

NATURES SUNSHINE PRODUCTS INC  
Form 10-Q  
August 05, 2010  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**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, 2010

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_ ..

Commission File Number: 0-8707

## NATURE S SUNSHINE PRODUCTS, INC.

(Exact name of Registrant as specified in its charter)

**Utah**  
(State or other jurisdiction of  
incorporation or organization)

**87-0327982**  
(IRS Employer  
Identification No.)

**75 East 1700 South**

**Provo, Utah 84606**

(Address of principal executive offices and zip code)

**(801) 342-4300**

(Registrant's telephone number including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

The number of shares of Common Stock, no par value, outstanding on July 31, 2010 was 15,513,409 shares.

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NATURE S SUNSHINE PRODUCTS, INC.

FORM 10-Q

For the Quarter Ended June 30, 2010

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## NATURE S SUNSHINE PRODUCTS, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Amounts in thousands)

*(Unaudited)*

|   | June 30,<br>2010 | December 31,<br>2009 |
|---|------------------|----------------------|
| <b>Assets</b>   |                  |                      |
| Current Assets:   |                  |                      |
| Cash and cash equivalents   | \$ 40,010        | \$ 35,538            |
| Restricted cash   | 249              | 1,495                |
| Accounts receivable, net of allowance for doubtful accounts of \$1,742 and \$1,840 respectively   | 8,166            | 8,294                |
| Investments available for sale  | 3,122            | 3,167                |
| Inventories, net  | 38,590           | 40,623               |
| Deferred income tax assets  | 5,894            | 6,646                |
| Prepaid expenses and other current assets   | 5,770            | 5,629                |
| Total current assets  | 101,801          | 101,392              |
| Property, plant and equipment, net  | 27,965           | 28,757               |
| Investment securities   | 1,786            | 1,752                |
| Intangible assets   | 1,362            | 1,421                |
| Deferred income tax assets  | 12,281           | 12,228               |
| Other assets  | 18,778           | 19,306               |
|   | \$ 163,973       | \$ 164,856           |
| <b>Liabilities and Shareholders' Equity</b>   |                  |                      |
| Current Liabilities:  |                  |                      |
| Accounts payable  | \$ 4,770         | \$ 4,176             |
| Accrued volume incentives   | 18,643           | 17,495               |
| Accrued liabilities   | 34,269           | 34,143               |
| Deferred revenue  | 3,679            | 4,513                |
| Income taxes payable  | 5,005            | 7,542                |
| Total current liabilities   | 66,366           | 67,869               |
| Liability related to unrecognized tax benefits  | 29,128           | 35,028               |
| Deferred compensation payable   | 1,786            | 1,752                |
| Other liabilities   | 2,606            | 3,112                |
| Total long-term liabilities   | 33,520           | 39,892               |
| <b>Commitments and Contingencies (Note 10)</b>  |                  |                      |
| Shareholders' Equity:   |                  |                      |
| Common stock, no par value; 50,000 shares authorized, 15,513 and 15,510 shares issued and outstanding as of June 30, 2010 and December 31, 2009 | 67,428           | 67,183               |

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|                                      |            |            |
|--------------------------------------|------------|------------|
| Retained earnings                    | 14,718     | 9,511      |
| Accumulated other comprehensive loss | (18,059)   | (19,599)   |
| Total shareholders' equity           | 64,087     | 57,095     |
|                                      | \$ 163,973 | \$ 164,856 |

See accompanying notes to condensed consolidated financial statements.

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

(Amounts in thousands, except per share information)

*(Unaudited)*

|   | <b>Three Months Ended</b> |             |
|---|---------------------------|-------------|
|   | <b>June 30,</b>           |             |
|   | <b>2010</b>               | <b>2009</b> |
| Net Sales Revenue (net of the rebate portion of volume incentives of \$11,104 and \$12,183, respectively) | \$ 87,358                 | \$ 84,149   |
| Cost and Expenses:  |                           |             |
| Cost of goods sold  | 16,845                    | 15,787      |
| Volume incentives   | 32,559                    | 31,217      |
| Selling, general and administrative   | 34,995                    | 35,089      |
|   | 84,399                    | 82,093      |
| Operating Income  | 2,959                     | 2,056       |
| Other (Expense) Income, Net   | (937)                     | 544         |
| Income Before Income Tax Provision  | 2,022                     | 2,600       |
| Income Tax Provision  | 968                       | 1,066       |
| Net Income  | \$ 1,054                  | \$ 1,534    |
| Basic Net Income Per Common Share   | \$ 0.07                   | \$ 0.10     |
| Diluted Net Income Per Common Share   | \$ 0.07                   | \$ 0.10     |
| Weighted Average Basic Common Shares Outstanding  | 15,512                    | 15,510      |
| Weighted Average Diluted Common Shares Outstanding  | 15,602                    | 15,510      |

See accompanying notes to condensed consolidated financial statements.

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

(Amounts in thousands, except per share information)

*(Unaudited)*

|   | Six Months Ended<br>June 30, |            |
|---|------------------------------|------------|
|   | 2010                         | 2009       |
| Net Sales Revenue (net of the rebate portion of volume incentives of \$22,357 and \$23,454, respectively) | \$ 174,404                   | \$ 167,325 |
| Cost and Expenses:  |                              |            |
| Cost of goods sold  | 34,846                       | 33,334     |
| Volume incentives   | 65,123                       | 62,213     |
| Selling, general and administrative   | 71,458                       | 72,566     |
|   | 171,427                      | 168,113    |
| Operating Income (Loss)   | 2,977                        | (788)      |
| Other Income, Net   | 1,898                        | 1,748      |
| Income Before Income Tax (Benefit) Provision  | 4,875                        | 960        |
| Income Tax (Benefit) Provision  | (332)                        | 888        |
| Net Income  | \$ 5,207                     | \$ 72      |
| Basic Net Income Per Common Share   | \$ 0.34                      | \$ 0.00    |
| Diluted Net Income Per Common Share   | \$ 0.33                      | \$ 0.00    |
| Weighted Average Basic Common Shares Outstanding  | 15,511                       | 15,510     |
| Weighted Average Diluted Common Shares Outstanding  | 15,597                       | 15,510     |

See accompanying notes to condensed consolidated financial statements.



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

(Amounts in thousands)

(Unaudited)

|   | Six Months Ended<br>June 30, |         |
|---|------------------------------|---------|
|   | 2010                         | 2009    |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |                              |         |
| Net income  | \$ 5,207                     | \$ 72   |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                              |         |
| Provision for doubtful accounts   | (54)                         | 5       |
| Depreciation and amortization   | 2,152                        | 2,303   |
| Share-based compensation expense  | 218                          |         |
| Loss on sale of property and equipment  | 2                            | 141     |
| Deferred income taxes   | (62)                         | 46      |
| Loss on restricted cash   | 497                          |         |
| Amortization of bond discount   | 11                           | 15      |
| Purchase of trading investment securities   | (116)                        | (131)   |
| Proceeds from sale of trading investment securities   | 60                           | 39      |
| Realized and unrealized losses (gains) on investments                                       | 59                           | (68)    |
| Amortization of prepaid taxes related to gain on intercompany sales                         | 542                          | 608     |
| Foreign exchange gains  | (2,280)                      | (2,029) |
| Changes in assets and liabilities:  |                              |         |
| Accounts receivable   | (4)                          | 1,510   |
| Inventories   | 2,010                        | (1,339) |
| Prepaid expenses and other current assets   | (345)                        | (2,209) |
| Other assets  | (76)                         | (336)   |
| Accounts payable  | 710                          | (1,869) |
| Accrued volume incentives   | 1,369                        | 2,806   |
| Accrued liabilities   | 647                          | 682     |
| Deferred revenue  | (834)                        | (1,176) |
| Income taxes payable  | (2,429)                      | (1,865) |
| Liability related to unrecognized tax positions   | (1,986)                      | (348)   |
| Deferred compensation payable   | 83                           | 141     |
| Net cash provided by (used in) operating activities   | 5,381                        | (3,002) |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |                              |         |
| Purchases of property, plant and equipment  | (1,286)                      | (1,812) |
| Proceeds from sale of investments available for sale  |                              | 600     |
| Proceeds from sale of restricted investments  |                              | 2,050   |
| Proceeds from sale of property, plant and equipment   |                              | 25      |
| Net cash (used in) provided by investing activities   | (1,286)                      | 863     |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |                              |         |
| Proceeds from the exercise of stock options   | 27                           |         |
| Payment of cash dividends   |                              | (776)   |
| Proceeds from short-term borrowings   |                              | 3,677   |
| Payments on short-term borrowings   |                              | (2,711) |
| Net cash provided by financing activities   | 27                           | 190     |
| Effect of exchange rates on cash and cash equivalents                                       | 350                          | (65)    |
| Net increase (decrease) in cash and cash equivalents  | 4,472                        | (2,014) |

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|  |    |        |    |        |
|--|----|--------|----|--------|
| Cash and cash equivalents at the beginning of the period |    | 35,538 |    | 34,853 |
| Cash and cash equivalents at end of the period           | \$ | 40,010 | \$ | 32,839 |
| <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b> |    |        |    |        |
| Cash paid for income taxes                               | \$ | 3,506  | \$ | 4,395  |
| Cash paid for interest                                   | \$ |        | \$ |        |

See accompanying notes to condensed consolidated financial statements.

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NATURE S SUNSHINE PRODUCTS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except per-share information)

*(Unaudited)*

**(1) Basis of Presentation**

Nature s Sunshine Products, Inc. and its subsidiaries (hereinafter referred to collectively as the Company ) are primarily engaged in the manufacturing and marketing of herbal products, vitamin and mineral supplements, personal care products, and miscellaneous products. Nature s Sunshine Products, Inc. is a Utah corporation with its principal place of business in Provo, Utah. The Company sells its products to a sales force of independent Distributors and Managers who use the products themselves or resell them to other Distributors or consumers. The formulation, manufacturing, packaging, labeling, advertising, distribution and sale of each of the Company s major product groups are subject to regulation by one or more governmental agencies.

The Company markets its products in the United States, Mexico, Central America, Canada, Venezuela, the Dominican Republic, Japan, Ecuador, the United Kingdom, Colombia, Peru, Israel, Russia, Ukraine, Latvia, Lithuania, Kazakhstan, Mongolia, Belarus, China, Poland, Brazil, South Korea, Singapore, Thailand, Taiwan, Malaysia, Hong Kong, the Philippines, Indonesia, Germany, Austria , the Netherlands, Norway, Sweden, the Czech Republic, and Vietnam. The Company also exports its products to several other countries, including Argentina, Australia, Chile, New Zealand, and Norway.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The unaudited condensed consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions are eliminated in consolidation. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the Company s financial information as of June 30, 2010, and for the three and six-month periods ended June 30, 2010 and 2009. The results of operations of any interim period are not necessarily indicative of the results of operations to be expected for the fiscal year ending December 31, 2010.

These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2009.

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

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As of January 1, 2010, Venezuela was designated as a highly inflationary economy under U.S. generally accepted accounting principles ( U.S. GAAP ). Accordingly, the U.S. dollar became the functional currency for the Company s subsidiary in Venezuela. All gains and losses resulting from the re-measurement of its financial statements are determined using official exchange rates. On January 8, 2010, the Venezuelan government announced the devaluation of the bolivar fuerte against the U.S. dollar and the establishment of a two-tier exchange structure for essential and non-essential goods. The official exchange rate for imported goods classified as essential, such as food and medicine, changed from 2.15 to 2.60, while payments for non-essential goods are at an exchange rate of 4.30. The majority of the Company s products are currently classified as essential and qualify for the 2.60 exchange rate. However, its overall results in Venezuela are re-measured to the U.S. dollar at approximately 4.30, the exchange rate applicable to dividend repatriations.

As a result, the Company recorded a gain of \$3,668 in January 2010 in connection with the re-measurement of its balance sheet to reflect the highly inflationary designation and the devaluation due to the negative position of the Company s Venezuelan subsidiary s net monetary assets, which is recorded in other income. The increase in the exchange rate from 2.15 to 4.30 reduced the Company s total reported sales by approximately 1.8 percent and 1.7 percent for the three and six months ended June 30, 2010, respectively. On an ongoing basis, the Company expects future total net sales to be reduced by approximately two percent. The effect of the highly inflationary designation and the devaluation reduced reported operating income for the three and six months ended June 30, 2010 by approximately \$132 and \$491, respectively. The success of future operations will be affected by several factors, including the Company s ability to take actions to mitigate the effect of the devaluation, further actions of the Venezuelan government, and economic conditions in Venezuela such as inflation and consumer spending.

As of June 30, 2010, and December 31, 2009, the Company had approximately \$887 and \$2,005, respectively, in cash denominated in Venezuelan bolivar fuertes, of which \$249 and \$1,495, respectively, was restricted. The restriction of \$249 and \$1,495 in cash as of June 30, 2010 and December 31, 2009 in Venezuela is the result of the local government seizing control of the bank in which this operating cash was deposited and temporarily freezing its deposits. As a result, the Company has classified these deposits

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as restricted cash. While the Company expects these funds to become unrestricted in the near future, at this time it cannot estimate when they will be released. However, even if these funds are released, the Company anticipates some loss and has recorded a write-down of \$497 during the second quarter of 2010 to cover the estimated loss related to such release, which is included in other income and expense.

Currency restrictions enacted by the government of Venezuela require approval from the government's currency control organization for the Company's subsidiary in Venezuela to obtain U.S. dollars at the official exchange rate to pay for imported products or to repatriate dividends back to the Company. In prior periods the market rate, which is substantially lower than the official rate, was available to obtain U.S. dollars or other currencies without approval of the government's currency control organization. In June 2010, the government of Venezuela enacted additional currency restrictions, which effectively replaced the market rate with the System for Foreign Currency Denominated Securities (SITME), which is administered by the Venezuela Central Bank. Under SITME, entities domiciled in Venezuela can obtain U.S. denominated securities in limited quantities each month through banking institutions approved by the government.

At this time, the Company is not able to reasonably estimate the future state of exchange controls in Venezuela and the availability of U.S. dollars at the official foreign exchange rate or at the SITME rate. The application and approval process has been delayed in recent periods, and the timing and ability to obtain U.S. dollars in the future at the official exchange rate remains uncertain. Currently the Company has \$30 of funds pending approval at the official exchange rate. Unless the official exchange rate is made more readily available, the Company's Venezuelan subsidiary's operations could be adversely affected as it may need to obtain U.S. dollars at the less favorable SITME rate.

During the three months ended June 30, 2010 and 2009, the Company's Venezuelan subsidiary's net sales revenue represented approximately 1.8 percent and 3.4 percent of consolidated net sales revenue, respectively. During the six months ended June 30, 2010 and 2009, its net sales revenue represented approximately 1.7 percent and 3.6 percent of consolidated net sales revenue, respectively. Its Venezuelan subsidiary held total assets of \$8,584 and \$11,233 (which includes an intercompany receivable denominated in U.S. dollars of \$1,915 and \$1,850 and net assets of \$3,964 and \$524 at June 30, 2010 and December 31, 2009, respectively).

**Recent Accounting Pronouncements**

In October 2009, the FASB issued amendments to the accounting and disclosure for revenue recognition. These amendments, effective for fiscal years beginning on or after June 15, 2010 (early adoption is permitted), modify the criteria for recognizing revenue in multiple element arrangements and the scope of what constitutes a non-software deliverable. The Company does not expect the adoption of these amendments to have a material impact on its financial condition, results of operations, or cash flows.

In January 2010, the FASB issued authoritative guidance that requires new disclosures related to fair value measurements and clarifies existing disclosure requirements about the level of disaggregation, inputs and valuation techniques. Specifically, reporting entities now must disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. In addition, in the reconciliation for Level 3 fair value measurements, a reporting entity should present separately information about purchases, sales, issuances and settlements. The guidance clarifies that a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities for disclosure of fair value measurement, considering the level of disaggregated information required by other applicable U.S. GAAP guidance, and should also provide disclosures about the valuation techniques and inputs used to measure fair value for each class of assets and liabilities. This guidance was effective for the Company on January 1, 2010, except for the disclosures about purchases, sales, issuances and settlements in the reconciliation for Level 3 fair value measurements, which will be effective for the Company on January 1, 2011. The adoption of this guidance did not have an impact on the Company's financial condition, results of operations, or cash flows. The Company does not expect this guidance for disclosures about purchases, sales, issuances and settlements in the reconciliation for Level 3 fair

value measurements to have a material impact on its financial condition, results of operations, or cash flows.

(2) **Inventories**

Inventories consist of the following:

|                  | <b>June 30,<br/>2010</b> | <b>December 31,<br/>2009</b> |
|------------------|--------------------------|------------------------------|
| Raw Materials    | \$ 9,119                 | \$ 9,205                     |
| Work in Progress | 1,454                    | 675                          |
| Finished Goods   | 28,017                   | 30,743                       |
|                  | \$ 38,590                | \$ 40,623                    |

Table of Contents**(3) Intangible Assets**

At June 30, 2010 and December 31, 2009, intangibles for product formulations had a gross carrying amount of \$1,763 and \$1,763, accumulated amortization of \$401 and \$342, and a net amount of \$1,362 and \$1,421, respectively. The estimated useful life of the product formulations is estimated to be 15 years.

Amortization expense for intangible assets for the three months ended June 30, 2010 and 2009 was \$29 and \$29, respectively. Amortization expense for intangible assets for the six months ended June 30, 2010 and 2009 was \$59 and \$59, respectively. Estimated amortization expense for each of the five succeeding fiscal years is \$118.

**(4) Investment Securities**

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

|  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|--|-------------------|------------------------------|-------------------------------|---------------|
| <b>As of June 30, 2010</b>             |                   |                              |                               |               |
| Municipal obligations                  | \$ 2,019          | \$ 100                       |                               | \$ 2,119      |
| U.S. government securities funds       | 702               |                              |                               | 702           |
| Equity securities                      | 228               | 73                           |                               | 301           |
| Total short-term investment securities | \$ 2,949          | \$ 173                       |                               | \$ 3,122      |
| <br>                                   |                   |                              |                               |               |
|  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
| <b>As of December 31, 2009</b>         |                   |                              |                               |               |
| Municipal obligations                  | \$ 2,030          | \$ 107                       |                               | \$ 2,137      |
| U.S. government securities funds       | 698               | 13                           |                               | 711           |
| Equity securities                      | 233               | 90                           | (4)                           | 319           |
| Total short-term investment securities | \$ 2,961          | \$ 210                       | (4)                           | \$ 3,167      |

The municipal obligations held at a fair value of \$2,119 at June 30, 2010 all mature in less than five years.

During the six month periods ended June 30, 2010 and 2009, the proceeds from the sales of available-for-sale securities were \$0 and \$600, respectively. There were no gross realized gains (losses) on sales of available-for-sale securities (net of tax) for the three and six month periods ended June 30, 2010 and 2009, respectively.

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The Company's trading securities portfolio totaled \$1,786 at June 30, 2010 and \$1,752 at December 31, 2009, and generated losses of \$70 and gains of \$92 for the three months ended June 30, 2010 and 2009, respectively, and generated losses of \$26 and gains of \$46 for the six months ended June 30, 2010 and 2009, respectively.

As of June 30, 2010 and December 31, 2009, the Company had unrealized losses of \$0 and \$4, respectively, in its municipal obligations and equity securities investments. These losses are due to the interest rate sensitivity of the municipal obligations and the performance of the overall stock market for the equity securities.

### **(5) Net Income Per Share**

Basic net income per common share ( Basic EPS ) is computed by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted net income per common share ( Diluted EPS ) reflects the potential dilution that could occur if stock options or other contracts to issue common stock were exercised or converted into common stock. The computation of Diluted EPS does not assume exercise or conversion of securities that would have an anti-dilutive effect on net income per common share.



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The following is a reconciliation of the numerator and denominator of Basic EPS to the numerator and denominator of Diluted EPS for the three and six months ended June 30, 2010 and 2009:

|   | Three Months Ended June 30, |          | Six Months Ended June 30, |         |
|---|-----------------------------|----------|---------------------------|---------|
|   | 2010                        | 2009     | 2010                      | 2009    |
| <b>Basic net income per common share:</b>                                   |                             |          |                           |         |
| Net income available to common stockholders                                 | \$ 1,054                    | 1,534    | \$ 5,207                  | \$ 72   |
| Basic weighted average shares outstanding                                   | 15,512                      | 15,510   | 15,511                    | 15,510  |
| Basic net income per common share   | \$ 0.07                     | \$ 0.10  | \$ 0.34                   | \$ 0.00 |
| <b>Diluted net income per common share:</b>                                 |                             |          |                           |         |
| Net income available to common stockholders                                 | \$ 1,054                    | \$ 1,534 | \$ 5,207                  | \$ 72   |
| <b>Diluted Shares Outstanding</b>   |                             |          |                           |         |
| Basic weighted average shares outstanding                                   | 15,512                      | 15,510   | 15,511                    | 15,510  |
| Stock options   | 90                          |          | 86                        |         |
| Diluted weighted average shares outstanding                                 | 15,602                      | 15,510   | 15,597                    | 15,510  |
| Diluted net income per common share   | \$ 0.07                     | \$ 0.10  | \$ 0.33                   | \$ 0.00 |
| <b>Potentially dilutive shares excluded from diluted per share amounts:</b> |                             |          |                           |         |
| Stock options   | 416                         | 209      | 430                       | 209     |

(6) **Comprehensive Income (Loss)**

The components of comprehensive income (loss), net of tax, for the three and six months ended June 30, 2010 and 2009, respectively, are as follows:

|  | Three Months Ended June 30, |          |
|--|-----------------------------|----------|
|  | 2010                        | 2009     |
| Net income                                     | \$ 1,054                    | \$ 1,534 |
| Foreign currency translation gain              | 296                         | 358      |
| Net unrealized losses on investment securities | (31)                        | (56)     |
| Total comprehensive income                     | \$ 1,319                    | \$ 1,836 |

  

|  | Six Months Ended June 30, |            |
|--|---------------------------|------------|
|  | 2010                      | 2009       |
| Net income   | \$ 5,207                  | \$ 72      |
| Foreign currency translation gain (loss)               | 1,573                     | (2,485)    |
| Net unrealized (losses) gains on investment securities | (33)                      | 12         |
| Total comprehensive income (loss)                      | \$ 6,747                  | \$ (2,401) |

(7) **Share-based Compensation**

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Stock option activity for the six months ended June 30, 2010 is as follows:

|  | Number of<br>Shares | Weighted Average<br>Exercise<br>Price Per Share |
|--|---------------------|---|
| Options outstanding at December 31, 2009 | 455                 | \$ 8.25   |
| Granted                                  | 450                 | 10.10   |
| Expired                                  | (3)                 | 7.63  |
| Exercised                                | (3)                 | 8.18  |
| Options outstanding at June 30, 2010     | 899                 | 9.17  |
| Exercisable at June 30, 2010             | 344                 | \$ 9.14   |

During the six month period ended June 30, 2010, the Company issued options to purchase 450 shares of common stock under the 2009 Incentive Plan, of which 300 were subject to achieving certain earnings metrics. These options were issued with a weighted-

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average exercise price of \$10.10. The weighted-average grant date fair value of these options was \$4.29 per share, and these options are exercisable from 12 months to 36 months. All of the 450 options issued have an option termination date of ten years from the option grant date.

The fair value of each option grant was estimated on the date of the grant using the Black-Scholes option-pricing model with the following weighted-average assumptions for the six-month period ended June 30, 2010:

|  | <b>2010</b> |              |
|--|-------------|--------------|
| Weighted average grant date fair value of grants | \$          | 4.29         |
| Expected life (in years)                         |             | 4.0          |
| Risk-free interest rate                          |             | 1.4 to 1.5   |
| Expected volatility                              |             | 51.3 to 55.0 |
| Dividend yield                                   |             | 0.0          |

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

Share-based compensation expense from stock options for the three-month periods ended June 30, 2010 and 2009, was approximately \$149 and \$0, respectively; the related tax benefit was approximately \$58 and \$0, respectively. Share-based compensation expense from stock options for the six-month periods ended June 30, 2010 and 2009, was approximately \$218 and \$0, respectively; the related tax benefit was approximately \$85 and \$0, respectively. As of June 30, 2010 and 2009, the unrecognized share-based compensation cost related to outstanding options to purchase shares of common stock described above was \$665 and \$0, respectively.

For the six months ended June 30, 2010, the Company issued 3 shares of common stock upon the exercise of stock options at an average exercise price of \$8.18 per share. The aggregate intrinsic values on the dates of exercise of options during the six month period ended June 30, 2010 was \$13. No options were issued or exercised during the six months ended June 30, 2009.

At June 30, 2010, the aggregate intrinsic value of options outstanding to purchase 899 shares of common stock, the exercisable options to purchase 344 shares of common stock and approximately 280 options to purchase shares of common stock expected to vest was \$756, \$437 and \$344, respectively. At December 31, 2009, the aggregate intrinsic value of options outstanding to purchase 455 shares of common stock was \$804.

**(8) Segment Information**

The Company has three business segments. These reportable segments are components of the Company for which separate information is available and evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance.

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The Company has two reportable business segments based on geographic operations that include a United States segment and an international segment that operate under the Nature's Sunshine Products name. The Company's third reportable business segment is Synergy Worldwide, which offers products with formulations different from those of the Nature's Sunshine Products offerings. In addition, Synergy Worldwide's marketing and Distributor compensation plans are sufficiently different from those of Nature's Sunshine Products to warrant accounting for these operations as a separate business segment. Net sales revenues for each segment have been reduced by any intercompany sales as they are not included in the measure of segment profit or loss reviewed by the chief operating decision maker. The Company evaluates performance based on operating income (loss) by segment before consideration of certain inter-segment transfers and expenses.

Reportable business segment information is as follows:

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|  | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|--|--------------------------------|-----------|------------------------------|-----------|
|  | 2010                           | 2009      | 2010                         | 2009      |
| <b>Net Sales Revenue:</b>                |                                |           |                              |           |
| Nature's Sunshine Products:              |                                |           |                              |           |
| United States                            | \$ 37,467                      | \$ 39,507 | \$ 75,296                    | \$ 75,975 |
| International                            | 33,285                         | 31,603    | 68,554                       | 65,165    |
|  | 70,752                         | 71,110    | 143,850                      | 141,140   |
| Synergy Worldwide                        | 16,606                         | 13,039    | 30,554                       | 26,185    |
|  | 87,358                         | 84,149    | 174,404                      | 167,325   |
| <b>Operating Expenses:</b>               |                                |           |                              |           |
| Nature's Sunshine Products:              |                                |           |                              |           |
| United States                            | 35,382                         | 35,987    | 72,874                       | 73,391    |
| International                            | 32,433                         | 32,078    | 67,306                       | 64,060    |
|  | 67,815                         | 68,065    | 140,180                      | 137,451   |
| Synergy Worldwide                        | 16,584                         | 14,028    | 31,247                       | 30,662    |
|  | 84,399                         | 82,093    | 171,427                      | 168,113   |
| <b>Operating Income (Loss):</b>          |                                |           |                              |           |
| Nature's Sunshine Products:              |                                |           |                              |           |
| United States                            | 2,085                          | 3,520     | 2,422                        | 2,584     |
| International                            | 852                            | (475)     | 1,248                        | 1,105     |
|  | 2,937                          | 3,045     | 3,670                        | 3,689     |
| Synergy Worldwide                        | 22                             | (989)     | (693)                        | (4,477)   |
|  | 2,959                          | 2,056     | 2,977                        | (788)     |
| Other (Expense) Income, Net              | (937)                          | 544       | 1,898                        | 1,748     |
| Income Before Provision for Income Taxes | \$ 2,022                       | \$ 2,600  | \$ 4,875                     | \$ 960    |

From an individual country perspective, only the United States comprises approximately 10 percent or more of consolidated net sales revenue for any of the three and six-month periods ended June 30, 2010 and 2009 as follows:

|                       | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |            |
|-----------------------|--------------------------------|-----------|------------------------------|------------|
|                       | 2010                           | 2009      | 2010                         | 2009       |
| <b>Sales Revenue:</b> |                                |           |                              |            |
| United States         | \$ 40,092                      | \$ 39,748 | \$ 79,323                    | \$ 76,755  |
| Other                 | 47,266                         | 44,401    | 95,081                       | 90,570     |
| Total Sales Revenue   | \$ 87,358                      | \$ 84,149 | \$ 174,404                   | \$ 167,325 |

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

Segment long-lived assets as of June 30, 2010 and December 31, 2009, are as follows:

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|                                | June 30,<br>2010 | December 31,<br>2009 |
|--------------------------------|------------------|----------------------|
| <b>Long-Lived Assets:</b>      |                  |                      |
| United States                  | \$ 22,041        | \$ 22,629            |
| Venezuela                      | 4,466            | 4,620                |
| Other                          | 2,820            | 2,929                |
| <b>Total Long-Lived Assets</b> | <b>\$ 29,327</b> | <b>\$ 30,178</b>     |

**(9) Income Taxes**

Interim income taxes are based on an estimated annualized effective tax rate applied to the respective quarterly periods, adjusted for discrete tax items in the period in which they occur. For the three months ended June 30, 2010 and 2009, the Company's provision for income taxes, as a percentage of income before income taxes, was approximately 47.9 percent and 41.0 percent, respectively, compared with a U.S. federal statutory rate of 35.0 percent. For the six months ended June 30, 2010 and 2009, the Company's income tax (benefit) provision was approximately (6.8) percent and 92.5 percent as a percentage of pre-tax income, respectively, compared with a U.S. federal statutory rate of 35.0 percent.

The differences between the effective rate and the U.S. federal statutory rate for the three months ended June 30, 2010 were primarily attributed to increases due to foreign subsidiary net losses for which no tax benefit is currently being recognized, offset by decreases in tax liabilities associated with uncertain tax positions and the utilization of foreign tax credits. The differences between the effective rate and the U.S. federal statutory rate for the six months ended June 30, 2010 were primarily attributed to decreases in tax

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liabilities associated with uncertain tax positions and the utilization of foreign tax credits, offset by foreign subsidiary net losses for which no tax benefit is currently being recognized, and a large foreign exchange gain recognized for financial reporting purposes but not for income tax purposes recognized in the first quarter of 2010. The differences between the effective rate and the federal statutory rate for the three and six months ended June 30, 2009 were primarily attributed to increases in tax liabilities associated with uncertain tax positions, the U.S. impact of foreign operations, and increases in foreign valuation allowances primarily related to foreign subsidiary net losses for which no tax benefit was recognized. With the Company's relatively low pretax income amounts, tax amounts recorded related to the uncertain tax positions, foreign operations and other permanent tax items have a significant impact on the effective tax rate.

As of June 30, 2010, the Company had accrued \$13,743 (net of \$15,385 of other assets related to competent authority and royalty benefits) related to unrecognized tax positions compared with \$19,643 (net of \$15,385 of other assets related to competent authority and royalty benefits) as of December 31, 2009. This net decrease was primarily attributed to the devaluation of the bolivar in Venezuela and to the expiration of the statute of limitations on certain liabilities in various foreign jurisdictions.

In October 2009, the Internal Revenue Service ( IRS ) issued an examination report formally proposing adjustments with respect to the 2003 through 2005 taxable years, which primarily relate to the prices that were charged in intra-group transfers of property and the disallowance of related deductions. The Company has commenced administrative proceedings with the Office of Appeals of the Internal Revenue Service challenging the proposed adjustments. Management believes that the Company has appropriately reserved for these matters at an amount which it believes will ultimately be due upon resolution of the administrative proceedings. The Company is currently unable to determine the outcome of these discussions and their related impact, if any, on the Company's financial condition, results of operations, or cash flows.

The IRS is also examining the Company's tax returns for the taxable years 2006 through 2008. The Company's U.S. federal income tax returns are open from 2003 to 2008, and the Company has several foreign jurisdictions that have open years between 2003 and 2008.

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

**(10) Commitments and Contingencies**

**Legal Proceedings**

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

*Class-Action Litigation*

As referenced in the Company's Annual Report on Form 10-K for the year ended December 31, 2009, the Company and certain present and former officer and directors were defendants in a shareholder class action filed in 2006 in the United States District Court for the District of Utah (the Court). The parties to this litigation and the Company's directors and officers' liability insurer signed a Stipulation of Settlement, which the Court preliminarily approved on October 8, 2009. Following the notification and claim periods stipulated by the Court, the Court, on February 10, 2010, the day after it held the final approval hearing, formally entered an Order and Final Judgment dated February 9, 2010 (Final Judgment), which gave final approval to the Stipulation and approved the proposed plan of allocation of the settlement proceeds, the application for an award of attorneys' fees and reimbursement of costs and expenses by the settlement class counsel, and the application for incentive awards to the settlement class representatives. Among other things, the Final Judgment also included findings by the Court that notice of the action and of the proposed settlement had been properly given to the class members and that no one had opted out of the class or objected to any of the terms of the Stipulation. Furthermore, the Final Judgment provided that the Company and the individual defendants were released from all of the Released Claims, as defined by the Stipulation, and that the Consolidated Complaint was dismissed with prejudice.



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There was no appeal of the Final Judgment within 30 days following the entry of the Final Judgment. As a result, the case is now formally concluded and the Claims Administrator is proceeding with distribution of the settlement proceeds in accordance with the Stipulation.

***Derivative Lawsuits***

By letter dated October 4, 2007, a shareholder of the Company alleged that a number of the current and former officers and directors of the Company breached their fiduciary duties to the Company by supposedly engaging in the same alleged wrongdoing that was the subject of the class-action lawsuit. The shareholder demanded that the Company take action to recover from the specified officers and directors all damages sustained by the Company as a result of the alleged misconduct, and threatened to commence a derivative action if the Company failed to act on the shareholder's demand within a reasonable period of time.

On December 26, 2007, before the expiration of the Company's allotted 90-day period for responding to the demand, the shareholder presented a second but substantially identical demand on the Company, thereby triggering a new 90-day response period. The Company's Board of Directors responded to this demand on March 20, 2008, rejecting the shareholder's demands.

On May 21, 2008, the same shareholder filed a summons and complaint in the Fourth Judicial District Court for the State of Utah seeking an order compelling the Company to produce certain books and records to the shareholder. The Company filed its answer to the complaint on June 12, 2008, and the shareholder has taken no action since then to prosecute the case or otherwise pursue any derivative claim. On April 22, 2010, the Court issued an order requiring the parties to appear and show cause why the case should not be dismissed for failure to prosecute. On June 11, 2010, the Court held a hearing based on its order requiring the parties to show cause, and at the conclusion of this hearing, the Court dismissed the case with prejudice, formally concluding this litigation.

***Other Litigation***

The Company is party to various other legal proceedings in several foreign jurisdictions related to VAT assessments and other civil litigation. While there is a reasonable possibility that a material loss may be incurred, the Company cannot at this time estimate the loss, if any; therefore, no provision for losses has been provided. The Company believes future payments related to these matters could range from \$0 to approximately \$1,400.

**Non-Income Tax Contingencies**

The Company has reserved for certain state sales and use tax and foreign non-income tax contingencies based on the likelihood of an obligation in accordance with accounting guidance for probable loss contingencies. Loss contingency provisions are recorded for probable losses at management's best estimate of a loss, or when a best estimate cannot be made, a minimum loss contingency amount is recorded. The Company provides provisions for potential payments of tax to various tax authorities for contingencies related to non-income tax matters, including value added taxes and sales tax. The Company provides provisions for state sales taxes in each of the states where the Company has potential nexus. As of June 30, 2010 and December 31, 2009, accrued liabilities include \$12,822 and \$13,174, respectively, related to non-income tax

contingencies. While management believes that the assumptions and estimates used to determine this liability are reasonable, the ultimate outcome of those matters cannot presently be determined. The Company is not able at this time to predict the ultimate outcomes of those matters or to estimate the effect the ultimate outcomes, if greater than the amounts accrued, would have on the financial condition, results of operations, or cash flows of the Company.

### **Government Regulations**

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

Table of Contents**(11) Fair Value Measurements**

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

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

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

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

The following table presents the Company's hierarchy for its asset measured at fair value on a recurring basis as of June 30, 2010:

|  | Level 1<br>Quoted Prices<br>in Active<br>Markets for<br>Identical Assets | Level 2<br>Significant<br>Other<br>Observable<br>Inputs | Level 3<br>Significant<br>Unobservable<br>Inputs | Total    |
|--|--|---|--|----------|
| Investments available for sale                           | \$ 1,003   | \$ 2,119  | \$   | \$ 3,122 |
| Investment securities                                    | 1,786  |   |  | 1,786    |
| Total assets measured at fair value on a recurring basis | \$ 2,789   | \$ 2,119  | \$   | \$ 4,908 |

The following table presents the Company's hierarchy for its asset measured at fair value on a recurring basis as of December 31, 2009:

|  | Level 1<br>Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets | Level 2<br>Significant<br>Other<br>Observable<br>Inputs | Level 3<br>Significant<br>Unobservable<br>Inputs | Total    |
|--|---|---|--|----------|
| Investments available for sale                           | \$ 1,030  | \$ 2,137  | \$   | \$ 3,167 |
| Investment securities                                    | 1,752   |   |  | 1,752    |
| Total assets measured at fair value on a recurring basis | \$ 2,782  | \$ 2,137  | \$   | \$ 4,919 |

*Investments available for sale* The majority of the Company's investment portfolio consist of various fixed income securities such as U.S government funds, state and municipal bonds, mutual funds, and equity securities. The Level 1 securities are valued using quoted prices for identical assets in active markets including equity securities, U.S. government treasuries, and various mutual funds. The Level 2 securities

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include investments in state and municipal bonds whereby all significant inputs are observable or can be derived from or corroborated by observable market data for substantially the full term of the asset.

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

For the three months ended June 30, 2010 and 2009, there were no fair value measurements using significant unobservable inputs (Level 3).

The following table shows a reconciliation of the beginning and ending fair value measurements using significant unobservable inputs (Level 3) for the six months ended June 30, 2010 and 2009:

|   | 2010 | 2009     |
|---|------|----------|
| Balance at January 1,                     | \$   | \$ 2,050 |
| Net unrealized gains included in earnings |      |          |
| Sales of restricted investments           |      | (2,050)  |
| Purchases                                 |      |          |
| Balance at June 30,                       | \$   | \$       |

*Restricted investments* The Company's restricted investments included auction rate preferred investments that failed at auction during 2008. Despite the underlying long-term contractual maturity of auction-rate securities (ARS), there was historically a readily liquid market for these securities based on the interest reset mechanism. However, as a result of negative liquidity and

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uncertainty in financial credit markets, the Company experienced failed auctions associated with its ARS. In the case of a failed auction, the ARS become illiquid investments (until a future auction is successful or the security is called prior to the contractual maturity date by the issuer) and the rates are reset in accordance with terms in the prospectus/offering circular.

The ARS consisted primarily of AAA securities. In determining the fair value of the Company's restricted investments at December 31, 2008, the Company took into consideration fair values determined by the financial institutions, current credit rating of the underlying securities, insurance provisions, discounted cash flow analysis, as deemed appropriate, and its current liquidity position. These securities were sold in January 2009 at their estimated fair value.

The carrying amounts reflected on the consolidated balance sheet for cash and cash equivalents, restricted cash, accounts and notes receivable, accounts payable, and short-term borrowings approximate fair value due to their short-term nature. During the three months ended June 30, 2010, the Company did not have any write-offs related to the re-measurement of non-financial assets at fair value on a nonrecurring basis subsequent to their initial recognition.

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**Item 2.**  
***OPERATIONS***

***MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF***

The following Management's Discussion and Analysis should be read in conjunction with the unaudited consolidated financial statements and notes thereto included in this report, as well as the consolidated financial statements, the notes thereto, and management's discussion and analysis included in our Annual Report on Form 10-K for the year ended December 31, 2009, and our Reports on Form 8-K, that have been filed with the SEC since then through the date of this report.

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

**OVERVIEW**

Nature's Sunshine Products, Inc. and its subsidiaries are primarily engaged in the manufacturing and marketing of herbal products, vitamin and mineral supplements, personal care, and miscellaneous other products. Nature's Sunshine Products, Inc. is a Utah corporation with its principal place of business in Provo, Utah. We sell our products to a sales force of independent Distributors and Managers who use the products themselves or resell them to other Distributors or consumers. The formulation, manufacturing, packaging, labeling, advertising, distribution and sale of each of our major product groups are subject to regulation by one or more governmental agencies.

We market our products in the United States, Mexico, Central America, Canada, Venezuela, the Dominican Republic, Japan, Ecuador, the United Kingdom, Colombia, Peru, Israel, Russia, Ukraine, Latvia, Lithuania, Kazakhstan, Mongolia, Belarus, China, Poland, and Brazil. We also export our products to several other countries, including Argentina, Australia, Chile, New Zealand, and Norway.

We also sell our products through a separate division and operating business segment, Synergy Worldwide, which was acquired by us in 2000. Synergy Worldwide offers products with formulations different from those of the Nature's Sunshine Products offerings. In addition, Synergy Worldwide's marketing and Distributor compensation plans are sufficiently different from those of Nature's Sunshine Products to warrant accounting for these operations as a separate business segment. Synergy Worldwide sells products in Japan, the United States, South Korea, Singapore, Thailand, Taiwan, Malaysia, Hong Kong, the Philippines, Indonesia, the United Kingdom, Germany, Austria, the Netherlands, Norway, Sweden, Australia, the Czech Republic, and Vietnam.

During the second quarter of 2010, we experienced an increase in our consolidated net sales of 3.8 percent. Our Nature's Sunshine Products International business segment (NSP International) experienced an increase in net sales of approximately 5.3 percent compared to the same period in 2009 (or 7.9 percent excluding the negative impact of foreign currency fluctuations), while our domestic business segment (NSP United States) net sales decreased approximately 5.2 percent. Our Synergy Worldwide business segment (Synergy Worldwide) experienced an increase in net sales revenue of approximately 27.4 percent (or 22.6 percent excluding the positive impact of foreign currency fluctuations). Within our foreign markets, we saw improvements due to the weakening of the U.S. dollar against many of the foreign currencies in which our subsidiaries operate and its positive impact on consumer demand in these markets, as well as strengthening demand in certain foreign markets as a result of current economic conditions, and growth from expansion into new or existing markets. The most significant positive impact on sales revenue was from our United States (Synergy), European, Russian, Canadian, and Mexican markets during the second quarter of 2010. Gains in these markets were offset by decreases in Venezuela due to the devaluation of its currency of 2.0 percent of consolidated sales, as well as

continued weakness in our Japanese markets.

Over the same period, our cost of goods sold increased as a percentage of net sales revenue primarily as a result of inventory write-offs in some of our foreign markets and increased importation costs related to higher product transfer prices. Our selling, general and administrative expenses decreased slightly for the quarter.

We distribute our products to consumers through an independent sales force comprised of Managers and Distributors. A person who joins our independent sales force begins as a Distributor. A Distributor interested in earning additional income by committing more time and effort to selling our products may earn Manager status. Manager status is contingent upon attaining certain purchase volume levels, recruiting additional Distributors, and demonstrating leadership abilities. Active Managers worldwide totaled approximately 30,600 and 29,900 at June 30, 2010 and March 31, 2010, respectively. Active Distributors worldwide totaled approximately 687,500 and 693,200 at June 30, 2010 and March 31, 2010, respectively.

Table of Contents**RESULTS OF OPERATIONS**

The following table summarizes our unaudited consolidated operating results in U.S. dollars and as a percentage of net sales for the three months ended June 30, 2010 and 2009 (dollar amounts in thousands).

|                                       | 2010             |                         | 2009             |                         | Change from<br>2010 to 2009 |            |
|---------------------------------------|------------------|-------------------------|------------------|-------------------------|-----------------------------|------------|
|                                       | Total<br>dollars | Percent of<br>net sales | Total<br>dollars | Percent of<br>net sales | Dollar                      | Percentage |
| Net sales revenue                     | \$ 87,358        | 100.0%                  | \$ 84,149        | 100.0%                  | \$ 3,209                    | 3.8%       |
| Cost of goods sold                    | 16,845           | 19.3                    | 15,787           | 18.8                    | 1,058                       | 6.7        |
| Volume incentives                     | 32,559           | 37.3                    | 31,217           | 37.1                    | 1,342                       | 4.3        |
| SG&A expenses                         | 34,995           | 40.0                    | 35,089           | 41.7                    | (94)                        | (0.3)      |
| Total operating expenses              | 84,399           | 96.6                    | 82,093           | 97.6                    | 2,306                       | 2.8        |
| Operating income                      | 2,959            | 3.4                     | 2,056            | 2.4                     | 903                         | 43.9       |
| Other (expense) income, net           | (937)            | (1.1)                   | 544              | 0.7                     | (1,481)                     | (272.2)    |
| Income before income tax<br>provision | 2,022            | 2.3                     | 2,600            | 3.1                     | (578)                       | (22.2)     |
| Income tax provision                  | 968              | 1.1                     | 1,066            | 1.3                     | (98)                        | (9.2)      |
| Net income                            | \$ 1,054         | 1.2%                    | \$ 1,534         | 1.8%                    | (480)                       | (31.3)%    |

The following table summarizes our unaudited consolidated operating results in U.S. dollars and as a percentage of net sales for the six months ended June 30, 2010 and 2009 (dollar amounts in thousands).

|   | 2010             |                         | 2009             |                         | Change from<br>2010 to 2009 |            |
|---|------------------|-------------------------|------------------|-------------------------|-----------------------------|------------|
|   | Total<br>dollars | Percent of<br>net sales | Total<br>dollars | Percent of<br>net sales | Dollar                      | Percentage |
| Net sales revenue                               | \$ 174,404       | 100.0%                  | \$ 167,325       | 100.0%                  | \$ 7,079                    | 4.2%       |
| Cost of goods sold                              | 34,846           | 20.0                    | 33,334           | 19.9                    | 1,512                       | 4.5        |
| Volume incentives                               | 65,123           | 37.3                    | 62,213           | 37.2                    | 2,910                       | 4.7        |
| SG&A expenses                                   | 71,458           | 41.0                    | 72,566           | 43.4                    | (1,108)                     | (1.5)      |
| Total operating expenses                        | 171,427          | 98.3                    | 168,113          | 100.5                   | 3,314                       | 2.0        |
| Operating income (loss)                         | 2,977            | 1.7                     | (788)            | (0.5)                   | 3,765                       | 477.8      |
| Other income, net                               | 1,898            | 1.1                     | 1,748            | 1.1                     | 150                         | 8.6        |
| Income before income tax<br>(benefit) provision | 4,875            | 2.8                     | 960              | 0.6                     | 3,915                       | 407.8      |
| Income tax (benefit)<br>provision               | (332)            | (0.2)                   | 888              | 0.5                     | (1,220)                     | (137.4)    |
| Net income                                      | \$ 5,207         | 3.0%                    | \$ 72            | 0.1%                    | \$ 5,135                    | 7,131.9%   |

**Net Sales Revenue**



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Consolidated net sales revenue for the three and six months ended June 30, 2010 was \$87.4 million and \$174.4 million compared to \$84.1 million and \$167.3 million for the same periods in 2009, increases of approximately 3.8 percent and 4.2 percent, respectively. The increase in net sales revenue for the three and six months ended June 30, 2010 compared to the same periods in 2009 was due to improvements within our NSP International and Synergy Worldwide segments, offset by a decline in NSP United States.

### NSP United States

Net sales revenue related to NSP United States for the three and six months ended June 30, 2010 was \$37.5 million and \$75.3 million compared to \$39.5 million and \$76.0 million for the same periods in 2009, or decreases of 5.2 percent and 0.9 percent, respectively, in 2010 compared to 2009. We saw decreases in net sales revenue compared to the same time in the prior year due to changes in our promotional programs, which resulted in lower than expected Manager and Distributor recruiting and retention, and changes in the timing of event qualification periods, which reduced average Manager and Distributor purchases during the second quarter of 2010, as well as some continuing weakness in the U.S. economy.

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Active Managers within NSP United States totaled approximately 7,300 and 7,200 at June 30, 2010 and March 31, 2010, respectively. Active Distributors within NSP United States totaled approximately 247,400 and 251,000 at June 30, 2010 and March 31, 2010, respectively.

### NSP International

NSP International reported net sales revenue for the three and six months ended June 30, 2010 of \$33.3 million and \$68.5 million compared to \$31.6 million and \$65.2 million for the same periods in 2009, or increases of approximately 5.3 percent and 5.2 percent, respectively. The increase in net sales revenue for the three and six months ended June 30, 2010 compared to the same periods in 2009 is primarily due to the weakening of the U.S. dollar against many of the foreign currencies in which our subsidiaries operate and its positive impact on consumer demand in these markets, as well as strengthening demand in certain foreign markets as a result of current economic conditions. The most significant positive impact on sales revenue was from our Russian, Canadian, and Mexican markets, during the 2010 second quarter and the year-to-date. The improvements in many of our markets were offset by a decrease in Venezuela due to the devaluation of its currency.

We had the following significant changes within the markets in which NSP International operates:

In our Russian markets, our net sales revenues increased approximately \$1.2 million, or 10.6 percent, to \$12.5 million for the three months ended June 30, 2010, from \$11.3 million for the same period in 2009. For the six months ended June 30, 2010, net sales revenue increased \$1.9 million, or 7.4 percent, to \$27.5 million in 2010 from \$25.6 million for the same period in 2009. In our Russian markets, our products are priced using the U.S. dollar. The strengthening of the U.S. dollar in relation to the various local currencies in the region (primarily the Russian ruble and the Ukrainian hryvnia) during the prior year significantly increased the price of our products in the prior year and therefore reduced demand. Since that time, the relative price of our products has slightly decreased as the U.S. dollar has weakened and the economies of some of the countries in this market have begun to recover during 2010, contributing to increasing demand. In addition, improved Manager and Distributor recruiting efforts and the launch of several new products contributed to revenue growth in this market.

In Canada, our net sales revenues increased approximately \$0.6 million, or 17.6 percent, to \$4.0 million for the three months ended June 30, 2010, from \$3.4 million for the same period in 2009. For the six months ended June 30, 2010, net sales revenue increased \$1.4 million, or 21.5 percent, to \$7.9 million in 2010 from \$6.5 million for the same period in 2009. Our net sales in Canada for the three and six months ended in 2010 were positively affected by approximately \$0.5 million, or 14.7 percent, and by \$1.1 million, or 16.9 percent, by foreign currency fluctuations due to the U.S. dollar weakening in 2010 in relation to the Canadian dollar from the same periods in 2009. Excluding the effect of foreign currency fluctuations, net sales in Canada increased approximately \$0.1 million, or 2.9 percent, and \$0.3 million, or 4.6 percent, for the three and six months ended June 30, 2010, respectively, compared to the same periods in 2009.

In Mexico, our net sales revenues increased approximately \$0.5 million, or 14.3 percent, to \$4.0 million for the three months ended June 30, 2010, from \$3.5 million for the same period in 2009. For the six months ended June 30, 2010, net sales revenue increased \$0.9 million, or 13.6 percent, to \$7.5 million in 2010 from \$6.6 million for the same period in 2009. Our net sales in Mexico for the three and six months ended in 2010 were positively affected by approximately \$0.2 million, or 5.7 percent, and \$0.6 million, or 9.1 percent, by foreign currency fluctuations due to the U.S. dollar weakening in 2010 in relation to the Mexican peso from the same periods in 2009. Excluding the effect of foreign currency fluctuations, net sales in Mexico increased approximately \$0.3 million, or 8.6 percent and 4.5 percent, for both the three and six months ended June 30, 2010, respectively, compared to the same periods in 2009.

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In Venezuela, our net sales revenues decreased approximately \$1.3 million, or 44.8 percent, to \$1.6 million for the three months ended June 30, 2010, from \$2.9 million for the same period in 2009. For the six months ended June 30, 2010, net sales revenue decreased \$3.0 million, or 50.0 percent, to \$3.0 million in 2010 from \$6.0 million for the same period in 2009. The decrease in our sales for the quarter and year-to-date in Venezuela was primarily the result of Venezuela's currency, the bolivar fuerte ( bolivar ), being devalued from an official rate of 2.15 bolivars to the U.S. dollar to 4.30 bolivars in January of this year. As a result, net sales revenues in Venezuela have been significantly reduced since that time. Excluding the effect of foreign currency fluctuations, net sales revenues in Venezuela increased approximately \$0.3 million and decreased approximately \$0.1 million, or 10.3 percent and 1.7 percent, for the three and six months ended June 30, 2010, respectively, compared to the same periods in 2009.

In the remaining markets in which NSP International operates, our net sales revenues increased approximately \$0.7 million and \$2.1 million, or 6.7 percent and 10.2 percent, to \$11.2 million and \$22.6 million for the three and six months ended June 30, 2010, respectively, from \$10.5 million and \$20.5 million for the same periods in 2009. Our net sales for the three and six months ended were positively affected in 2010 by approximately \$0.4 million, or 3.8 percent, and \$1.0 million, or 4.9 percent, due to foreign currency fluctuations resulting from the U.S. dollar weakening in relation to the various currencies in the markets in which we operate

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from the same periods in 2009. Excluding the effect of foreign currency fluctuations, net sales revenues in NSP International's remaining markets increased approximately \$0.3 million and \$1.1 million, or 2.9 percent and 5.4 percent, for the three and six months ended June 30, 2010, respectively, compared to the same periods in 2009.

Active Managers within NSP International totaled approximately 21,300 and 21,000 at June 30, 2010 and March 31, 2010, respectively. Active Distributors within NSP International totaled approximately 361,000 and 367,500 at June 30, 2010 and March 31, 2010, respectively.

Synergy Worldwide

Synergy Worldwide net sales revenue increased to \$16.6 million and \$30.6 million for the three and six months ended June 30, 2010, compared to \$13.0 million and \$26.2 million for the same periods in 2009, increases of approximately 27.4 percent and 16.7 percent, respectively. The increase in sales for the three and six months was primarily due to improvements in sales in our European markets and the United States, the opening of our Vietnam market, as well as positive currency fluctuations due to the weakening of the U.S. dollar in relation to many of the local currencies in the markets in which we operate, offset by sales declines in our Japanese and Indonesian markets.

We had the following significant changes within the markets in which Synergy Worldwide operates:

In the United States, our net sales revenues increased approximately \$2.1 million, or 116.7 percent, to \$3.9 million for the three months ended June 30, 2010, from \$1.8 million for the same period in 2009. For the six months ended June 30, 2010, net sales revenue increased \$3.3 million, or 106.5 percent, to \$6.4 million from \$3.1 million for the same period in 2009. Our growth within the United States is primarily due to growth of our U.S. Distributor base.

In Europe, our net sales revenues increased approximately \$1.2 million, or 75.0 percent, to \$2.8 million for the three months ended June 30, 2010 from \$1.6 million for the same period in 2009. For the six months ended June 30, 2010, net sales revenue increased \$2.7 million, or 103.8 percent, to \$5.3 million from \$2.6 million for the same period in 2009. Our net sales in Europe were negatively affected by approximately \$0.2 million, or 12.5 percent, for the three months ended June 30, 2010 by foreign currency fluctuations due to the U.S. dollar strengthening in relation to the euro from 2009 to 2010, and were flat for the year-to-date. Excluding the effect of foreign currency fluctuations, net sales in Europe increased approximately \$1.4 million, or 87.5 percent, and \$2.7 million, or 103.8 percent, for the three and six months ended June 30, 2010, respectively, compared to the same periods in 2009 due to the continued growth of our operations.

In Korea, our net sales revenues increased approximately \$0.6 million, or 33.3 percent, to \$2.4 million for the three months ended June 30, 2010 from \$1.8 million for the same period in 2009. For the six months ended June 30, 2010, net sales revenue increased \$1.6 million, or 55.2 percent, to \$4.5 million from \$2.9 million for the same period in 2009. Our net sales in Korea for the three and six months ended in 2010 were positively affected by approximately \$0.3 million, or 16.7 percent, and \$0.6 million, or 20.7 percent, by foreign currency fluctuations due to the U.S. dollar weakening in 2010 in relation to the Korean won from the same periods in 2009. Excluding the effect of foreign currency fluctuations, net sales in Korea increased approximately \$0.3 million, or 16.7 percent, and \$1.0 million, or 34.5 percent, for the three and six months ended June 30, 2010, respectively, compared to the same periods in 2009.

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We launched our operations in the Vietnam market during the second quarter, which achieved net sales of \$0.7 million.

In Japan, our net sales revenues decreased approximately \$1.2 million, or 24.5 percent, to \$3.7 million for the three months ended June 30, 2010, from \$4.9 million for the same period in 2009. For the six months ended June 30, 2010, net sales revenue decreased \$2.4 million, or 23.5 percent, to \$7.8 million in 2010 from \$10.2 million for the same period in 2009. Our net sales in Japan for the three and six months ended in 2010 were positively affected by approximately \$0.2 million, or 4.1 percent, and by \$0.3 million, or 2.9 percent, by foreign currency fluctuations due to the U.S. dollar weakening in relation to the Japanese yen from the same periods in 2009 to 2010. Excluding the effect of foreign currency fluctuations, net sales in Japan decreased approximately \$1.4 million, or 28.6 percent, and \$2.7 million or 26.5 percent, for the three and six months ended June 30, 2010, respectively, compared to the same periods in 2009. The decrease in net sales was primarily due to import restrictions on several of our key products, strong competition, and continuing economic weakness in Japan, which resulted in a decrease in the number of active Managers and Distributors.

In Indonesia, our net sales revenues decreased approximately \$0.3 million, or 16.7 percent, to \$1.5 million for the three months ended June 30, 2010, from \$1.8 million for the same period in 2009. For the six months ended June 30, 2010, net sales revenue decreased \$2.0 million, or 40.0 percent, to \$3.0 million in 2010 from \$5.0 million for the same period in 2009. Our net sales in Indonesia for the three and six months ended 2010 were positively affected by approximately \$0.2 million, or 11.1 percent, and by \$0.5 million, or 10.0 percent, by foreign currency fluctuations due to the U.S. dollar weakening in 2010 in relation to the Indonesian

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rupiah from the same periods in 2009. Excluding the effect of foreign currency fluctuations, net sales in Indonesia decreased approximately \$0.5 million, or 27.8 percent, and \$2.5 million, or 50.0 percent, for the three and six months ended June 30, 2010, compared to the same periods in 2009. The decrease in net sales compared to the same periods in the prior year was primarily due to significant price increases in the prior year, which resulted in large purchases mainly in the first quarter of 2009 before the price increases took effect.

In the remaining markets in which Synergy Worldwide operates, our net sales revenues increased approximately \$0.5 million and \$0.5 million, or 45.5 percent and 20.8 percent, to \$1.6 million and \$2.9 million for the three and six months ended June 30, 2010, respectively, from \$1.1 million and \$2.4 million for the same periods in 2009. Our net sales for the three and six months ended June 30, 2010 were positively affected by approximately \$0.2 million, or 18.2 percent, and \$0.4 million, or 16.7 percent, due to foreign currency fluctuations resulting from the U.S. dollar weakening in relation to the various currencies our markets operate in from the same periods in 2009. Excluding the effect of foreign currency fluctuations, net sales revenue in Synergy Worldwide's remaining markets increased approximately \$0.3 million, or 27.3 percent, and \$0.1 million, or 4.2 percent, for the three and six months ended June 30, 2010, respectively, compared to the same periods in 2009.

Active Managers within Synergy Worldwide totaled approximately 2,000 and 1,700 at June 30, 2010 and March 31, 2010, respectively. Active Distributors within Synergy Worldwide totaled approximately 79,100 and 74,700 at March 31, 2010 and December 31, 2009, respectively.

Further information related to NSP United States, NSP International and Synergy Worldwide is set forth in Note 8 to the Unaudited Condensed Consolidated Financial Statements in Part 1, Item 1 of this report.

**Cost of Goods Sold**

Cost of goods sold as a percent of net sales revenue increased to 19.3 percent and 20.0 percent of net sales for the three and six months ended June 30, 2010, compared to 18.8 percent and 19.9 percent for the same periods in 2009. This increase is primarily due to write-offs of finished products in some of our foreign markets, increased importation fees related to higher transfer prices within some of our foreign markets during the current quarter, and changes in product mix between markets.

**Volume Incentives**

Volume incentives are a significant part of our direct sales marketing program and represent commission payments made to our independent Distributors and Managers. These payments are designed to provide incentives for reaching higher sales levels and for recruiting additional Distributors. Volume incentives vary slightly, on a percentage basis, by product due to our pricing policies and commission plans in place in our international operations. Volume incentives as a percent of net sales revenue increased to 37.3 percent for each of the three and six months ended June 30, 2010, compared to 37.1 percent and 37.2 percent for the same periods in 2009.

**Selling, General and Administrative**

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Selling, general and administrative expenses decreased to 40.0 percent and 41.0 percent of net sales for the three and six months ended June 30, 2010, compared to 41.7 percent and 43.4 percent for the same periods in 2009. For the three months ended June 30, 2010, expenses decreased by approximately \$0.1 million, from \$35.1 million in 2009 to \$35.0 million in 2010, and for the six months ended June 30, 2010 expenses decreased by approximately \$1.1 million, from \$72.6 million in 2009 to \$71.5 million in 2010. The decrease in year-to-date selling, general and administrative expenses is the result of decreased costs in Synergy Worldwide's Japanese and Indonesian markets of \$1.3 million due to efforts to reduce costs, decreases in NSP United States related to the prior year settlement with the SEC of \$0.6 million, and decreases in administrative costs within Venezuela of approximately \$1.4 million, which are primarily the result of the significant devaluation of the bolivar. These decreases were offset by increased costs of \$0.9 million as a result of our further expansion of our markets in Synergy Worldwide Europe and Vietnam, and \$1.9 million of negative foreign currency fluctuations (excluding Venezuela) due to the weakening of the U.S. dollar in relation to many of the markets in which we operate, as well as additional declines throughout the U.S. and our remaining markets as we continue to reduce our professional and other operating costs. We continue to implement cost reduction measures within all of our operating segments.

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**Operating Income (Loss)**

Operating income increased \$0.9 million during the three months ended June 30, 2010, compared to the same period in 2009, from \$2.1 million to \$3.0 million. For the six months ended June 30, 2010, operating income increased \$3.7 million compared to the same period in 2009, from an operating loss of \$0.7 million to operating income of \$3.0 million.

The operating income for NSP United States decreased \$1.4 million and \$0.2 million for the three and six month periods ended June 30, 2010 from \$3.5 million and \$2.6 million for the same periods in 2009 to \$2.1 million and \$2.4 million in 2010, respectively. The decrease for the quarter and year-to-date sales is primarily the result of the reduced sales described above.

Operating income for NSP International increased \$1.4 million and \$0.1 million for the three and six months ended June 30, 2010 from an operating loss of \$0.5 million and operating income of \$1.1 million for the same periods in 2009 to operating income of \$0.9 million and \$1.2 million, respectively, in 2010. These increases were the result of increased sales for the quarter and year-to-date as described above.

The operating loss in Synergy Worldwide decreased \$1.0 million and \$3.8 million for the three and six months ended June 30, 2010, from operating losses of \$1.0 million and \$4.5 million in 2009 to above breakeven and an operating loss of \$0.7 million, for the same periods in 2010, respectively. This was primarily due to improvements in sales within its European and U.S subsidiaries, the opening of a new market in Vietnam, and adjustments to the costs of some of its products in certain markets due to changes in transfer prices from NSP United States, as well as significant cost reductions made throughout the course of 2009, and the impact of favorable currency fluctuations.

**Other Income (Expense), Net**

Other income (expense), net for the three and six months ended June 30, 2010 decreased \$1.5 million, or 272.2 percent, and increased \$0.2 million, or 8.6 percent, compared to the same periods in 2009. The decrease in other income during the second quarter is primarily related to the write-down of our restricted cash balance of \$0.5 million, while the increase in year-to-date other income is primarily due to foreign exchange gains of \$3.7 million in Venezuela as a result of the devaluation of the bolivar and the change to a highly inflationary economy. These gains were offset by net foreign exchange gains and losses in certain of our other markets based on changes in exchange rates.

**Income Taxes**

Interim income taxes are based on an estimated annualized effective tax rate applied to the respective quarterly periods, adjusted for discrete tax items in the period in which they occur. For the three months ended June 30, 2010 and 2009, the Company's provision for income taxes, as a percentage of income before income taxes, was approximately 47.9 percent and 41.0 percent, respectively, compared with a U.S. federal statutory rate of 35.0 percent. For the six months ended June 30, 2010 and 2009, the Company's income tax (benefit) provision was approximately (6.8) percent and 92.5 percent as a percentage of pre-tax income, respectively, compared with a U.S. federal statutory rate of 35.0 percent.



The differences between the effective rate and the U.S. federal statutory rate for the three months ended June 30, 2010 were primarily attributed to increases due to foreign subsidiary net losses for which no tax benefit is currently being recognized, offset by decreases in tax liabilities associated with uncertain tax positions and the utilization of foreign tax credits. The differences between the effective rate and the U.S. federal statutory rate for the six months ended June 30, 2010 were primarily attributed to decreases in tax liabilities associated with uncertain tax positions and the utilization of foreign tax credits, offset by foreign subsidiary net losses for which no tax benefit is currently being recognized, and a large foreign exchange gain recognized for financial reporting purposes but not for income tax purposes recognized in the first quarter of 2010. The differences between the effective rate and the federal statutory rate for the three and six months ended June 30, 2009 were primarily attributed to increases in tax liabilities associated with uncertain tax positions, the U.S. impact of foreign operations, and increases in foreign valuation allowances primarily related to foreign subsidiary net losses for which no tax benefit was recognized. With the Company's relatively low pretax income amounts, tax amounts recorded related to the uncertain tax positions, foreign operations and other permanent tax items have a significant impact on the effective tax rate.

In October 2009, the Internal Revenue Service ( IRS ) issued an examination report formally proposing adjustments with respect to the 2003 through 2005 taxable years, which primarily relate to the prices that were charged in intra-group transfers of property and the disallowance of related deductions. The Company has commenced administrative proceedings with the Office of Appeals of the Internal Revenue Service challenging the proposed adjustments. Management believes that the Company has appropriately reserved for these matters at an amount which it believes will ultimately be due upon resolution of the administrative

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proceedings. The Company is currently unable to determine the outcome of these discussions and their related impact, if any, on the Company's financial condition, results of operations, or cash flows.

The IRS is also examining the Company's tax returns for the taxable years 2006 through 2008. The Company's U.S. federal income tax returns are open from 2003 to 2008, and the Company has several foreign jurisdictions that have open years between 2003 and 2008.

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

**LIQUIDITY AND CAPITAL RESOURCES**

Our principal use of cash is to pay for operating expenses, including Volume Incentives, inventory purchases, capital assets, and funding of international expansion. As of June 30, 2010, working capital was \$35.4 million, compared to \$33.5 million as of December 31, 2009. At June 30, 2010, we had \$40.0 million in cash and cash equivalents, of which \$35.5 is held in our foreign markets and may be subject to various withholding taxes and other restrictions related to repatriation, and \$3.1 million is held in unrestricted short-term investments, which were available to be used along with our normal cash flows from operations to fund any unanticipated shortfalls in future cash flows.

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

|                      | <b>Six Months Ended June 30,</b> |             |
|----------------------|----------------------------------|-------------|
|                      | <b>2010</b>                      | <b>2009</b> |
| Operating activities | \$ 5,381                         | \$ (3,002)  |
| Investing activities | (1,286)                          | 863         |
| Financing activities | 27                               | 190         |

For the six months ended June 30, 2010, we generated cash from operating activities of \$5.4 million compared to using \$3.0 million during the same period in 2009. The increase in cash generated from operating activities was primarily due to improvements in operating income for the six months ended June 30, 2010 compared to the same period in the prior year, which excludes non-cash foreign exchange gains and losses included in other income. In addition, operating cash flow improved as a result of the timing of payments for accounts payable and volume incentives.

Capital expenditures related to the purchase of equipment, computer systems and software for the six months ended June 30, 2010 and 2009, were \$1.3 million and \$1.8 million, respectively.

During the six months ended June 30, 2009, we also had cash proceeds of \$2.1 million from the sale of restricted investments and \$0.6 million of available-for-sale investments. During the six months ended June 30, 2010, we did not buy or sell any available-for-sale investments.

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During the six months ended June 30, 2009, we used cash to pay dividends of \$0.8 million. We suspended the payment of our quarterly cash dividends, effective the second quarter of 2009, in an effort to conserve cash in the United States.

We believe that our working capital requirements can be met for the foreseeable future through our available cash and cash equivalents, and cash generated from operating activities. However, a prolonged economic downturn, a decrease in the demand for our products, the unfavorable settlement of our unrecognized tax positions or non-income tax contingencies could adversely affect our long-term liquidity. In the event of a significant decrease in cash provided by our operating activities, it might be necessary for us to obtain additional external sources of funding.

We do not currently maintain a long-term credit facility or any other external sources of long-term funding; however, we are exploring the possibility of establishing a long-term credit facility and believe that such funding can be established with competitive terms in the event additional sources of funds become necessary.

During the six months ended June 30, 2009, we had short-term borrowings of \$3.7 million and repayments of \$2.7 million from our investment brokerage secured by our available-for-sale investments in order to generate additional liquidity from month-to-month based upon our working capital needs. We have the ability to borrow up to approximately 80 percent of the fair value of our municipal obligations within our available-for-sale investments. These borrowings began in 2009 and were typically paid in the month following the initial borrowing.

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**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

Our unaudited consolidated financial statements have been prepared in accordance with U.S. GAAP and form the basis for the following discussion and analysis on critical accounting policies and estimates. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On a regular basis we evaluate our estimates and assumptions. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from these estimates and those differences could have a material effect on our financial position and results of operations. Management has discussed the development, selection and disclosure of these estimates with the Board of Directors and its Audit Committee.

A summary of our significant accounting policies is provided in Note 1 of the Notes to Consolidated Financial Statements in Item 8 of our Annual Report on Form 10-K for the year ended December 31, 2009. We believe the critical accounting policies and estimates described below reflect our more significant estimates and assumptions used in the preparation of our consolidated financial statements. The impact and any associated risks on our business that are related to these policies are also discussed throughout this Management's Discussion and Analysis of Financial Condition and Results of Operations where such policies affect reported and expected financial results.

*Revenue Recognition*

Net sales revenue and related volume incentive expenses are recorded when persuasive evidence of an arrangement exists, collectability is reasonably assured, the amount is fixed and determinable, and title and risk of loss have passed, generally when the merchandise has been delivered. The amount of the volume incentive is determined based upon the amount of qualifying purchases in a given month. It is necessary for the Company to make estimates about the timing of when merchandise has been delivered. These estimates are based upon the Company's historical experience related to time in transit, timing of when shipments occurred, and shipping volumes. Amounts received for undelivered merchandise are recorded as deferred revenue. From time to time, the Company's United States operation extends short-term credit associated with product promotions. In addition, for certain of the Company's international operations, the Company offers credit terms consistent with industry standards within the country of operation. Payments to Distributors and Managers for sales incentives or rebates are recorded as a reduction of revenue. Payments for sales incentives and rebates are calculated monthly based upon qualifying sales. Membership fees are recorded as revenue over the life of the membership, primarily one year. Prepaid event registration fees are deferred and recognized as revenues when the related event is held.

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

*Investments*

The Company's available-for-sale investment portfolio is recorded at fair value and consists of various fixed income securities such as U.S. government and state and municipal bonds, mutual funds, and equity securities. These investments are valued using (a) quoted prices for

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identical assets in active markets or (b) significant inputs that are observable or can be derived from or corroborated by observable market data for substantially the full term of the asset. The Company's trading portfolio is recorded at fair value and consists of various mutual funds that are valued using quoted prices in active markets.

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

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

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

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

*Inventories*

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

*Self-insurance Liabilities*

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

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

*Incentive Trip Accrual*

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

### *Impairment of Long-Lived Assets*

The Company reviews its long-lived assets, such as property, plant and equipment and intangible assets for impairment when events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. The Company uses an estimate of future undiscounted net cash flows of the related assets or groups of assets over their remaining lives in measuring whether the assets are recoverable. An impairment loss is calculated by determining the difference between the carrying values and the fair values of these assets. As of June 30, 2010 and December 31, 2009, the Company did not consider any of its long-lived assets to be impaired.

### *Contingencies*

We are involved in certain legal proceedings. When a loss is considered probable in connection with litigation or non-income tax contingencies and when a loss can be reasonably estimated with a range, we record our best estimate within the range related to the contingency. If there is no best estimate, we record the minimum of the range. As additional information becomes available, we assess the potential liability related to the contingency and revise the estimates. Revision in estimates of the potential liabilities could materially impact our results of operations in the period of adjustment. Our contingencies are discussed in further detail in Note 10, *Commitments and Contingencies*, to the Notes of our Condensed Consolidated Financial Statements, of Item 1, Part 1 of this report.

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*Income Taxes*

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

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

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

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

*Share-Based Compensation*

The Company recognizes all share-based payments to employees, including grants of employee stock options, to be recognized in the statement of operations based on their grant-dated fair values in accordance with authoritative U.S. GAAP. The Company records compensation expense, net of an estimated forfeiture rate, over the vesting period of the stock options based on the fair value of the stock options on the date of grant. The Company's estimated forfeiture rate is based upon historical experience.

**RECENT ACCOUNTING PRONOUNCEMENTS**

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

**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**



The Management's Discussion and Analysis of Financial Condition and Results of Operations and other sections of this report may contain forward-looking statements. Such forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and Section 21E of the Securities and Exchange Act. All statements other than statements of historical fact are forward-looking statements. Forward-looking statements may include, but are not limited to, statements relating to our objectives, plans and strategies. All statements (other than statements of historical fact) that address activities, events or developments that we intend, expect, project, believe or anticipate will or may occur in the future are forward-looking statements. These statements are often characterized by terminology such as believe, hope, may, anticipate, should, intend, plan, will, expect, estimate, project, positioned, strategy and similar terms, based on assumptions and assessments made by management in light of their experience and their perception of historical trends, current conditions, expected future developments and other factors they believe to be appropriate. Forward-looking statements are not guarantees of future performance and are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified. Future events and actual results could differ materially from those set forth in, contemplated by, or underlying the forward-looking statements.

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

- our relationship with and our ability to influence the actions of our independent Distributors and Managers;
- our ability to attract and retain a sufficient number of independent Distributors and Managers;
- changes in laws and regulations regarding network marketing that may prohibit or restrict our ability to sell our products in new or existing markets;

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- determinations regarding tax liabilities and required tax obligations in U.S. and foreign jurisdictions;
- our products and manufacturing activities are subject to extensive government regulations and restrictions;
- general economic conditions;
- an economic slowdown in the markets in which we do business could reduce consumer demand for our products;
- currency and exchange rate fluctuations could lower our revenue and net income;
- some of the markets in which we operate may become highly inflationary;
- some of the markets in which we operate have currency controls in place which restrict our ability to repatriate funds to the United States;
- the availability and integrity of raw materials could be compromised;
- geopolitical issues and conflicts could adversely affect our business;
- our business is subject to the effects of adverse publicity and negative public perception;
- changes in taxation and transfer pricing could affect our operations;
- our business is subject to intellectual property risks;

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

Additional factors that could cause actual results to differ materially from our forward-looking statements are set forth in this report and our Annual Report on Form 10-K for the fiscal year ended December 31, 2009 under the heading Risk Factors.

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

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

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

Table of Contents**Foreign Currency Risk**

During the six months ended June 30, 2010, approximately 54.5 percent of our net sales revenue and approximately 54.3 percent of our operating expenses were realized outside of the United States. Inventory purchases are transacted primarily in U.S. dollars from vendors located in the United States. The local currency of each international subsidiary is generally the functional currency, while certain regions, including Russia and the Ukraine, are served by a U.S. subsidiary through third party entities, for which all business is conducted in U.S. dollars. We conduct business in twenty-three different currencies with exchange rates that are not on a one-to-one relationship with the U.S. dollar. All revenues and expenses are translated at average exchange rates for the periods reported. Therefore, our operating results will be positively or negatively affected by a weakening or strengthening of the U.S. dollar in relation to another fluctuating currency. Given the uncertainty and diversity of exchange rate fluctuations, we cannot estimate the effect of these fluctuations on our future business, product pricing, results of operations, or financial condition, but we have provided consolidated sensitivity analyses below of functional currency/reporting currency exchange rate risks. Changes in various currency exchange rates affect the relative prices at which we sell our products. We regularly monitor our foreign currency risks and periodically take measures to reduce the risk of foreign exchange rate fluctuations on our operating results. We do not use derivative instruments for hedging, trading, or speculating on foreign exchange rate fluctuations. Additional discussion of the impact on the effect of currency fluctuations has been included in our management's discussion and analysis included in Part 1, Item 2 of this report.

The following table sets forth a composite sensitivity analysis of our net sales revenue, costs and expenses, and operating income in connection with strengthening of the U.S. dollar (our reporting currency) by 10%, 15% and 25% against every other fluctuating functional currency in which we conduct business. We note that while our individual net sales revenue and cost and expenses components were sensitive to increases in the strength of the U.S. dollar, our operating income was less sensitive to such increases assuming a strengthening of the U.S. dollar by 10%, 15% and 25% against every other fluctuating currency in which we conduct business.

Exchange rate sensitivity for the three months ended June 30, 2010 (dollar amounts in thousands)

|                                     |           | With Strengthening of U.S. Dollar by: |        |            |        |            |        |
|-------------------------------------|-----------|---------------------------------------|--------|------------|--------|------------|--------|
|                                     |           | 10%                                   |        | 15%        |        | 25%        |        |
|                                     |           | (\$)                                  | (%)    | (\$)       | (%)    | (\$)       | (%)    |
| Net sales revenue                   | \$ 87,358 | \$ (2,840)                            | (3.3)% | \$ (4,073) | (4.7)% | \$ (6,246) | (7.1)% |
| Cost and expenses                   |           |                                       |        |            |        |            |        |
| Cost of goods sold                  | 16,845    | (560)                                 | (3.3)  | (802)      | (4.8)  | (1,230)    | (7.3)  |
| Volume incentives                   | 32,559    | (1,109)                               | (3.4)  | (1,591)    | (4.9)  | (2,441)    | (7.5)  |
| Selling, general and administrative | 34,995    | (1,189)                               | (3.4)  | (1,705)    | (4.9)  | (2,614)    | (7.5)  |
| Operating income                    | \$ 2,959  | \$ 18                                 | 0.6%   | \$ 25      | 0.8%   | \$ 39      | 1.3%   |

Exchange rate sensitivity for the six months ended June 30, 2010 (dollar amounts in thousands)

|                   |            | With Strengthening of U.S. Dollar by: |        |            |        |             |        |
|-------------------|------------|---------------------------------------|--------|------------|--------|-------------|--------|
|                   |            | 10%                                   |        | 15%        |        | 25%         |        |
|                   |            | (\$)                                  | (%)    | (\$)       | (%)    | (\$)        | (%)    |
| Net sales revenue | \$ 174,404 | \$ (5,531)                            | (3.2)% | \$ (7,935) | (4.5)% | \$ (12,167) | (7.0)% |

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|                                     |                 |         |       |         |       |         |       |  |
|-------------------------------------|-----------------|---------|-------|---------|-------|---------|-------|--|
| Cost and Expenses                   |                 |         |       |         |       |         |       |  |
| Cost of goods sold                  | <b>34,846</b>   | (1,050) | (3.0) | (1,506) | (4.3) | (2,309) | (6.6) |  |
| Volume incentives                   | <b>65,123</b>   | (2,150) | (3.3) | (3,085) | (4.7) | (4,731) | (7.3) |  |
| Selling, general and administrative | <b>71,458</b>   | (2,347) | (3.3) | (3,367) | (4.7) | (5,163) | (7.2) |  |
| Operating income                    | \$ <b>2,977</b> | \$ 16   | 0.5%  | \$ 23   | 0.8%  | 36      | 1.2%  |  |

As noted above, certain of our operations including Russia and the Ukraine are served by a U.S. subsidiary through third party entities, for which all business is conducted in U.S. dollars. Although changes in exchange rates between the U.S. dollar and the Russian ruble or the Ukrainian hryvnia do not result in currency fluctuations within our financial statements, a weakening or strengthening of the U.S. dollar in relation to these other currencies can significantly affect the prices of our products and the purchasing power of our independent Managers and Distributors within these markets.

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

Exchange rate sensitivity of as of June 30, 2010 (dollar amounts in thousands)

|   | With Strengthening of U.S. Dollar by: |            |        |            |         |            |         |
|---|---------------------------------------|------------|--------|------------|---------|------------|---------|
|   | 10%                                   |            | 15%    |            | 25%     |            |         |
|   | (\$)                                  | (%)        | (\$)   | (%)        | (\$)    | (%)        |         |
| <b><i>Current Assets subject to Exchange Rate Risk</i></b>      |                                       |            |        |            |         |            |         |
| Cash and cash equivalents                                       | \$ 40,010                             | \$ (3,205) | (8.0)% | \$ (4,598) | (11.5)% | \$ (7,051) | (17.6)% |
| Restricted cash   | 249                                   | (23)       | (9.2)% | (32)       | (12.9)% | (50)       | (20.1)% |
| Accounts receivable, net  | 8,166                                 | (409)      | (5.0)% | (587)      | (7.2)%  | (900)      | (11.0)% |
| <b><i>Current Liabilities subject to Exchange Rate Risk</i></b> |                                       |            |        |            |         |            |         |
| Accounts payable  | 4,770                                 | (127)      | (2.7)% | (183)      | (3.8)%  | (280)      | (5.9)%  |
| <b><i>Net Current Assets subject to Exchange Rate Risk</i></b>  |                                       |            |        |            |         |            |         |
|   | 43,655                                | (3,510)    | (8.0)% | (5,034)    | (11.5)% | (7,721)    | (17.7)% |

The following table sets forth the local currencies other than the U.S. dollar, in which our assets that are subject to exchange rate risk were denominated as of June 30, 2010 and exceeded \$1 million upon translation into U.S. dollars. None of our liabilities that are denominated in a local currency other than the U.S. dollar and that are subject to exchange rate risk exceeded \$1 million upon translation into U.S. dollars. We use the spot exchange rate for translating balance sheet items from local currencies into our reporting currency. The respective spot exchange rate for each such local currency meeting the foregoing thresholds is provided in the table as well.

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Translation of Balance Sheet Amounts Denominated in Local Currency (dollar amounts in thousands)

|                                  | Translated into U.S.<br>Dollars | At Spot Exchange Rate<br>per One U.S. Dollar as<br>of June 30, 2010 |
|----------------------------------|---------------------------------|---|
| <b>Cash and Cash Equivalents</b> |                                 |   |
| Canada (Dollar)                  | \$ 3,524                        | 1.0   |
| Colombia (Peso)                  | 1,734                           | 1,918.4   |
| Indonesia (Rupiah)               | 1,491                           | 9,165.9   |
| Japan (Yen)                      | 7,244                           | 88.7  |
| Mexico (Peso)                    | 2,433                           | 12.4  |
| European Markets (Euro)          | 1,583                           | 0.8   |
| South Korea (Won)                | 2,507                           | 1,217.3   |
| Other                            | 1,636                           | Varies  |
| <b>Total</b>                     | <b>\$ 22,152</b>                |   |
| <b>Accounts Receivable</b>       |                                 |   |
| Japan (Yen)                      | \$ 1,229                        | 88.7  |
| Other                            | 3,272                           | Varies  |
| <b>Total</b>                     | <b>\$ 4,501</b>                 |   |

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

| <b>Six months ended June 30,</b> | <b>2010</b> | <b>2009</b> |
|----------------------------------|-------------|-------------|
| Canada (Dollar)                  | 1.0         | 1.2         |
| Japan (Yen)                      | 91.4        | 95.6        |
| Mexico (Peso)                    | 12.7        | 13.8        |
| Venezuela (Bolivar)              | 4.3         | 2.1         |

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

The functional currency in highly inflationary economies is the U.S. dollar and transactions denominated in the local currency are re-measured as if the functional currency were the U.S. dollar. The re-measurement of local currencies into U.S. dollars creates translation adjustments, which are included in the consolidated statements of operations. A country is considered to have a highly inflationary economy if it has a cumulative inflation rate of approximately 100 percent or more over a three year period as well as other qualitative factors including historical inflation rate trends (increasing and decreasing), the capital intensiveness of the operation, and other pertinent economic factors. There were no countries considered to have a highly inflationary economy during the six months ended June 30, 2009.

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As of January 1, 2010, Venezuela was designated as a highly inflationary economy under U.S. GAAP. Accordingly, the U.S. dollar became the functional currency for our subsidiary in Venezuela. All gains and losses resulting from the re-measurement of its financial statements are determined using official exchange rates. On January 8, 2010, the Venezuelan government announced the devaluation of the bolivar fuerte against the U.S. dollar and the establishment of a two-tier exchange structure for essential and non-essential goods. The official exchange rate for imported goods classified as essential, such as food and medicine, changed from 2.15 to 2.60, while other payments for non-essential goods are at an exchange rate of 4.30. The majority of the Company's products are currently classified as essential and qualify for the 2.60 exchange rate. However, its overall results in Venezuela are re-measured to the U.S. dollar at approximately 4.30, the exchange rate applicable to dividend repatriations.

As a result, we recorded a gain of \$3.7 million in January 2010 in connection with the re-measurement of its balance sheet to reflect the highly inflationary designation and the devaluation due to the negative position of the Company's Venezuelan subsidiary's



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net monetary assets, which is recorded in other income. The increase in the exchange rate from 2.15 to 4.30 reduced our total reported sales by approximately 1.8 percent and 1.7 percent for the three and six months ended June 30, 2010, respectively. On an ongoing basis, we expect future total net sales to be reduced by approximately two percent. The effect of the highly inflationary designation and the devaluation reduced reported operating income for the three and six months ended June 30, 2010 by approximately \$0.1 million and \$0.5 million, respectively. The success of future operations will be impacted by several factors, including our ability to take actions to mitigate the effect of the devaluation, further actions of the Venezuelan government, and economic conditions in Venezuela such as inflation and consumer spending.

As of June 30, 2010, we had approximately \$0.9 million in cash, of which \$0.2 million was restricted, denominated in Venezuelan bolivar fuertes. The restriction of \$0.2 million in cash as of June 30, 2010 in Venezuela is the result of the local government seizing control of the bank in which this operating cash was deposited and temporarily freezing its deposits. As a result, the Company has classified these deposits as restricted cash. While we expect these funds to become unrestricted in the near future, at this time we cannot estimate when they will be released. However, even if these funds are released, the Company anticipates some loss and has recorded a write-down of \$0.5 million during the second quarter of 2010 to cover the estimated loss related to such release, which is included in other income and expense.

Currency restrictions enacted by the government of Venezuela require approval from the government's currency control organization for our subsidiary in Venezuela to obtain U.S. dollars at the official exchange rate to pay for imported products or to repatriate dividends back to the Company. In prior periods, the market rate, which is substantially lower than the official rate, was available to obtain U.S. dollars or other currencies without approval of the government's currency control organization. In June 2010, the government of Venezuela enacted additional currency restrictions, which effectively replace the market rates with the System for Foreign Currency Denominated Securities (SITME), which is administered by the Venezuela Central Bank. Under SITME, entities domiciled in Venezuela can obtain U.S. denominated securities in limited quantities each month through banking institutions approved by the government.

At this time, we are not able to reasonably estimate the future state of exchange controls in Venezuela and the availability of U.S. dollars at the official foreign exchange rate or at the SITME rate. The application and approval process has been delayed in recent periods, and the timing and ability to obtain U.S. dollars in the future at the official exchange rate remains uncertain. Currently we have \$0.1 million of funds pending approval at the official exchange rate. Unless the official exchange rate is made more readily available, our subsidiary's operations could be adversely affected as it may need to obtain U.S. dollars at the less favorable SITME rate.

**Interest Rate Risk**

The primary objectives of our investment activities are to preserve principal while maximizing yields without significantly increasing risk. These objectives are accomplished by purchasing investment grade securities. On June 30, 2010, we had investments of \$3.1 million, of which \$2.1 million were municipal obligations, which carry an average fixed interest rate of 5.1 percent and mature over a 5-year period. A hypothetical 1.0 percent change in interest rates would not have had a material effect on our liquidity, financial position, or results of operations.

**Item 4. CONTROLS AND PROCEDURES**

**Overview**

Management identified a material weakness related to accounting for taxes, which is described in our Annual Report on Form 10-K for the year ended December 31, 2009. During 2010 through the date of this filing, management has been focused on remediating this material weakness. This overview discusses management's evaluation of our disclosure controls and procedures as of June 30, 2010. In addition, this item provides a summary of the status of our material weakness for accounting for income taxes, followed by a discussion of management's evaluation of our disclosure controls and procedures, and management's efforts to remediate the material weaknesses.

#### **Evaluation of Disclosure Controls and Procedures**

Our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) are designed to ensure that information required to be disclosed in reports filed or submitted under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in rules and forms adopted by the SEC, and that such information is accumulated and communicated to management, including the Chief Executive Officer and the Chief Financial Officer, to allow timely decisions regarding required disclosures.

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In connection with the preparation of this report as of June 30, 2010, our management, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of June 30, 2010. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were not effective as of June 30, 2010, as a result of the existence of a material weakness in our internal control over financial reporting related to accounting for taxes.

Since December 31, 2009, we continue our progress in improving our disclosure controls and procedures. We have taken and are taking action to remediate our material weakness in our internal control over financial reporting related to accounting for income taxes that existed at that date. We continue to strive to improve our processes to enable us to provide complete and accurate public disclosure. Management believes that we will not be able to conclude that our disclosure controls and procedures are effective until the material weakness has been fully remediated.

Description of Material Weakness Related to Accounting for Taxes

Our processes, procedures and controls related to the preparation and review of the annual tax provision and the accrual of other non-income tax contingencies were not effective to ensure that amounts related to the tax provision, related current or deferred income tax asset and liability accounts, and non-income tax contingencies were accurate, recorded in the proper period, and determined in accordance with U.S. GAAP. Specifically, we did not (i) analyze and reconcile certain deferred income and tax payable accounts, (ii) appropriately consider the need to record or disclose contingencies for certain income tax positions in accordance with U.S. GAAP, and (iii) file tax returns in certain foreign jurisdictions. Additionally, we had insufficient personnel with appropriate qualifications and training in accounting for taxes.

Description of Remediation Actions

In October 2009, we engaged tax consultants with specific expertise related to the remediation of accounting for taxes to assist us in completing the remediation of its material weakness in this area. We continue to evaluate our tax processes. We are completing the few remaining delinquent foreign statutory filings identified during the prior years as result of management's analysis, as well as refining our process to help ensure timely completion of future filings. During 2010, we continue to monitor and assess the uncertain tax positions and non-income tax contingencies and have implemented plans to reduce these contingencies. In late 2009 and during 2010, we have implemented procedures to analyze and reconcile certain deferred income and tax payable accounts. In November 2009, we added an additional tax professional, which will provide continued strengthening of tax processes. In the second quarter of 2010, we updated our tax process documentation, including detail tax checklists and our tax risk control matrix. In July 2010, we began internal testing of the processes related to accounting for taxes. We continue to evaluate the adequacy of our tax resources. We are in the process of remediating this material weakness and our goal is to conclude our remediation efforts by the end of fiscal year 2010.

**Conclusion**

We believe that the process is in place to facilitate the remediation of the remaining material weakness. We believe the measures described above will facilitate remediation of the material weakness related to accounting for taxes and will continue to strengthen our internal control over financial reporting. We are committed to continually improving our internal control processes and will diligently and vigorously review our financial reporting controls and procedures. As we continue to evaluate and work to improve our internal control over financial reporting, we

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may determine that additional measures are necessary to address control deficiencies. Moreover, we may decide to modify, or in appropriate circumstances not to complete, certain of the remediation measures described above.

### **PART II OTHER INFORMATION**

#### **Item 1. LEGAL PROCEEDINGS**

Please refer to Note 10 to the Unaudited Condensed Consolidated Financial Statements in Part 1, Item 1 of this report, as well as our recent SEC filings, including our Annual Report on Form 10-K for the year ended December 31, 2009, for information regarding the status of certain legal proceedings that have been previously reported.

#### **Item 1A. RISK FACTORS**

In addition to the other information set forth in this report, you should carefully consider the risks discussed under the heading "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2009, which could materially affect our business or our consolidated financial statements, results of operations, and cash flows. Additional risks not currently known to us, or risks that

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we currently believe are not material, may also impair our business operations. There have been no material changes to our risk factors since the filing of our Annual Report on Form 10-K for the year ended December 31, 2009.

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

None.

**Item 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**Item 4. REMOVED AND RESERVED**

**Item 5. OTHER INFORMATION**

None.

**Item 6. EXHIBITS**

a) Index to Exhibits

| <b>Item No.</b> | <b>Exhibit</b>  |
|-----------------|---|
| 31.1(1)         | Certification of Chief Executive Officer under SEC Rule 13a 14(a)/15d 14(a) promulgated under the Securities Exchange Act of 1934 |
| 31.2(1)         | Certificate of Chief Financial Officer under SEC Rule 13a 14(a)/15d 14(a) promulgated under the Securities Exchange Act of 1934   |
| 32.1(1)         | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350   |
| 32.2(1)         | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350   |

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(1) Filed currently herewith.

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**SIGNATURES**

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

NATURE S SUNSHINE PRODUCTS, INC.

Date: August 4, 2010

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

Date: August 4, 2010

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