NATURAL HEALTH TRENDS CORP
Form 10-Q
August 06, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2013

OR

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

For the transition period from ______ to _______

Commission File Number: 0-26272

NATURAL HEALTH TRENDS CORP.

(Exact name of registrant as specified in its charter)

Delaware	59-2705336
(State or other jurisdiction of	(I.R.S. Employer

incorporation or organization) Identification No.)

4514 Cole Avenue

Suite 1400

Dallas, Texas 75205

(Address of principal executive offices, including zip code)

Registrant’s telephone number, including area code: (972) 241-4080

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 during the preceding 12 months (or for shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

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

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

At July 30, 2013, the number of shares outstanding of the registrant’s common stock was 11,332,033 shares.

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FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, in particular “Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operation,” includes “forward-looking statements” within the meaning of section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). When used in this report, the words or phrases “will likely result,” “expect,” “intend,” “will continue,” “anticipate,” “estimate,” “project,” “believe” and similar expressions are inte identify “forward-looking statements” within the meaning of the Exchange Act. These statements represent our expectations or beliefs concerning, among other things, future revenue, earnings, growth strategies, new products and initiatives, future operations and operating results, and future business and market opportunities.

Forward-looking statements in this report speak only as of the date hereof, and forward looking statements in documents incorporated by reference speak only as of the date of those documents. We undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise, except as required by law. We caution and advise readers that these statements are based on certain assumptions that may not be realized and involve risks and uncertainties that could cause actual results to differ materially from the expectations and beliefs contained herein.

For a summary of certain risks related to our business, see “Item 1A. Risk Factors” in our most recent Annual Report on Form 10-K, which include the following:

- We may experience substantial negative cash flows, which may have a significant adverse effect on our business and could threaten our solvency;
- If we experience negative cash flows, we may need to seek additional debt or equity financing, which may not be available on acceptable terms or at all. If available, it could have a highly dilutive effect on the holdings of existing stockholders;
- We could be adversely affected by management changes or an inability to attract and retain key management, directors and consultants;
- Because our Hong Kong operations account for a majority of our overall business, and most of our Hong Kong business is derived from the sale of products to members in China, any material adverse change in our business relating to either Hong Kong or China would likely have a material adverse impact on our overall business;
- Our failure to maintain and expand our distributor relationships could adversely affect our business;
- The high level of competition in our industry could adversely affect our business;
- An increase in the amount of compensation paid to distributors would reduce profitability;
- Failure of new products to gain distributor and market acceptance could harm our business;
- Direct-selling laws and regulations may prohibit or severely restrict our direct sales efforts and cause our revenue and profitability to decline, and regulators could adopt new regulations that harm our business;
- Challenges by third parties to the form of our business model could harm our business;
- Our products and related activities are subject to extensive government regulation, which could delay, limit or prevent the sale of some of our products in some markets;
- New regulations governing the marketing and sale of nutritional supplements could harm our business;

Regulations governing the production and marketing of our personal care products could harm our business;
If we are found not to be in compliance with good manufacturing practices our operations could be harmed;
Failure to comply with domestic and foreign laws and regulations governing product claims and advertising could harm our business;
Although our distributors are independent contractors, improper distributor actions that violate laws or regulations could harm our business;
Adverse publicity associated with our products, ingredients or network marketing program, or those of similar companies, could harm our financial condition and operating results;
We have a limited product line;
We rely on a limited number of independent third parties to manufacture and supply our products;
Growth may be impeded by the political and economic risks of entering and operating foreign markets;
Currency exchange rate fluctuations could lower our revenue and net income;
Transfer pricing, duties and other tax regulations affect our business;
Failure to properly pay business taxes or customs duties, including those in China, could have a material adverse effect;
We may be held responsible for certain taxes or assessments relating to the activities of our distributors, which could harm our financial condition and operating results;
We may face litigation that could harm our business;
We may be unable to protect or use our intellectual property rights;
We do not have product liability insurance and product liability claims could hurt our business;

- Our internal controls and accounting methods may require modification;
- If we fail to achieve and maintain an effective system of internal controls in the future, we may not be able to accurately report our financial results or prevent fraud. As a result, investors may lose confidence in our financial reporting;
- We rely on and are subject to risks associated with our reliance upon information technology systems;
- System failures and attacks could harm our business;
- Terrorist attacks, cyber attacks, acts of war, epidemics or other communicable diseases or any other natural disasters may seriously harm our business;
- Because our system, software and data reside on third-party servers, our access could be temporarily or permanently interrupted;
- Disappointing quarterly revenue or operating results could cause the price of our common stock to fall;
- Our common stock is particularly subject to volatility because of the industry in which we operate;
- There is no assurance of an active public trading market;
- The exercise of our warrants may result in substantial dilution and may depress the market price of our common stock;
- Future sales by us or our existing stockholders could depress the market price of our common stock; and
- Penny stock regulations are applicable to investment in our shares of common stock.

Additional factors that could cause actual results to differ materially from our forward-looking statements are set forth in this report, including under the heading “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and in our financial statements and the related notes.

PART I – FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

NATURAL HEALTH TRENDS CORP.

CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share Data)

	December 31, 2012	June 30, 2013 (Unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 4,207	$ 6,695
Accounts receivable	122	172
Inventories, net	867	1,031
Other current assets	641	515
Total current assets	5,837	8,413
Property and equipment, net	121	136
Goodwill	1,764	1,764
Restricted cash	239	223
Other assets	258	249
Total assets	$ 8,219	$ 10,785
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 1,385	$ 1,626
Income taxes payable	10	37
Accrued distributor commissions	1,308	1,768
Other accrued expenses	1,688	2,057
Deferred revenue	836	1,120
Deferred tax liability	92	92
Other current liabilities	991	979
Total current liabilities	6,310	7,679
Commitments and contingencies		
Stockholders' equity:		
	124	111

Preferred stock, $0.001 par value; 5,000,000 shares authorized; 1,761,900 shares designated Series A convertible preferred stock, 138,400 and 123,693 shares issued and outstanding at December 31, 2012 and June 30, 2013, respectively, aggregate liquidation value of $301		
Common stock, $0.001 par value; 50,000,000 shares authorized; 11,324,048 and 11,334,678 shares issued and outstanding at December 31, 2012 and June 30, 2013, respectively	11	11
Additional paid-in capital	80,584	80,629
Accumulated deficit	(78,708)	(77,517)
Accumulated other comprehensive loss:		
Foreign currency translation adjustments	(102)	(128)
Total stockholders’ equity	1,909	3,106
Total liabilities and stockholders’ equity	$ 8,219	$ 10,785

See accompanying notes to consolidated financial statements.

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NATURAL HEALTH TRENDS CORP.

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(In Thousands, Except Per Share Data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2013	2012	2013
Net sales	$10,980	$10,598	$20,070	$19,249
Cost of sales	2,884	2,570	5,283	4,798
Gross profit	8,096	8,028	14,787	14,451
Operating expenses:				
Distributor commissions	4,886	4,443	8,577	8,117
Selling, general and administrative expenses (including stock-based compensation expense of $20 and $23 during the three months ended June 30, 2012 and 2013, respectively, and $40 and $53 during the six months ended June 30, 2012 and 2013, respectively)	2,313	2,609	4,750	5,054
Depreciation and amortization	8	28	20	40
Total operating expenses	7,207	7,080	13,347	13,211
Income from operations	889	948	1,440	1,240
Other income (expense), net	2	(28)	(61)	(21)
Income before income taxes	891	920	1,379	1,219
Income tax provision	45	16	26	28
Net income	846	904	1,353	1,191
Preferred stock dividends	(4)	(4)	(8)	(8)
Net income available to common stockholders	$842	$900	$1,345	$1,183
Income per share – basic and diluted	$0.08	$0.08	$0.12	$0.11
Weighted-average number of shares outstanding:				
Basic	10,919	11,131	10,891	11,100
Diluted	11,219	11,269	11,208	11,265

See accompanying notes to consolidated financial statements.

NATURAL HEALTH TRENDS CORP.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(In Thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2013	2012	2013
Net income	$846	$904	$1,353	$1,191
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustment	(50)	2	1	(26)
Comprehensive income	$796	$906	$1,354	$1,165

See accompanying notes to consolidated financial statements.

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NATURAL HEALTH TRENDS CORP.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In Thousands)

	Six Months Ended June 30, 2012	Six Months Ended June 30, 2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$1,353	$1,191
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	20	40
Stock-based compensation	40	53
Changes in assets and liabilities:		
Accounts receivable	(118)	(60)
Inventories, net	(170)	(183)
Other current assets	(97)	110
Other assets	(6)	(1)
Accounts payable	271	242
Income taxes payable	55	28
Accrued distributor commissions	347	483
Other accrued expenses	278	382
Deferred revenue	661	297
Other current liabilities	(48)	(4)
Net cash provided by operating activities	2,586	2,578
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment, net	(65)	(57)
Decrease in restricted cash	494	–
Net cash provided by (used in) investing activities	429	(57)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repurchase of common stock	–	(21)
Net cash used in financing activities	–	(21)
Effect of exchange rates on cash and cash equivalents	5	(12)
Net increase in cash and cash equivalents	3,020	2,488
CASH AND CASH EQUIVALENTS, beginning of period	1,617	4,207
CASH AND CASH EQUIVALENTS, end of period	$4,637	$6,695
NON-CASH FINANCING ACTIVITY:		
Conversion of preferred stock	–	$13

See accompanying notes to consolidated financial statements.

NATURAL HEALTH TRENDS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Nature of Operations

Natural Health Trends Corp. (the "Company"), a Delaware corporation, is an international direct-selling and e-commerce company headquartered in Dallas, Texas. Subsidiaries controlled by the Company sell personal care, wellness, and "quality of life" products under the "NHT Global" brand. In most markets, we sell our products to an independent member network that either uses the products themselves or resells them to consumers.

Our majority-owned subsidiaries have an active physical presence in the following markets: North America; Greater China, which consists of Hong Kong, Taiwan and China; Russia; South Korea; Japan; and Europe, which consists of Italy and Slovenia. In June 2013, we opened a marketing center in Almaty, Kazakhstan through our engagement with our Russian service provider.

Basis of Presentation

The unaudited interim 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. As a result, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. In the opinion of management, the accompanying unaudited interim consolidated financial statements contain all adjustments, consisting of normal recurring adjustments, considered necessary for a fair statement of the Company's financial information for the interim periods presented. The results of operations of any interim period are not necessarily indicative of the results of operations to be expected for the fiscal year. These consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in our 2012 Annual Report on Form 10-K filed with the United States Securities and Exchange Commission (SEC) on March 12, 2013.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and all of its majority-owned subsidiaries. All significant inter-company balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reported period.

The most significant accounting estimates inherent in the preparation of the Company's financial statements include estimates associated with obsolete inventory and the fair value of acquired intangible assets, including goodwill, as well as those used in the determination of liabilities related to sales returns and income taxes. Various assumptions and other factors prompt the determination of these significant estimates. The process of determining significant estimates is fact specific and takes into account historical experience and current and expected economic conditions. The actual results may differ materially and adversely from the Company's estimates. To the extent that there are material differences between the estimates and actual results, future results of operations will be affected.

Income Taxes

The Company recognizes income taxes under the liability method of accounting for income taxes. Deferred income taxes are recognized for differences between the financial reporting and tax bases of assets and liabilities at enacted statutory tax rates in effect for the years in which the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be ultimately realized. The Company recognizes tax benefits from uncertain tax positions only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate resolution. The Company recognizes interest and penalties related to unrecognized tax benefits as a component of income tax expense. Deferred taxes are not provided on the portion of undistributed earnings of subsidiaries outside of the United States when these earnings are considered permanently reinvested.

The Company and its subsidiaries file income tax returns in the United States, various states, and foreign jurisdictions. The Company is no longer subject to U.S. federal income tax examinations for years prior to 2009, and is no longer subject to state income tax examinations for years prior to 2008. No jurisdictions are currently examining any income tax returns of the Company or its subsidiaries.

Fair Value of Financial Instruments

The carrying amounts of the Company’s financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and accrued expenses, approximate fair value because of their short maturities. The carrying amount of the noncurrent restricted cash approximates fair value since, absent the restrictions, the underlying assets would be included in cash and cash equivalents.

Accounting standards permit companies, at their option, to choose to measure many financial instruments and certain other items at fair value. The Company has elected to not fair value existing eligible items.

Revenue Recognition

Product sales are recorded when the products are shipped and title passes to independent distributors. Product sales to distributors are made pursuant to a distributor agreement that provides for transfer of both title and risk of loss upon our delivery to the carrier that completes delivery to the distributors, which is commonly referred to as “F.O.B.

Shipping Point." The Company primarily receives payment by credit card at the time distributors place orders. Amounts received for unshipped product are recorded as deferred revenue. The Company's sales arrangements do not contain right of inspection or customer acceptance provisions other than general rights of return.

Actual product returns are recorded as a reduction to net sales. The Company estimates and accrues a reserve for product returns based on its return policies and historical experience.

Enrollment package revenue, including any nonrefundable set-up fees, is deferred and recognized over the term of the arrangement, generally twelve months. Enrollment packages provide distributors access to both a personalized marketing website and a business management system. No upfront costs are deferred as the amount is nominal.

Shipping charges billed to distributors are included in net sales. Costs associated with shipments are included in cost of sales.

Various taxes on the sale of products and enrollment packages to distributors are collected by the Company as an agent and remitted to the respective taxing authority. These taxes are presented on a net basis and recorded as a liability until remitted to the respective taxing authority.

Income Per Share

Basic income per share is computed by dividing net income available to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted income per share is determined using the weighted-average number of common shares outstanding during the period, adjusted for the dilutive effect of common stock equivalents, consisting of non-vested restricted stock and shares that might be issued upon the exercise of outstanding warrants and the conversion of preferred stock.

The dilutive effect of non-vested restricted stock and warrants is reflected by application of the treasury stock method. Under the treasury stock method, the amount of compensation cost for future service that the Company has not yet recognized and the amount of tax benefit that would be recorded in additional paid-in capital when the award becomes deductible are assumed to be used to repurchase shares.

The following tables illustrate the computation of basic and diluted income per share for the periods indicated (in thousands, except per share data):

	Three Months Ended June 30,					
	2012			2013		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS:						
Net income available to common stockholders	$842	10,919	$ 0.08	$900	11,131	$ 0.08
Effect of dilutive securities:						
Non-vested restricted stock		300			138	
Diluted EPS:						
Net income available to common stockholders plus assumed conversions	$842	11,219	$ 0.08	$900	11,269	$ 0.08

	Six Months Ended June 30,					
	2012			2013		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS:						
Net income available to common stockholders	$1,345	10,891	$ 0.12	$1,183	11,100	$ 0.11
Effect of dilutive securities:						
Non-vested restricted stock		317			165	
Diluted EPS:						
Net income available to common stockholders plus assumed conversions	$1,345	11,208	$ 0.12	$1,183	11,265	$ 0.11

Certain non-vested restricted stock is anti-dilutive upon applying the treasury stock method since the amount of compensation cost for future service results in the hypothetical repurchase of shares exceeding the actual number of shares to be vested. Other common stock equivalents are also anti-dilutive since the average market price of the related common stock for the period exceeds the exercise price.

The following securities were not included for the time periods indicated as their effect would have been anti-dilutive:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2013	2012	2013
Warrants to purchase common stock	3,704,854	2,259,731	3,704,854	2,986,285
Non-vested restricted stock	–	81,041	–	85,161
Convertible preferred stock	138,400	125,000	138,400	131,737

Warrants to purchase 1,495,952 shares of common stock were still outstanding at June 30, 2013. Such warrants expire April 21, 2015.

Recently Issued and Adopted Accounting Pronouncements

In February 2013, the FASB issued Accounting Standards Update ("ASU") No. 2013-02, *Comprehensive Income (Topic 220) —Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*, to require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items in net income but only if the amount reclassified is required under U.S. generally accepted accounting principles ("GAAP") to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about those amounts. ASU 2013-02 is effective prospectively for reporting periods, including interim periods, beginning after December 15, 2012. The Company’s adoption of the standard on January 1, 2013 did not have a material impact on its consolidated financial statements.

In March 2013, the FASB issued ASU No. 2013-05, *Foreign Currency Matters (Topic 830) —Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity*, to clarify the guidance for entities that cease to hold a controlling financial interest in a subsidiary or group of assets within a foreign entity when (1) the subsidiary or group of assets is a nonprofit activity or a business (other than a sale of in substance real estate or conveyance of oil and gas mineral rights) and (2) there is a cumulative translation adjustment balance associated with that foreign entity. ASU 2013-05 is effective prospectively for reporting periods, including interim periods, beginning after December 15, 2013. Early adoption is permitted. The Company is currently evaluating the impact of adopting ASU 2013-05.

In July 2013, the FASB issued ASU No. 2013-11, *Income Taxes (Topic 740) — Presentation of an Unrecognized Tax Benefit When A Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*, to provide explicit guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The amendments in this update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013 and should be applied prospectively to all tax benefits that exist at the effective date. Retrospective application is permitted. The Company is currently evaluating the impact of adopting ASU 2013-11.

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.

3. STOCK-BASED COMPENSATION

Stock-based compensation expense totaled $20,000 and $23,000 for the three months ended June 30, 2012 and 2013, respectively, and $40,000 and $53,000 for the six months ended June 30, 2012 and 2013, respectively. No tax benefits were attributed to the stock-based compensation because a valuation allowance was maintained for substantially all net deferred tax assets.

The following table summarizes the Company's restricted stock activity:

	Shares	Wtd. Avg. Grant-Date Fair Value
Nonvested at December 31, 2012	261,658	$ 0.37

Granted	–	–
Vested	(103,336)	0.37
Forfeited	–	–
Nonvested at June 30, 2013	158,322	0.37

As of June 30, 2013, total unrecognized stock-based compensation expense related to non-vested restricted stock was $58,000, which is expected to be recognized over a weighted-average period of 0.7 years.

On August 13, 2012, the Company's Board of Directors authorized the Company, acting as trustee for certain of its non-officer, overseas employees, to execute a Rule 10b5-1 plan to purchase 100,000 shares of its common stock in accordance with guidelines specified under Rule 10b5-1 of the Securities Exchange Act of 1934 and the Company's policies regarding stock transactions. The employees will receive the stock as incentive compensation in quarterly increments over three years beginning March 15, 2013, provided that they are employees of the Company on the date of the distribution. The following table summarizes this stock award activity:

	Shares	Wtd. Avg. Grant-Date Fair Value
Nonvested at December 31, 2012	100,000	$ 1.37
Granted	–	–
Vested	(13,338)	1.37
Forfeited	(20,000)	1.37
Nonvested at June 30, 2013	66,662	1.37

As of June 30, 2013, total unrecognized stock-based compensation expense related to these stock awards was $81,000, which is expected to be recognized over a weighted-average period of 2.5 years.

4. CONTINGENCIES

Consumer Indemnity

As required by the Door-to-Door Sales Act in South Korea, the Company maintains insurance for consumer indemnity claims with a mutual aid cooperative by possessing a mutual aid contract with Mutual Aid Cooperative & Consumer (the “Cooperative”). The contract secures payment to distributors in the event that the Company is unable to provide refunds to distributors. Typically, requests for refunds are paid directly by the Company according to the Company’s normal Korean refund policy, which requires that refund requests be submitted within three months. Accordingly, the Company estimates and accrues a reserve for product returns based on this policy and its historical experience. Depending on the sales volume, the Company may be required to increase or decrease the amount of the contract. The maximum potential amount of future payments the Company could be required to make to address actual distributor claims under the contract is equivalent to three months of rolling sales. At June 30, 2013, non-current other assets include KRW 100 million (USD $88,000) underlying the contract, which can be utilized by the Cooperative to fund any outstanding distributor claims. The Company believes that the likelihood of utilizing these funds to provide for distributors claims is remote.

Registration Payment Arrangements

Pursuant to the agreement with the investors in the Company’s October 2007 financing of variable rate convertible debentures having an aggregate face amount of $4,250,000, seven-year warrants to purchase 1,495,952 shares of the Company’s common stock, and one-year warrants to purchase 1,495,952 shares of the Company’s common stock, the Company was obligated to (i) file a registration statement covering the resale of the maximum number of Registrable Securities (as defined) that is permitted by SEC Guidance (as defined) prior to November 18, 2007, (ii) cause the registration statement to be declared effective within certain specified periods of time and (iii) maintain the effectiveness of the registration statement until all Registrable Securities have been sold, or may be sold without volume restrictions pursuant to Rule 144(k) under the Securities Act. The Company timely filed that registration statement covering the shares of common stock underlying the debentures, which have been redeemed, and the one-year warrants, which have expired. At the time, the 1,495,952 shares of common stock underlying the seven-year warrants were not deemed Registrable Securities and were not included in the Registration Statement. If they are subsequently deemed Registrable Securities and we fail to file a new registration statement covering them, then the warrants may be exercised by means of a cashless exercise. The maximum number of shares that could be required to be issued upon exercise of the warrants (whether on a cashless basis or otherwise) is limited to the number of shares indicated on the face of the warrants. As of June 30, 2013, no contingent obligations have been recognized under registration payment arrangements.

5. RELATED PARTY TRANSACTIONS

In February 2013, the Company entered into a Royalty Agreement and License with Broady Health Sciences, L.L.C. (“BHS”) regarding the manufacture and sale of a new product called *Restor*™. Under this agreement, the Company has agreed to pay BHS a royalty of 2.5% of sales revenue for this product for 2011 and subsequent years in return for the right to manufacture (or have manufactured), market, import, export and sell this product worldwide, with certain rights being exclusive outside the United States. George Broady, a director of the Company and owner of more than 5% of its outstanding common stock, is owner of BHS, a Texas limited liability company. During 2011 and 2012, BHS permitted the Company to manufacture (or have manufactured), market and sell the *Restor*™ product. In April 2012, the Company reimbursed BHS $42,000 in expenses incurred in 2011 to promote the *Restor*™ product on the Company’s behalf. To permit the Company to continue selling *Restor*™ and obtain certain exclusive rights outside of the United States, BHS requested that the Company enter into the Royalty Agreement and License. This agreement was reviewed, considered, authorized and approved by the sole disinterested, non-employee member of the Board of Directors under appointment by the full Board of Directors as an ad hoc committee for this purpose. Upon signing this agreement, the Company paid BHS $12,000 and $25,000 as royalties for 2011 and 2012, respectively. Royalties accrued, but unpaid for each of the three and six month periods ended June 30, 2013 are $8,000 and $15,000, respectively. The Company is not required to purchase any product under the agreement, and the agreement may be terminated at any time on 120 days’ notice or, under certain circumstances, with no notice.

The Company is considering entering into another royalty agreement and license with BHS regarding the manufacture and sale of a new product called *Soothe*™, which the Company began selling in the fourth quarter of 2012 with the permission of BHS. To continue selling this product, BHS has requested that the Company pay a royalty of 2.5% of sales revenue for 2012 and subsequent years. The Company is considering that proposal and discussing the terms of a definitive agreement. At a royalty of 2.5% of net sales, the Company calculates that royalties for 2012 and the first six months of 2013 would total $3,100.

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

Business Overview

We are an international direct-selling and e-commerce company. Subsidiaries controlled by us sell personal care, wellness, and "quality of life" products under the "NHT Global" brand. In most markets, we sell our products to an independent distributor network that either uses the products themselves or resells them to consumers. Our majority-owned subsidiaries have an active physical presence in the following markets: North America; Greater China, which consists of Hong Kong, Taiwan and China; Russia; South Korea; Japan; and Europe, which consists of Italy and Slovenia. In June 2013, we opened a marketing center in Almaty, Kazakhstan through our engagement with our Russian service provider.

Our distributor network operates in a seamless manner from market to market, except for the Chinese market. We believe that each of our operating segments should be aggregated into a single reportable segment as they have similar economic characteristics. Additionally, we believe that each of the operating segments are similar in the nature of the products sold, the product acquisition process, the types of customers products are sold to, the methods used to distribute the products, and the nature of the regulatory environment. Our e-commerce retail business in China does not require a direct selling license and allows for discounts on volume purchases. There is no separate segment manager who is held accountable by our chief operating decision-makers, or anyone else, for operations, operating results and planning for the Chinese market on a stand-alone basis. Accordingly, we consider ourselves to be in a single reporting segment and operating unit structure.

As of June 30, 2013, we were conducting business through 20,100 active distributors. We consider a distributor "active" if they have placed at least one product order with us during the preceding year. Currently we do not intend to devote material resources to opening any additional foreign markets in the near future. Our priority is to focus our resources in our most promising markets, which we consider to be Greater China and certain Commonwealth of Independent States ("CIS") countries, namely Russia, Ukraine and Kazakhstan. Currently, orders received from members located in Ukraine and Kazakhstan are fulfilled by our North American subsidiary.

We generate about 95% of our net sales from subsidiaries located outside North America, with sales in Hong Kong representing 73% of net sales in the latest fiscal quarter. Because of the size of our foreign operations, operating results can be impacted negatively or positively by factors such as foreign currency fluctuations, and economic, political and business conditions around the world. In addition, our business is subject to various laws and regulations, in particular regulations related to direct selling activities that create certain risks for our business, including improper claims or activities by our distributors and potential inability to obtain necessary product registrations.

China has been and continues to be our most important business development project. In June 2004, NHT Global obtained a general business license in China. Direct selling is prohibited in China without a direct selling license that we do not have. In December 2005, we submitted a preliminary application for a direct selling license. In June 2006, we submitted a revised application package in accordance with new requirements issued by the Chinese government. In June 2007, we launched a new e-commerce retail platform in China that does not require a direct selling license and is separate from our current worldwide platform. We believe this model, which offers discounts based on volume purchases, will encourage repeat purchases of our products for personal consumption in the Chinese market. The platform is designed to be in compliance with our understanding of current laws and regulations in China. In November 2007, we filed a new, revised direct selling application incorporating a name change, our new e-commerce model and other developments. These direct selling applications were not approved or rejected by the pertinent authorities, but did not appear to materially progress. By 2009, the information contained in the most recent application was stale. The Company applied to temporarily withdraw the license application in February 2009 to furnish new information and intends to amend its application with the goal to re-apply in the future. We are unable to predict whether we will be successful in obtaining a direct selling license to operate in China, and if we are successful, when we will be permitted to enhance our e-commerce retail platform with direct selling operations.

Most of the Company's Hong Kong revenue is derived from the sale of products that are delivered to members in China. After consulting with outside professionals, the Company believes that its Hong Kong e-commerce business does not violate any applicable laws in China even though it is used for the internet purchase of our products by buyers in China. But the government in China could, in the future, officially interpret its laws and regulations – or adopt new laws and regulations – to prohibit some or all of our e-commerce activities with China and, if our members engage in illegal activities in China, those actions could be attributed to us. In addition, other Chinese laws regarding how and when members may assemble and the activities that they may conduct, or the conditions under which the activities may be conducted, in China are subject to interpretations and enforcement attitudes that sometimes vary from province to province, among different levels of government, and from time to time. Members sometimes violate one or more of the laws regulating these activities, notwithstanding training that the Company attempts to provide. Enforcement measures regarding these violations, which can include arrests, raise the uncertainty and perceived risk associated with conducting this business, especially among those who are aware of the enforcement actions but not the specific activities leading to the enforcement. The Company believes that this has led some existing members in China – who are signed up as distributors in Hong Kong - to leave the business or curtail their selling activities and has led some potential members to choose not to participate. Among other things, the Company is combating this with more training and public relations efforts that are designed, among other things, to distinguish the Company from businesses that make no attempt to comply with the law. This environment creates uncertainty about the future of doing this type of business in China generally and under our business model, specifically.

Income Statement Presentation

We derive revenue from sales of products, enrollment packages, and shipping charges. Substantially all of our product sales are to independent distributors at published wholesale prices. Product sales are recorded when the products are shipped and title passes to independent distributors, which generally is upon our delivery to the carrier that completes delivery to the distributors. We estimate and accrue a reserve for product returns based on our return policies and historical experience. Enrollment package revenue, including any nonrefundable set-up fees, is deferred and recognized over the term of the arrangement, generally twelve months.

Cost of sales consists primarily of products purchased from third-party manufacturers, freight cost for shipping products to distributors, import duties, costs of promotional materials sold to the Company's distributors at or near cost, and provisions for slow moving or obsolete inventories. Cost of sales also includes purchasing costs, receiving costs, inspection costs and warehousing costs.

Distributor commissions are typically our most significant expense and are classified as an operating expense. Under our compensation plan, distributors are paid weekly commissions, generally in their home country currency, for product sold by their down-line distributor network across all geographic markets, except China, where we launched an e-commerce retail platform and do not pay any commissions. Distributors are not paid commissions on purchases or sales of our products made directly by them. This "seamless" compensation plan enables a distributor located in one country to sponsor other distributors located in other countries where we are authorized to conduct our business. Currently, there are basically two ways in which our distributors can earn income:

- Through retail markups on sales of products purchased by distributors at wholesale prices (in some markets, sales are for personal consumption only and income may not be earned through retail mark-ups on sales in that market); and
- Through commissions paid on product purchases made by their down-line distributors.

Each of our products is designated a specified number of sales volume points, also called bonus volume or "BV." Commissions are based on total personal and group sales volume points per sales period. Sales volume points are essentially a percentage of a product's wholesale cost. As the distributor's business expands from successfully sponsoring other distributors who in turn expand their own businesses by sponsoring other distributors, the distributor receives higher commissions from purchases made by an expanding down-line network. To be eligible to receive commissions, a distributor may be required to make nominal monthly or other periodic purchases of our products. Certain of our subsidiaries do not require these nominal purchases for a distributor to be eligible to receive commissions. In determining commissions, the number of levels of down-line distributors included within the distributor's commissionable group increases as the number of distributorships directly below the distributor increases. Under our current compensation plan, certain of our commission payouts may be limited to a hard cap in terms of a specific percentage of total product sales. In some markets, commissions may be further limited. In some markets, we also pay certain bonuses on purchases by several generations of personally sponsored distributors, as well as bonuses on commissions earned by several generations of personally sponsored distributors. Distributors can also earn income, trips and other prizes in specific time-limited promotions and contests we hold from time to time. Distributor commissions are dependent on the sales mix and, for the first six months in 2012 and 2013, represented 43% and 42% of net sales, respectively. From time to time we make modifications and enhancements to our compensation plan to help motivate distributors, which can have an impact on distributor commissions. From time to time we also enter into agreements for business or market development, which may result in additional compensation to specific distributors.

Selling, general and administrative expenses consist of administrative compensation and benefits (including stock-based compensation), travel, credit card fees and assessments, professional fees, certain occupancy costs, and other corporate administrative expenses. In addition, this category includes selling, marketing, and promotion expenses including costs of distributor conventions, which are designed to increase both product awareness and distributor recruitment. Because our various distributor conventions are not always held at the same time each year, interim period comparisons will be impacted accordingly.

The functional currency of our international subsidiaries is generally their local currency. Local currency assets and liabilities are translated at the rates of exchange on the balance sheet date, and local currency revenues and expenses are translated at average rates of exchange during the period. Equity accounts are translated at historical rates. The resulting translation adjustments are recorded directly into a separate component of stockholders' equity and represent the only component of accumulated other comprehensive income.

Sales by our foreign subsidiaries are transacted in the respective local currencies and are translated into U.S. dollars using average rates of exchange for each monthly accounting period to which they relate. Most of our product purchases from third-party manufacturers are transacted in U.S. dollars. Consequently, our sales and net earnings are affected by changes in currency exchange rates, with sales and earnings generally increasing with a weakening U.S. dollar and decreasing with a strengthening U.S. dollar.

Results of Operations

The following table sets forth our operating results as a percentage of net sales for the periods indicated.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2013	2012	2013
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	26.3	24.2	26.3	24.9
Gross profit	73.7	75.8	73.7	75.1
Operating expenses:				
Distributor commissions	44.5	41.9	42.7	42.2
Selling, general and administrative expenses	21.0	24.6	23.7	26.3
Depreciation and amortization	0.1	0.3	0.1	0.2
Total operating expenses	65.6	66.8	66.5	68.7
Income from operations	8.1	9.0	7.2	6.4
Other income (expense), net	–	(0.3)	(0.3)	(0.1)
Income before income taxes	8.1	8.7	6.9	6.3
Income tax provision	0.4	0.2	0.2	0.1
Net income	7.7%	8.5%	6.7%	6.2%

Net Sales

The following table sets forth revenue by market for the periods indicated (in thousands):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2012		2013		2012		2013	
North America	$534	4.9%	$525	5.0%	$969	4.8%	$1,054	5.5%
Hong Kong	8,142	74.1	7,766	73.3	14,268	71.1	13,814	71.8

China	159	1.4	227	2.1	374	1.9	371	1.9
Taiwan	460	4.2	754	7.1	959	4.8	1,355	7.0
South Korea	51	0.5	137	1.3	165	0.8	233	1.2
Japan	42	0.4	24	0.2	87	0.4	53	0.3
Russia	1,515	13.8	1,102	10.4	3,088	15.4	2,232	11.6
Europe	77	0.7	63	0.6	160	0.8	137	0.7
Total	$10,980	100.0%	$10,598	100.0%	$20,070	100.0%	$19,249	100.0%

Net sales were $10.6 million for the three months ended June 30, 2013 compared with $11.0 million for the comparable period a year ago, a decrease of $382,000, or 3%. Hong Kong net sales decreased $376,000, or 5%, over the comparable period a year ago. In January 2013, we launched a 12-month incentive program around our international recognition program called the Supreme Bonus. This year-long program rewards members with additional cash bonuses and other prizes for maintaining and advancing rank in our international recognition program. Similar incentive programs during 2012 were more quarterly-focused and only offered during the first six months of the year, which may have resulted in more sales during the first and/or second quarter of 2012 as compared to the current year periods. Additionally, a price increase for our *Premium Noni Juice*™ product effective in mid-June of 2012 may have pulled forward more orders into the second quarter of the prior year.

Outside of our Hong Kong business, net sales elsewhere totaled $2.8 million for the three months ended June 30, 2013, the same as the comparable period in 2012. A decrease in the Russian market was substantially offset by increases in both Taiwan and South Korea.

Net sales were $19.2 million for the six months ended June 30, 2013 compared with $20.1 million for the comparable period a year ago, a decrease of $821,000, or 4%. Hong Kong net sales decreased $454,000, or 3%, over the comparable period a year ago. The sales decline is also mainly attributable to, as described above, the nature of the recognition system incentive programs, which may have resulted in more sales during the first six months of 2012 as compared to the current year period, as well as the price increase for our *Premium Noni Juice*™ product effective in Hong Kong in mid-June 2012, which may have pulled forward orders that would have occurred in the third quarter of 2012.

Outside of our Hong Kong business, net sales elsewhere decreased $367,000, or 6%, during the six months ended June 30, 2013, as compared to the same period a year ago. This decrease can be mainly attributable to a product promotion offered in early 2012 that increased orders during the first six months of 2012, but deferred subsequent monthly purchase requirements for up to one year.

As of June 30, 2013, the operating subsidiaries of the Company had 20,100 active distributors, compared to 21,200 active distributors at June 30, 2012. As of June 30, 2013, the Company had deferred revenue of $1.1 million, of which $958,000 pertained to product sales and $162,000 pertained to unamortized enrollment package revenue.

Gross Profit

Gross profit was 75.8% of net sales for the three months ended June 30, 2013 compared with 73.7% of net sales for the three months ended June 30, 2012. The gross profit margin percentage increase is attributable to lower fees paid to our third-party service provider in Russia and less importation costs incurred in the Russian market as a percentage of overall net sales, which occurs when sales from the Russian market comprise a lower percentage of our overall net sales. Additionally, the increase is attributable to the *Premium Noni Juice*™ price increase that occurred in mid-June 2012 in Hong Kong and the introduction of new higher margin products in Hong Kong late 2012 and early 2013.

Gross profit was 75.1% of net sales for the six months ended June 30, 2013 compared with 73.7% of net sales for the six months ended June 30, 2012. The margin increase for the six month period was also mainly due to, as described above, lower fees paid to our third-party service provider in Russia, less importation costs incurred in the Russian market as a percentage of overall net sales, as well as the *Premium Noni Juice*™ price increase and product introductions that have occurred in Hong Kong since the end of the second quarter of 2012.

Distributor Commissions

Distributor commissions were 41.9% for the three months ended June 30, 2013, compared with 44.5% for the comparable period a year ago, and 42.2% of net sales for the six months ended June 30, 2013, compared with 42.7% for the comparable period a year ago. The decrease as a percent of net sales during the second quarter can be largely attributable to less supplemental commission expense when compared to the prior year and less overall commission payout in the Greater China market. On a year to date basis, the decrease is somewhat offset by the additional incentive trip and event costs incurred during the first six months of 2013 as compared to the prior year.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were $2.6 million for the three months ended June 30, 2013 compared with $2.3 million for the comparable period a year ago. Selling, general and administrative expenses increased by $296,000, or 13%, due to higher employee-related costs totaling $259,000 primarily resulting from employee incentive programs, new hires in Hong Kong and Russia during the latter half of the prior year, and higher employee travel costs for both incentive trips and training programs. Additionally, we incurred higher rent expense of $25,000 for office space in Dallas and Beijing as compared to the second quarter of 2012.

Selling, general and administrative expenses were $5.1 million for the six months ended June 30, 2013 compared with $4.8 million for the comparable period a year ago. Selling, general and administrative expenses increased by $304,000, or 6%, mainly due to higher employee-related costs totaling $144,000 resulting from new hires in Hong Kong and Russia during the latter half of the prior year and higher employee travel costs for both incentive trips and training programs. Additionally, we incurred higher rent expense of $46,000 for office space in Dallas and Beijing as compared to the same period in 2012 and we incurred professional fees totaling $20,000 for development of the Ukraine and Kazakhstan markets during the first quarter of 2013.

Other Income (Expense), Net

Loss on foreign exchange was $64,000 for the six months ended June 30, 2012 due to impact of strengthening currencies (against the U.S. dollar) earlier in the year on inter-company balances, namely the European euro and Russian ruble. The Company took certain steps during the second quarter to mitigate its exposure to the European euro going forward. A loss on foreign exchange totaling $21,000 was recognized in the first six months of 2013.

Income Taxes

An income tax provision of $16,000 and $28,000 was recognized during the three and six months ended June 30, 2013, respectively, related to our operations outside the United States. An income tax provision of $45,000 and $26,000 was recognized during the three and six months ended June 30, 2012, respectively. The Company did not recognize a tax benefit for U.S. tax purposes due to uncertainty that the benefit will be realized.

Liquidity and Capital Resources

At June 30, 2013, the Company's cash and cash equivalents totaled $6.7 million. Total cash and cash equivalents increased by $2.5 million from December 31, 2012 to June 30, 2013.

At June 30, 2013, the ratio of current assets to current liabilities was 1.10 to 1.00 and the Company had working capital of $734,000. Current liabilities included deferred revenue of $1.1 million that consisted of unamortized enrollment package revenues and unshipped orders. The ratio of current assets to current liabilities, excluding deferred revenue, is 1.28 to 1.00. Working capital as of June 30, 2013 increased $1.2 million compared to that as of December 31, 2012 due to cash generated from operations.

Cash provided by operations for the first six months of 2013 was $2.6 million, the same as the comparable period of 2012.

No significant investing activities occurred during the first six months of 2013. Cash provided by investing activities for the first six months of 2012 was $429,000, which resulted from a $494,000 decrease in restricted cash. In April 2010, the Company's primary credit card processing company required that the Company gradually increase to and maintain the reserve balance at $500,000. The Company reached the necessary reserve requirement during the second quarter of 2011. One-half of the reserve balance was returned to the Company in January 2012 and the remainder was returned in May 2012.

No significant financing activities occurred during the first six months of 2012 or 2013.

The Company believes that its existing internal liquidity, supported by cash on hand and cash flows from operations should be adequate to fund normal business operations and address its financial commitments for at least the next 12 months, assuming no significant unforeseen expense or revenue decline. If the Company's foregoing beliefs or assumptions prove to be incorrect, however, the Company's business, results of operations and financial condition could be materially adversely affected.

The Company does not have any significant unused sources of liquid assets. Potentially the Company might receive additional external funding if currently outstanding warrants are exercised. Furthermore, if necessary, the Company may attempt to generate more funding from the capital markets, but currently does not believe that will be necessary.

On October 19, 2007, the Company issued warrants to purchase 3,141,499 shares of common stock in connection with a convertible debentures financing. The warrants consisted of seven-year warrants to purchase 1,495,952 shares of common stock, one-year warrants to purchase 1,495,952 shares of common stock, and five-year warrants to purchase 149,595 shares of common stock. The term for each of the warrants began six months and one day after their respective issuance and each have an exercise price of $3.52 per share. Such one-year warrants expired unexercised on April 21, 2009 and such five-year warrants expired unexercised on April 21, 2013. Additionally, on May 4, 2013, warrants issued by the Company in a May 2007 private equity placement representing the right to purchase 2,059,307 shares of common stock expired unexercised.

We do not intend to devote material resources to opening any additional foreign markets in the near future. Our priority is to focus our resources in our most promising markets, which we consider to be Greater China and certain CIS countries, namely Russia, Ukraine and Kazakhstan.

Critical Accounting Policies and Estimates

The Company has identified certain policies and estimates that are important to the portrayal of its financial condition and results of operations. Critical accounting policies and estimates are defined as both those that are material to the portrayal of our financial condition and results of operations and as those that require management's most subjective judgments. These policies and estimates require the application of significant judgment by the Company's management.

The most significant accounting estimates inherent in the preparation of the Company's financial statements include estimates associated with obsolete inventory and the fair value of acquired intangible assets, including goodwill, as well as those used in the determination of liabilities related to sales returns and income taxes. Various assumptions and other factors prompt the determination of these significant estimates. The process of determining significant estimates is fact specific and takes into account historical experience and current and expected economic conditions. The actual results may differ materially and adversely from the Company's estimates. To the extent that there are material differences between the estimates and actual results, future results of operations will be affected. The Company's critical accounting policies at June 30, 2013 include the following:

Inventory Valuation. The Company reviews its inventory carrying value and compares it to the net realizable value of its inventory and any inventory value in excess of net realizable value is written down. In addition, the Company reviews its inventory for obsolescence and any inventory identified as obsolete is reserved or written off. The Company's determination of obsolescence is based on assumptions about the demand for its products, product expiration dates, estimated future sales, and management's future plans. Also, if actual sales or management plans are less favorable than those originally projected by management, additional inventory reserves or write-downs may be required. At December 31, 2012 and June 30, 2013, the Company's inventory value was $867,000 and $1.0 million, respectively, net of reserves of $72,000 and $1,000, respectively. No significant provision was recorded during the periods presented.

Valuation of Goodwill. In accordance with accounting principles generally accepted in the United States of America, the value of residual goodwill is not amortized, but is tested at least annually for impairment. The Company first assesses qualitative factors in order to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, through this qualitative assessment, the conclusion is made that it is more likely than not that a reporting unit's fair value is less than its carrying amount, a two-step impairment test is performed. The Company's policy is to test for impairment annually during the fourth quarter. At December 31, 2012 and June 30, 2013, goodwill of $1.8 million was reflected on the Company's balance sheet. No impairment of goodwill was recognized during the periods presented.

Allowance for Sales Returns. An allowance for sales returns is provided during the period the product is shipped. The allowance is based upon the return policy of each country, which varies from 14 days to one year, and their historical return rates, which range from 1% to 5% of sales. Sales returns were 2% of sales for each of the six month periods ended June 30, 2012 and 2013. The allowance for sales returns was $181,000 and $251,000 at December 31, 2012 and June 30, 2013, respectively. No material changes in estimates have been recognized during the periods presented.

Revenue Recognition. Product sales are recorded when the products are shipped and title passes to independent distributors. Product sales to distributors are made pursuant to a distributor agreement that provides for transfer of both title and risk of loss upon our delivery to the carrier that completes delivery to the distributors, which is commonly referred to as "F.O.B. Shipping Point." The Company primarily receives payment by credit card at the time distributors place orders. The Company's sales arrangements do not contain right of inspection or customer acceptance provisions other than general rights of return. Amounts received for unshipped product are recorded as deferred revenue. Such amounts totaled $647,000 and $958,000 at December 31, 2012 and June 30, 2013, respectively. Shipping charges billed to distributors are included in net sales. Costs associated with shipments are included in cost of sales.

Enrollment package revenue, including any nonrefundable set-up fees, is deferred and recognized over the term of the arrangement, generally twelve months. Enrollment packages provide distributors access to both a personalized marketing website and a business management system. No upfront costs are deferred as the amount is nominal. At December 31, 2012 and June 30, 2013, enrollment package revenue totaling $189,000 and $162,000 was deferred, respectively. Although the Company has no immediate plans to significantly change the terms or conditions of enrollment packages, any changes in the future could result in additional revenue deferrals or could cause us to recognize the deferred revenue over a longer period of time.

Tax Valuation Allowance. The Company evaluates the probability of realizing the future benefits of any of its deferred tax assets and records a valuation allowance when it believes a portion or all of its deferred tax assets may not be realized. The Company increased the valuation allowance to equal its net deferred tax assets during 2005 due to the uncertainty of future operating results. The valuation allowance will be reduced at such time as management believes it is more likely than not that the deferred tax assets will be realized. During each of the six month periods ended June 30, 2012 and 2013, no such reduction in the valuation allowance occurred. Any reductions in the valuation allowance will reduce future income tax provisions.

Provision for income taxes depends on the statutory tax rates in each of the jurisdictions in which we operate. We believe that we operate in compliance with all applicable transfer pricing laws and we intend to continue to operate in compliance with such laws. However, there can be no assurance that we will continue to be found to be operating in compliance with transfer pricing laws, or that those laws would not be modified, which, as a result, may require changes in our operating procedures. If the United States Internal Revenue Service or the taxing authorities of any other jurisdiction were to successfully challenge these agreements, plans, or arrangements, or require changes in our transfer pricing practices, we could be required to pay higher taxes, interest and penalties, and our earnings would be adversely affected.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable under smaller reporting company disclosure rules.

Item 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Management, with the participation of the Company’s principal executive officer and principal financial officer, evaluated the effectiveness of the design and operation of the Company’s disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) as of June 30, 2013. The Company’s disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to management, including the Company’s principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. Based on this evaluation, the principal executive officer and principal financial officer concluded that, as of June 30, 2013, the Company’s disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

There were no changes in internal control over financial reporting that occurred during the fiscal quarter ended June 30, 2013 that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

None.

Item 1A. RISK FACTORS

Not applicable under smaller reporting company disclosure rules.

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

(c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers

A summary of the Company's purchases, as Trustee, of shares of its common stock during the quarter ended June 30, 2013 is as follows:

Period	Total Number of Shares Purchased (a)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (b)	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs (c)
April 1–30, 2013	2,800	$ 1.43	58,520	85,910
May 1–31, 2013	2,800	1.12	61,320	83,110
June 1–30, 2013	2,800	0.87	64,120	80,310

(a) The shares were purchased in open market transactions under the Employee Plan described in footnote (b) below.

(b) On August 13, 2012, the Company disclosed in its Quarterly Report on Form 10-Q that its Board of Directors had, on that day, authorized the Company, acting as trustee for certain of its distributors, to execute a Rule 10b5-1 plan to purchase up to $60,000 of its common stock (less commissions and other transaction costs) in accordance with guidelines specified under Rule 10b5-1 of the Securities Exchange Act of 1934 and the Company's policies regarding stock transactions (the "Distributor Plan") and that, on that same date, the Company's Board of Directors further authorized the Company, acting as trustee for certain of its non-officer, overseas employees, to execute a Rule 10b5-1 plan to purchase 100,000 shares of its common stock in accordance with guidelines specified under Rule 10b5-1 of the Securities Exchange Act of 1934 and the Company's policies regarding stock transactions (the "Employee Plan"). The Company may terminate the plans at any time. The distributors for whom the Company was authorized to purchase the stock as trustee under the Distributor Plan were authorized to receive the stock as compensation under a special incentive plan offered to certain distributors who are not citizens or residents of the United States. The employees for whom the Company was authorized to purchase stock as trustee under the Employee Plan are authorized to receive the stock as incentive compensation in quarterly increments over three years beginning March 15, 2013, provided that they are employees of the Company on the date of the distribution. Any stock that is purchased under the Employee Plan that is forfeited by an employee whose employment terminates will be delivered to the Company and held by it as treasury stock.

(c) The Company, as Trustee, completed its purchases under the Distributor Plan in October 2012, and all of those shares have been transferred to the qualifying distributor for whom they were purchased. The Company, as Trustee, began purchasing under the Employee Plan in December 2012. Under the 10b5-1 plan executed by the Company, as Trustee, with the Board's authorization, the Company, as Trustee, will not purchase more than 2,800 shares per month. The current 10b5-1 plan for the Employee Plan shares will expire on November 30, 2013, unless terminated earlier, and the Company, as Trustee, intends at or after that time to enter into a new 10b5-1 plan or plans to complete the Employee Plan purchases authorized by the Board.

Item 3. DEFAULTS UPON SENIOR SECURITIES

None.

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

Item 5. OTHER INFORMATION

None.

Item 6. EXHIBITS

Exhibit Number	Exhibit Description
31.1	Certification of Principal Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certifications of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
*101.INS***	*XBRL Instance*
*101.SCH***	*XBRL Taxonomy Extension Schema*
*101.CAL***	*XBRL Taxonomy Extension Calculation*
*101.DEF***	*XBRL Taxonomy Extension Definition*
*101.LAB***	*XBRL Taxonomy Extension Labels*
*101.PRE***	*XBRL Taxonomy Extension Presentation*

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.

NATURAL HEALTH TRENDS CORP.

Date: August 6, 2013	/s/ Timothy S. Davidson Senior Vice President and Chief Financial Officer (Principal Financial Officer)

EXHIBIT INDEX

Exhibit Number	*Exhibit Description*
31.1	Certification of Principal Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certifications of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
*101.INS***	*XBRL Instance*
*101.SCH***	*XBRL Taxonomy Extension Schema*
*101.CAL***	*XBRL Taxonomy Extension Calculation*
*101.DEF***	*XBRL Taxonomy Extension Definition*
*101.LAB***	*XBRL Taxonomy Extension Labels*
*101.PRE***	*XBRL Taxonomy Extension Presentation*