iv) settlements with tax authorities. Changes in any of these factors may result in adjustments to the Company's reserves, which would impact its reported financial results.

12. DEBT

Credit Agreement

On October 9, 2014, the Company entered into a Credit Agreement (the "Credit Agreement") with various financial institutions, and Bank of America, N.A. as administrative agent. The Credit Agreement provides for a \$127.5 million term loan facility, a 6.6 billion Japanese yen term loan facility and a \$187.5 million revolving credit facility, each with a term of five years. On October 10, 2014, the Company drew the full amount of the term loan facilities, and as of June 30, 2017 and December 31, 2016, the Company had an outstanding balance of \$72.5 million and \$47.5 million, respectively, on the revolving credit facility. Any additional amounts drawn under the revolving credit facility will bear interest at rates that will be determined in accordance with the Credit Agreement. The Credit Agreement requires that the Company maintains a consolidated leverage ratio not exceeding 2.25 to 1.00 and a consolidated interest coverage ratio of no less than 3.00 to 1.00. The Company believes these covenants provide it with greater flexibility to pay dividends and repurchase stock. The Company is in compliance with its debt covenants.

Convertible Note

On June 16, 2016, the Company issued \$210.0 million of convertible senior notes (the "Convertible Notes") in a private offering to a Chinese investor (the "Holder"). The Convertible Notes are senior unsecured obligations which will rank equal in right of payment to all senior unsecured indebtedness of the Company, and will rank senior in right of payment to any indebtedness that is contractually subordinated to the Convertible Notes. Interest on the Convertible Notes is payable semiannually in arrears on June 15 and December 15 of each year at a rate of 4.75% per annum.

The Convertible Notes mature on June 15, 2020, unless repurchased or converted prior to maturity. Prior to the stated maturity date, the Company may, at its option, redeem all or part of the Convertible Notes at a price equal to 100% of the principal amount thereof, plus accrued and unpaid interest, if any, provided that its common stock share price is equal to or exceeds 180% of the applicable conversion price for 20 or more trading days (including the final three trading days) in the 30 consecutive trading days prior to the Company's exercise of such redemption right. The Holder of the Convertible Notes may, at its option, cause the Company to repurchase all of such Holder's Convertible Notes or any portion thereof that is equal to \$1,000 in principal amount or multiples of \$1,000 upon a change in control or a termination of trading of the Company's common stock, as those terms are defined in the indenture governing the Convertible Notes. In addition, each holder of the Convertible Notes shall have the right, at such holder's option, to convert all or any portion thereof that is equal to \$1,000 in principal amount or multiples of \$1,000 at any time beginning six calendar months following June 16, 2016, at the then-applicable conversion rate. Upon conversion by the Holder, the Convertible Notes will be settled in cash with respect to principal and any accrued and unpaid interest to such date and in the Company's common shares with respect to any additional amounts, based on the applicable conversion rate at such time. The Convertible Notes had an initial conversion rate of 21.5054 common shares per \$1,000 principal amount of the Convertible Notes (which is equal to an initial conversion price of approximately \$46.50 per common share). Throughout the term of the Convertible Notes, the conversion rate may be adjusted upon the occurrence of certain specified events.

Of the \$210.0 million in proceeds received from the issuance of the Convertible Notes, \$199.1 million was allocated to long-term debt (the "Liability Component") and \$10.9 million was allocated to additional paid-in capital (the "Equity Component") within the Company's consolidated balance sheet. The Liability Component was calculated by measuring the fair value of a similar debt instrument that does not have an associated conversion feature. The amount allocated to the Equity Component, which represents the conversion option, was calculated by deducting the fair value of the Liability Component from the par value of the Convertible Notes. The Company determined that the conversion option does not require separate accounting treatment as a derivative instrument because it is both indexed to the Company's own stock and would be classified in stockholders' equity if freestanding. The Equity Component will not be remeasured as long as it continues to meet the conditions for equity classification. The excess of the principal amount of the Liability Component over its carrying amount (the "Debt Discount") will be amortized to interest expense over the term of the Convertible Notes. As a result, the Liability Component will be accreted up to the Convertible Notes' \$210.0 million face value, resulting in additional non-cash interest expense being recognized within the Company's consolidated statement of income. The effective interest rate on the Convertible Notes is approximately 7.1% per annum.

The net carrying amount of the Liability Component is as follows (U.S. dollars in thousands):

	June 30, 2017
Principal	\$210,000
Unamortized debt discount (conversion option)	(8,372)
Total long-term debt, net	201,628
Unamortized debt discount (issuance costs)	(4,791)
Net carrying amount	\$196,837

The net carrying amount of the Liability Component was recorded to long-term debt within the Company's consolidated balance sheet.

The Company incurred approximately \$6.6 million of issuance costs related to the issuance of the Convertible Notes. Of the \$6.6 million in issuance costs incurred, \$6.3 million and \$0.3 million were recorded to deferred financing cost and additional paid-in capital, respectively, in proportion to the allocation of the proceeds of the Convertible Notes. The \$6.3 million recorded to deferred financing cost on the Company's consolidated balance sheet as a reduction of long-term debt is being amortized over the contractual term of the Convertible Notes using the effective interest method.

During the three months ended June 30, 2017, the Company recognized \$3.5 million in interest expense related to the Convertible Notes, which included \$2.5 million of contractual interest and \$1.0 million in amortization of debt issuance costs and in amortization of the Debt Discount.

The following table summarizes the Company's debt facilities as of June 30, 2017 and December 31, 2016:

Facility or Arrangement	Original Principal Amount	Balance as of June 30, 2017 ⁽¹⁾⁽²⁾	Balance as of December 31, 2016	Interest Rate	Repayment terms
Credit Agreement term loan facility:					
U.S. dollar denominated:	\$127.5 million	\$102.0 million	\$108.4 million	Variable 30 day: 3.98%	One half of the principal amount payable in increasing quarterly installments over a five-year period beginning on December 31, 2014, with the remainder payable at the end of the five-year term.
Japanese yen denominated:	6.6 billion yen	5.3 billion yen (\$46.9 million as of June 30, 2017)	5.6 billion yen (\$47.9 million as of December 31, 2016)	Variable 30 day: 2.75%	One half of the principal amount payable in increasing quarterly installments over a five-year period beginning on December 31, 2014, with the remainder payable at the end of the five-year term.
Credit Agreement revolving credit facility:					
		\$72.5 million	\$47.5 million	Variable 30 day: 3.92%	Revolving line of credit expires October 2019.
Korea subsidiary loan:	\$20.0 million	—	\$10.0 million	1.12%	Loan paid in full as of March 2017.
Japan subsidiary loan:	2.0 billion yen	1.0 billion yen (\$8.9 million as of June 30,	1.3 billion yen (\$11.4 million as of December 31,	0.66%	Payable in semi-annual installments over three years that began on

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		2017)	2016)		January 31, 2016.
Convertible note:	\$210.0 million	\$210.0 million	\$210.0 million	4.75%	Principal amount payable on June 15, 2020.

As of June 30, 2017, the current portion of the Company's debt (i.e. becoming due in the next 12 months) included \$15.1 million of the balance of its U.S. dollar denominated debt under the Credit Agreement facility, \$7.0 million of the balance of its Japanese yen-denominated debt under the Credit Agreement facility and \$5.9 million of the Japan subsidiary loan. The Company has classified the \$72.5 million borrowed under the revolving line of credit as short term because it is the Company's intention to use the line of credit to borrow and pay back funds over short periods of time.

The carrying value of the debt reflects the amounts stated in the above table less a debt discount of \$11.0 million and debt issuance costs of \$4.8 million (consisting of \$13.2 million related to the Convertible Note and \$2.6 million related to the credit agreement), which is not reflected in this table.

13. FAIR VALUE

The carrying value of financial instruments including cash and cash equivalents, accounts receivable and accounts payable approximate fair values due to the short-term nature of these instruments. The Company's current investments as of June 30, 2017 include certificates of deposits and pre-refunded municipal bonds that are classified by management as held-to-maturity as the Company had the positive intent and ability to hold to maturity. The carrying value of these current investments approximate fair values due to the short-term nature of these instruments. The Company has classified these instruments as Level 2 in the fair value hierarchy. Fair value estimates are made at a specific point in time, based on relevant market information.

The FASB Codification defines fair value as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. On a quarterly basis, the Company measures at fair value certain financial assets, including cash equivalents. Accounting standards specify a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. These two types of inputs have created the following fair-value hierarchy:

Level 1 – quoted prices in active markets for identical assets or liabilities;

Level 2 – inputs, other than the quoted prices in active markets, that are observable either directly or indirectly;

Level 3 – unobservable inputs based on the Company's own assumptions.

Accounting standards permit companies, at their option, to measure certain financial instruments and other eligible items at fair value. The Company has elected not to apply the fair value option to existing eligible items beyond what is required by US GAAP.

The following tables present the fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis (U.S. dollars in thousands):

Fair Value at June 30, 2017				
	Level			
	Level 1	2	Level 3	Total
Financial assets (liabilities):				
Cash equivalents and current investments	\$33,812	\$—	\$—	\$33,812
Other long-term assets	3,463	—	—	3,463
Forward contracts	—	256	—	256
Life insurance contracts	—	—	35,627	35,627
Total	\$37,275	\$256	\$35,627	\$73,158

Fair Value at December 31, 2016				
	Level			
	Level 1	2	Level 3	Total
Financial assets (liabilities):				
Cash equivalents and current investments	\$50,307	\$—	\$—	\$50,307
Other long-term assets	2,782	—	—	2,782
Forward contracts	—	1,371	—	1,371
Life insurance contracts	—	—	32,286	32,286
Total	\$53,089	\$1,371	\$32,286	\$86,746

The following table provides a summary of changes in fair value of the Company's Level 3 marketable securities (U.S. dollars in thousands):

Life Insurance Contracts	
Beginning balance at January 1, 2017	\$32,286
Actual return on plan assets:	
Relating to assets still held at the reporting date	2,606
Purchases and issuances	895
Sales and settlements	(160)
Transfers into Level 3	—
Ending balance at June 30, 2017	\$35,627

14. ACCOUNTING PRONOUNCEMENTS

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). The new revenue recognition standard provides a five-step analysis of transactions to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU is effective for annual periods beginning after December 15, 2017. As

the Company evaluates the impact of this ASU, the more significant changes that the Company has identified relate to the current method of accruing its loyalty points program from a cost provision method to a deferred revenue method in accordance with the new guidance. The Company is continuing to evaluate the impact this ASU, and related amendments and interpretive guidance, will have on its consolidated financial statements. The Company plans to adopt this ASU beginning in the first quarter of 2018 with a cumulative adjustment to retained earnings as opposed to retrospectively adjusting prior periods.

In July 2015, the FASB issued ASU 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory. This guidance requires an entity to measure inventory at the lower of cost and net realizable value, rather than at the lower of cost or market. This ASU was effective for the Company beginning on January 1, 2017. The adoption of this guidance did not have a significant impact on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Subtopic 842). ASU 2016-02 will require companies to recognize lease assets and lease liabilities on the balance sheet and disclose key information about leasing arrangements. For public companies, this standard is effective for annual reporting periods beginning after December 15, 2018, and early adoption is permitted. The Company is currently evaluating the impact of this standard on its consolidated financial position, results of operations, and cash flows.

In March 2016, the FASB issued ASU 2016-09, Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The objective of this update was to simplify several aspects of the accounting for employee share-based payment transactions, including accounting for income taxes related to share-based compensation, the related classification in the statement of cash-flows, and accounting for share award forfeitures. This ASU was effective for the Company beginning on January 1, 2017. As required by the adoption of this new guidance, the Company recognized excess tax benefits of \$2.2 million and \$3.0 million in the provision for income taxes as a discrete item for the three- and six-month periods ended June 30, 2017, respectively. Prior to January 1, 2017, excess tax benefits were recognized in equity. As permitted, the Company elected to classify excess tax benefits as an operating activity in the Statement of Cash Flows instead of as a financing activity on a prospective basis and did not retroactively adjust prior periods. As also permitted by the new guidance, beginning January 1, 2017 the Company has elected to account for share award forfeitures as they occur. Previously, share-based compensation expense was recorded net of estimated forfeitures. A cumulative adjustment of \$2.8 million was recorded to retained earnings and additional paid-in capital as of January 1, 2017. Prior periods were not retroactively adjusted.

In the second half of 2016, the FASB issued ASU Nos. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, and 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash. The objective of these updates is to reduce the diversity in practice in the classification of certain cash receipts and cash payments, and the presentation of restricted cash within an entity's statement of cash flows, respectively. These ASUs are effective for interim and annual fiscal periods beginning after December 15, 2017. Early adoption is permitted. The adoption of this guidance is not expected to have a material impact on the Company's consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business. This guidance revises the definition of a business as it relates to acquisitions, disposals, goodwill impairments and consolidations. This ASU is effective for annual periods beginning after December 15, 2017. Early adoption is permitted. The adoption of this guidance is not expected to have a material impact on the Company's consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. This guidance simplifies the required test of goodwill for impairment by eliminating Step 2 from the goodwill impairment test. If a company determines in Step 1 of the goodwill impairment test that the carrying value of goodwill is less than the fair value, an impairment in that amount should be recorded to the income statement, rather than proceeding to Step 2. This ASU is effective for interim and annual impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted. The adoption of this guidance is not expected to have a material impact on the Company's consolidated financial statements.