

NU SKIN ENTERPRISES INC
Form 10-K
March 02, 2015
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2014

or

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

For the transition period from _____ to _____

Commission file number: 001-12421

NU SKIN ENTERPRISES, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

75 WEST CENTER STREET
PROVO, UTAH 84601
(Address of principal executive offices, including zip code)

87-0565309
(IRS Employer Identification No.)

Registrant's telephone number, including area code: (801) 345-1000

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of each class</u>	<u>Name of exchange on which registered</u>
Class A common stock, \$.001 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

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Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Website, 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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.

Large accelerated filer

Accelerated filer

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

Based on the closing sales price of the Class A common stock on the New York Stock Exchange on June 30, 2014, the last business day of the Registrant's second fiscal quarter, the aggregate market value of the voting stock held by non-affiliates of the Registrant was approximately \$4.3 billion. All executive officers and directors of the Registrant, and all stockholders holding more than 10% of the Registrant's outstanding voting stock other than institutional investors, such as registered investment companies, eligible to file beneficial ownership reports on Schedule 13G, have been deemed, solely for the purpose of the foregoing calculation, to be "affiliates" of the Registrant.

As of January 31, 2015, 59,445,344 shares of the Registrant's Class A common stock, \$.001 par value per share, and no shares of the Registrant's Class B common stock, \$.001 par value per share, were outstanding.

Documents incorporated by reference. Portions of the Registrant's Definitive Proxy Statement for the Registrant's 2015 Annual Meeting of Stockholders are incorporated by reference in Part III of this report. The Definitive Proxy Statement or an amendment to this Form 10-K will be filed with the Securities and Exchange Commission within 120 days after the Registrant's fiscal year end.

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FORWARD-LOOKING STATEMENTS

THIS ANNUAL REPORT ON FORM 10-K, IN PARTICULAR "ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION," AND "ITEM 1. BUSINESS," CONTAINS FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1933, AS AMENDED, AND SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED THAT REPRESENT OUR CURRENT EXPECTATIONS AND BELIEFS. ALL STATEMENTS OTHER THAN STATEMENTS OF HISTORICAL FACT ARE "FORWARD-LOOKING STATEMENTS" FOR PURPOSES OF FEDERAL AND STATE SECURITIES LAWS AND INCLUDE, BUT ARE NOT LIMITED TO, STATEMENTS OF MANAGEMENT'S EXPECTATIONS REGARDING OUR PERFORMANCE, INITIATIVES, STRATEGIES, PRODUCT INTRODUCTIONS AND OFFERINGS, OPPORTUNITIES AND RISKS; STATEMENTS OF PROJECTIONS REGARDING FUTURE SALES, EXPENSES, OPERATING RESULTS, TAXES AND DUTIES, CAPITAL EXPENDITURES, SOURCES AND USES OF CASH, FOREIGN CURRENCY FLUCTUATIONS OR DEVALUATIONS, AND OTHER FINANCIAL ITEMS; STATEMENTS OF MANAGEMENT'S EXPECTATIONS AND BELIEFS REGARDING CHINA AND OTHER MARKETS; STATEMENTS REGARDING THE PAYMENT OF FUTURE DIVIDENDS AND STOCK REPURCHASES; STATEMENTS REGARDING THE OUTCOME OF LITIGATION; ACCOUNTING ESTIMATES AND ASSUMPTIONS; STATEMENTS OF BELIEF; AND STATEMENTS OF ASSUMPTIONS UNDERLYING ANY OF THE FOREGOING. IN SOME CASES, YOU CAN IDENTIFY THESE STATEMENTS BY FORWARD-LOOKING WORDS SUCH AS "BELIEVE," "EXPECT," "PROJECT," "ANTICIPATE," "ESTIMATE," "INTEND," "PLAN," "TARGETS," "LIKELY," "WILL," "WOULD," "COULD," "MAY," "MIGHT," THE NEGATIVE OF THESE WORDS AND OTHER SIMILAR WORDS. WE UNDERTAKE NO OBLIGATION TO PUBLICLY UPDATE OR REVISE ANY FORWARD-LOOKING STATEMENT, WHETHER AS A RESULT OF NEW INFORMATION, FUTURE EVENTS OR OTHERWISE, EXCEPT AS REQUIRED BY LAW. WE CAUTION AND ADVISE READERS THAT THESE STATEMENTS ARE BASED ON ASSUMPTIONS THAT MAY NOT BE REALIZED AND INVOLVE RISKS AND UNCERTAINTIES THAT COULD CAUSE ACTUAL RESULTS TO DIFFER MATERIALLY FROM THE EXPECTATIONS AND BELIEFS CONTAINED HEREIN. FOR A SUMMARY OF THESE RISKS, SEE "ITEM 1A – RISK FACTORS."

In this Annual Report on Form 10-K, references to "dollars" and "\$" are to United States dollars.

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

PART I

ITEM 1. BUSINESS

We are a leading, global direct selling company marketing personal care and nutritional products in 53 markets worldwide. In 2014, we recorded \$2.6 billion in revenue. Since our founding in 1984, we have strived to differentiate ourselves through innovation in both our products and our sales channel.

We develop and distribute innovative, premium-quality anti-aging personal care products and nutritional supplements under our Nu Skin and Pharmanex category brands, respectively. Over the last several years, we have introduced new Nu Skin personal care products and Pharmanex nutritional supplements under our ageLOC anti-aging brand.

We operate in the direct selling channel, primarily utilizing person-to-person marketing to promote and sell our products. Our consumers can purchase products either directly from a member of our sales force or directly from the company.

Approximately 91% of our 2014 revenue came from outside of the United States. Due to the size of our international operations, our results, as reported in U.S. dollars, are often impacted by foreign currency fluctuations. In addition, our results are impacted by global economic, political, demographic and business trends and conditions.

In 2014, Mainland China was our largest revenue market, accounting for approximately 26% of our revenue. Direct selling is relatively new to Mainland China, and we believe the market holds significant potential. We have implemented a distinct business model in Mainland China to conform with local laws and regulations, which are significantly different from regulations outside of Mainland China.

Our business is subject to various laws and regulations globally, particularly with respect to our direct selling business models and our product categories. As is the case with most companies in our industry, we receive inquiries from time to time from government regulatory authorities regarding the nature of our business and other issues. For example, in 2014, our revenue and number of Sales Leaders and Actives in the Greater China region were negatively impacted by our voluntary suspension of business meetings and acceptance of applications for new sales representatives in Mainland China in response to adverse media reports and a government review in the first part of the year. See "Risk Factors" for a more detailed description of the risks associated with our business.

PRODUCTS

We offer a branded, differentiated product platform. We believe our innovative approach to product development provides us with a competitive advantage in anti-aging and direct selling. We develop and distribute innovative, premium-quality anti-aging personal care products and nutritional supplements under our Nu Skin and Pharmanex category brands, respectively. Over the last several years, we have introduced new Nu Skin personal care products and Pharmanex nutritional supplements under our ageLOC anti-aging brand. Our research and product development is focused on understanding the sources of aging, including the influence of certain ingredients on gene expression, and utilizing that knowledge in our development of anti-aging products. We believe that our acquired and licensed technologies, research collaborations and in-house research expertise enable us to continue to introduce innovative, proprietary anti-aging products. We source and produce nearly all our proprietary products through trusted third parties, except in Mainland China, where we manufacture our own products.

We currently plan to introduce the following new products in various markets during 2015 and 2016:

Our ageLOC Youth nutritional supplement supports vital aging-defense mechanisms and consists of a blend of natural ingredients that are difficult to obtain through diet alone.

Our ageLOC Me personalized skin care system enables consumers to personalize a daily regimen based on individual preferences and skin care needs. This system consists of a variety of anti-aging serums and moisturizers and a proprietary hands-free dispenser.

Our essential oil products will be marketed under our Epoch and ageLOC brands.

Product Categories

We have two primary product categories, each operating under its own brand. We market our premium-quality personal care products under the Nu Skin category brand and our science-based nutritional supplements under the Pharmanex category brand. Over the last several years, we have introduced new Pharmanex nutritional supplements and Nu Skin personal care products under our ageLOC anti-aging brand.

Presented below are the U.S. dollar amounts and associated revenue percentages from the sale of Nu Skin and Pharmanex products for the years ended December 31, 2012, 2013, and 2014. This table should be read in conjunction with the information presented in the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations," which discusses the factors impacting revenue trends and the costs associated with generating the aggregate revenue presented.

Revenue by Product Category

(U.S. dollars in millions)⁽¹⁾

Product Category	Year Ended December 31,					
	2012		2013		2014	
Nu Skin	\$1,158.2	54.3 %	\$1,641.6	51.7 %	\$1,562.6	60.8 %
Pharmanex	966.6	45.3	1,529.2	48.1	1,000.3	38.9
Other ⁽²⁾	7.5	0.4	5.9	0.2	6.6	0.3
	\$2,132.3	100.0%	\$3,176.7	100.0%	\$2,569.5	100.0%

In 2014, 91% of our sales were transacted in foreign currencies that were then converted to U.S. dollars for financial reporting purposes at weighted-average exchange rates. Foreign currency fluctuations negatively impacted reported revenue by approximately 3% in both 2014 compared to 2013 and 2013 compared to 2012.

⁽²⁾ We currently offer a limited number of other products and services, including household products and technology services.

Nu Skin. Nu Skin is the brand of our original product line and offers premium-quality anti-aging personal care products. Our strategy is to leverage our distribution channel to strengthen Nu Skin's position as an innovative leader in the anti-aging personal care market. We are committed to continuously improving and evolving our product formulations to develop and incorporate innovative and proven ingredients. Our primary categories in this product line are core skin-care systems and targeted treatment products that address specific skin needs. We formulate these products with ingredients that are scientifically proven to provide visible results. Products in this category include ageLOC Spa systems, ageLOC Tru Face Essence Ultra anti-aging skin care serum and ageLOC Transformation anti-aging skin care system. Our ageLOC skin care products accounted for 28% of our total revenue and 46% of Nu Skin product category sales in 2014. We also offer our Epoch products, which feature botanical ingredients derived from renewable sources, and a number of other cosmetic, personal care and hair care products.

Pharmanex. We market a variety of products under our Pharmanex brand. Our strategy is to continue to introduce innovative, substantiated anti-aging products based on research and development and quality manufacturing. Direct selling has proven to be an effective method of marketing our high-quality supplements because our sales force can personally educate consumers on the quality and benefits of our products, differentiating them from our competitors' offerings. This product line includes our LifePak and ageLOC R² nutritional supplements and our ageLOC TR90 weight management and body shaping system. LifePak and ageLOC R² were our largest nutritional products in terms of revenue, each representing approximately 9% of our total revenue and approximately 22% and 23%, respectively, of Pharmanex revenue in 2014. We also offer a number of other anti-aging nutritional solutions and weight

management products.

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Product Development

We are committed to developing and marketing innovative products. We have several products in development, including next-generation skin care products, nutritional supplements and local initiatives. Our research and product development is focused on understanding the sources of aging, including the influence of certain ingredients on gene expression, and utilizing that knowledge in product development.

Our research and product development activities include:

- Internal research, product development and quality testing;
- Joint research projects, collaborations and clinical studies;
- Identification and assessment of technologies for potential licensing arrangements; and
- Acquisition of technologies.

We maintain research and product development facilities in the United States and Mainland China. We also contract with third parties for clinical studies and collaborate on basic research projects with researchers from universities and other research institutions in the United States and Asia, whose staffs include scientists with basic research expertise in natural product chemistry, biochemistry, dermatology, pharmacology and clinical studies. Our expenses for internal research and development activities and joint research projects and collaborations were \$14.9 million, \$18.0 million and \$18.9 million in 2012, 2013 and 2014, respectively.

We also work to identify and assess innovative technologies developed by third parties for potential licensing or supply arrangements. Because of the nature of our distribution channel, which allows us to provide a high level of product information on a person-to-person basis, we often have third parties who are interested in licensing innovative technologies to us to incorporate into our products and commercialize through our distribution channel. Licensing arrangements allow us to leverage the research activities of third parties that have resulted in demonstrated technologies, without the upfront costs and uncertainty associated with internal development, in exchange for the payment of a royalty on product sales. We have also invested in acquisitions to supplement our research capabilities and to acquire technologies, including our acquisition of Pharmanex in 1998 and the license and acquisition of the technology underlying our BioPhotonic Scanner, a non-invasive tool that measures the level of carotenoid anti-oxidants in skin. In 2011 and 2012, respectively, we acquired substantially all of the assets of LifeGen Technologies, LLC for \$11.7 million and acquired Nox Technologies, Inc. for \$12.6 million, including in each case, the acquisition of patents and previously licensed technology utilized in connection with Nu Skin's research efforts and incorporated into some of our products. Our expense for royalties and amortization for previous technology related acquisitions were approximately \$8.9 million, \$9.7 million and \$10.4 million in 2012, 2013 and 2014, respectively. These amounts do not include our expenses for acquiring proprietary ingredients and other technologies from vendors for our Tru Face Essence products, Galvanic Spa systems and other products.

Intellectual Property

Our major trademarks are registered in the United States and in each country where we operate or have plans to operate, and we consider trademark protection to be very important to our business. Our major trademarks include Nu Skin®, our fountain logos, Pharmanex®, ageLOC®, LifePak®, Galvanic Spa®, TR90®, and Epoch®. In addition, a number of our products, including our facial spas, ageLOC Body Spa, ageLOC TR90, ageLOC Tru Face Essence Ultra and Pharmanex BioPhotonic Scanner, are based on proprietary technologies, some of which are patented or licensed from third parties. We also rely on patents and trade secret protection to protect our proprietary formulas and other proprietary information for our ageLOC and other products.

Sourcing and Production

Nu Skin. For markets other than Mainland China, we acquire ingredients and contract production of nearly all our Nu Skin personal care products from third-party suppliers and manufacturers. In Mainland China, we operate manufacturing facilities where we produce the majority of our personal care products sold in Mainland China, as well as a limited number of products exported to some of our other markets.

We procure our ageLOC Galvanic Spa systems, including the ageLOC Edition Galvanic Spa System II and ageLOC Body Spa, and our Tru Face Essence products from single vendors who own or control the product formulations, ingredients, or other intellectual property rights associated with these products. We maintain good relationships with these vendors and do not anticipate termination of these relationships in the near term. However, to continue offering these product categories following any termination of our relationship with these vendors, we would need to develop and manufacture alternative products and source them from other vendors. We also acquire ingredients and products from one other supplier that manufactured products representing more than 10% of our Nu Skin personal care purchases in 2014. We maintain a good relationship with this supplier and do not anticipate that either party will terminate this relationship in the near term. In the event we become unable to source any products or ingredients from this supplier, we believe that we would be able to produce or replace those products or substitute ingredients. We also have ongoing relationships with secondary and tertiary suppliers. Please refer to "Risk Factors—The loss of suppliers or shortages in ingredients could harm our business" for a discussion of risks and uncertainties associated with our supplier relationships and with the sourcing of raw materials and ingredients.

Pharmanex. For markets other than Mainland China, we source most of our Pharmanex nutritional supplements from third-party suppliers and manufacturers. In Mainland China, we operate manufacturing facilities where we produce the majority of our nutritional supplements sold in Mainland China and herbal extracts used to produce other products sold globally.

Two of our suppliers manufactured products representing more than 10% of our Pharmanex nutritional supplement purchases in 2014. We maintain a good relationship with both of these suppliers and do not anticipate that any party will terminate these relationships in the near term. In the event we become unable to source any products or ingredients from these suppliers or from our other vendors, we believe that we would be able to produce or replace those products or substitute ingredients. We also have ongoing relationships with secondary and tertiary suppliers. Please refer to "Risk Factors—The loss of suppliers or shortages in ingredients could harm our business" for a discussion of certain risks and uncertainties associated with our supplier relationships, as well as with the sourcing of raw materials and ingredients.

DISTRIBUTION CHANNEL

We operate in the direct selling channel, primarily utilizing person-to-person marketing to promote and sell our products. These personal marketing efforts are supported by various mediums, including catalogs, the Internet, and walk-in centers. We believe our distribution channel is an effective vehicle to distribute our products because:

- our sales force can educate consumers about our products face-to-face, which we believe is more effective for differentiating our products than using traditional mass-media advertising;
- our distribution channel allows for actual product demonstrations and trial by potential consumers;
- our distribution channel allows our sales force to provide personal testimonials of product efficacy; and
- as compared to other distribution methods, our sales force has the opportunity to provide consumers higher levels of service and encourage repeat purchases.

The manner in which we operate our distribution channel can vary from market to market based on regulatory and socio-economic conditions. While our person-to-person marketing philosophy remains consistent globally, various aspects of our business may differ from market-to-market, including product mix and pricing, compensation structure, access to distribution outlets or product stores, the manner of getting products to consumers, product claims, branding and product formulations. For example, in Mainland China we have implemented a distinct hybrid business model that utilizes retail stores, sales employees, contractual sales promoters, independent direct sellers and independent marketers to market our products.

Given that members of our sales force are independent contractors in most markets, we do not control or direct their promotional efforts. We do, however, require that our sales force abide by policies and procedures that require them to act in an ethical and consumer-protective manner and in compliance with applicable laws and regulations. As a member of the United States Direct Selling Association and similar organizations in many of the markets where we do business, we are also subject to the ethical business practices and consumer service standards required by the industry's code of ethics.

Consumers and Sales Network

Our distribution channel is composed of two primary groups: our consumer group—individuals who buy our products primarily for personal or family consumption; and our sales network—individuals who personally buy, use and resell products, and who also find new consumers, and recruit, train and develop new Sales Leaders. We strive to develop both our consumer group and our sales network. Our strategy for growing our consumer group is to offer high-quality, innovative products that provide demonstrable benefits. Our strategy for growing our sales network is to provide a meaningful business opportunity for those persons who demonstrate the ability to develop both a consumer group and a team of Sales Leaders.

To monitor the growth trends in our consumer group, we track the number of persons who purchased products directly from the company during the previous three months ("Actives"). We believe a significant majority of Actives purchase our products primarily for personal or family consumption but are not actively pursuing the opportunity we offer to generate income by marketing and reselling products. To monitor the growth in our sales network, we track the number of persons who have completed and who maintain specified sales benchmarks at the end of a period ("Sales Leaders"). Sales Leaders are independent distributors, and sales employees, contractual sales promoters and independent marketers in China, who achieve certain qualification requirements. The following chart sets forth information concerning our Actives and Sales Leaders for the last three years.

Total Number of Actives and Sales Leaders by Region

	As of December 31, 2012		As of December 31, 2013		As of December 31, 2014	
	Actives	Sales Leaders	Actives	Sales Leaders	Actives	Sales Leaders
Greater China	216,000	18,527	490,000	61,546	393,000	24,537
North Asia	349,000	17,395	409,000	19,816	391,000	17,478
Americas	164,000	6,352	193,000	8,274	186,000	7,471
South Asia/Pacific	98,000	4,988	120,000	7,992	124,000	8,458
EMEA	119,000	4,528	123,000	4,489	114,000	4,065
Total	946,000					