

NATURES SUNSHINE PRODUCTS INC
Form 10-Q
November 09, 2004

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended
September 30, 2004

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)

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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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares of Common Stock, no par value, outstanding on November 7, 2004 was 15,390,269 shares.

When we refer in this Form 10-Q to the Company, we, our, and us, we mean Nature s Sunshine Products, Inc., a Utah corporation, together with our subsidiaries.

NATURE'S SUNSHINE PRODUCTS, INC.

FORM 10-Q

For the Quarter Ended September 30, 2004

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PART I FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

NATURE S SUNSHINE PRODUCTS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Amounts in Thousands)

(Unaudited)

| | September 30, 2004 | December 31, 2003 |
|--|-----------------------|----------------------|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 39,521 | \$ 30,665 |
| Accounts receivable, net | 6,920 | 5,567 |
| Inventories, net | 35,087 | 26,528 |
| Deferred income tax assets | 4,747 | 3,553 |
| Prepaid expenses and other | 13,261 | 9,723 |
| Total current assets | 99,536 | 76,036 |
| PROPERTY, PLANT AND EQUIPMENT, net | 33,874 | 32,318 |
| LONG-TERM INVESTMENTS | 7,554 | 6,416 |
| DEFERRED TAX ASSETS LONG TERM | 5,619 | 5,359 |
| DEFINITE-LIVED INTANGIBLE ASSETS, net | 1,832 | 2,094 |
| OTHER ASSETS | 2,053 | 3,335 |
| | \$ 150,468 | \$ 125,558 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| CURRENT LIABILITIES: | | |
| Line of credit | \$ | \$ 5,000 |
| Accounts payable | 6,519 | 4,003 |
| Accrued volume incentives | 14,323 | 12,093 |
| Accrued liabilities | 24,993 | 18,009 |
| Income taxes payable | 8,561 | 6,879 |
| Total current liabilities | 54,396 | 45,984 |
| DEFERRED COMPENSATION | 2,010 | 2,232 |
| SHAREHOLDERS EQUITY: | | |
| Common Stock, no par value; 20,000 shares authorized, 19,446 shares issued | 19,904 | 25,437 |
| Retained earnings | 135,178 | 124,997 |
| Treasury stock, at cost, 4,352 and 5,267 shares, respectively | (41,142) | (54,833) |
| Accumulated other comprehensive loss | (19,878) | (18,259) |
| Total shareholders equity | 94,062 | 77,342 |
| | \$ 150,468 | \$ 125,558 |

See accompanying notes to condensed consolidated financial statements.

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NATURE S SUNSHINE PRODUCTS, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF INCOME (LOSS)
 AND COMPREHENSIVE INCOME (LOSS)

(Amounts in Thousands, Except Per-Share Information)

(Unaudited)

| | Three Months Ended September 30, | |
|---|-------------------------------------|--------------------------------------|
| | 2004 | 2003 (As Restated, See Note 1) |
| NET SALES REVENUE (net of the rebate portion of volume incentives of \$8,823 and \$9,600, respectively) | \$ 83,617 | \$ 63,470 |
| COST AND EXPENSES: | | |
| Cost of goods sold | 15,312 | 13,228 |
| Volume incentives | 33,363 | 23,503 |
| Selling, general and administrative | 28,160 | 27,787 |
| OPERATING INCOME (LOSS) | 6,782 | (1,048) |
| OTHER INCOME (EXPENSE) | | |
| Interest income | 94 | 110 |
| Interest expense | (59) | (77) |
| Other income (expense), net | 140 | 187 |
| | 175 | 220 |
| INCOME (LOSS) BEFORE PROVISION FOR INCOME TAXES | 6,957 | (828) |
| PROVISION (BENEFIT) FOR INCOME TAXES | 2,350 | (264) |
| NET INCOME (LOSS) | 4,607 | (564) |
| OTHER COMPREHENSIVE INCOME (LOSS), net of tax: | | |
| Foreign currency translation adjustments | 319 | (57) |
| Net unrealized holding losses on marketable securities | (5) | (61) |
| Reclassification adjustment for net realized gains on marketable securities included in net income | 32 | 5 |
| | 346 | (113) |
| COMPREHENSIVE INCOME (LOSS) | \$ 4,953 | \$ (677) |
| BASIC NET INCOME (LOSS) PER COMMON SHARE | \$ 0.31 | \$ (0.04) |
| WEIGHTED AVERAGE BASIC COMMON SHARES | 15,076 | 13,930 |
| DILUTED NET INCOME (LOSS) PER COMMON SHARE | \$ 0.29 | \$ (0.04) |
| WEIGHTED AVERAGE DILUTED COMMON SHARES | 15,654 | 13,930 |

See accompanying notes to condensed consolidated financial statements.

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

(Amounts in Thousands, Except Per-Share Information)

(Unaudited)

| | 2004 | Nine Months Ended September 30, | 2003 (As Restated, See Note 1) |
|---|------|------------------------------------|--------------------------------------|
| NET SALES REVENUE (net of the rebate portion of volume incentives of \$27,930 and \$28,697, respectively) | \$ | 240,100 | \$ 189,725 |
| COST AND EXPENSES: | | | |
| Cost of goods sold | | 44,813 | 39,154 |
| Volume incentives | | 92,986 | 68,928 |
| Selling, general and administrative | | 87,142 | 77,744 |
| OPERATING INCOME | | 15,159 | 3,899 |
| OTHER INCOME (EXPENSE) | | | |
| Impairment of investment | | | (1,768) |
| Interest income | | 280 | 384 |
| Interest expense | | (73) | (207) |
| Other income, net | | 696 | 876 |
| | | 903 | (715) |
| INCOME BEFORE PROVISION FOR INCOME TAXES | | 16,062 | 3,184 |
| PROVISION FOR INCOME TAXES | | 3,645 | 1,019 |
| NET INCOME | | 12,417 | 2,165 |
| OTHER COMPREHENSIVE INCOME (LOSS), net of tax: | | | |
| Foreign currency translation adjustments | | (1,573) | (1,175) |
| Net unrealized holding losses on marketable securities | | (68) | (136) |
| Reclassification adjustment for net realized gains on marketable securities included in net income | | 22 | 338 |
| | | (1,619) | (973) |
| COMPREHENSIVE INCOME | \$ | 10,798 | \$ 1,192 |
| BASIC NET INCOME PER COMMON SHARE | \$ | 0.84 | \$ 0.15 |
| WEIGHTED AVERAGE BASIC COMMON SHARES | | 14,846 | 14,237 |
| DILUTED NET INCOME PER COMMON SHARE | \$ | 0.81 | \$ 0.15 |
| WEIGHTED AVERAGE DILUTED COMMON SHARES | | 15,395 | 14,411 |

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See accompanying notes to condensed consolidated financial statements.

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

(Amounts in Thousands)

(Unaudited)

| | Nine Months Ended September 30, | |
|---|------------------------------------|------------------|
| | 2004 | 2003 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$ 12,417 | \$ 2,165 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 4,229 | 5,025 |
| Tax benefit from stock option exercises | 966 | 120 |
| Gain on sale of property, plant and equipment | 313 | 100 |
| Deferred income taxes | (1,448) | (2,298) |
| Deferred compensation | (222) | 561 |
| Loss on impaired investments | | 1,768 |
| Changes in assets and liabilities: | | |
| Accounts receivable, net | (1,403) | 251 |
| Inventories, net | (8,523) | 224 |
| Prepaid expenses and other assets | (2,891) | (4,793) |
| Accounts payable | 2,532 | 782 |
| Accrued volume incentives | 2,170 | 1,952 |
| Accrued liabilities | 6,963 | 3,769 |
| Income taxes payable | 1,681 | 67 |
| Net cash provided by operating activities | 16,784 | 9,693 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Capital expenditures | (6,061) | (2,833) |
| Proceeds from sale (purchase) of investments | (1,176) | 2,020 |
| Payments received on long-term receivables | 478 | 840 |
| Proceeds from sale of property, plant and equipment | 79 | 138 |
| Net cash provided by (used) in investing activities | (6,680) | 165 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Net (payments) proceeds from line of credit | (5,000) | 4,500 |
| Payment of cash dividends | (2,235) | (1,426) |
| Purchase of treasury stock | (17) | (11,796) |
| Proceeds from exercise of stock options | 7,205 | 982 |
| Net cash used in financing activities | (47) | (7,740) |
| EFFECT OF EXCHANGE RATES ON CASH | (1,201) | (1,174) |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 8,856 | 944 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD | 30,665 | 26,175 |
| CASH AND CASH EQUIVALENTS AT END OF THE PERIOD | \$ 39,521 | \$ 27,119 |

See accompanying notes to condensed consolidated financial statements.

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 AND ACCOUNTING POLICIES

The unaudited, condensed consolidated financial statements of Nature's Sunshine Products, Inc. and subsidiaries (together, the Company) included herein have been prepared pursuant to the rules and regulations of the United States Securities and Exchange Commission. Certain information and footnote disclosures normally required in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although the Company believes the following disclosures are adequate to make the information presented not misleading.

These unaudited, condensed consolidated financial statements reflect all adjustments, which in the opinion of management are necessary to present fairly the Company's financial position as of September 30, 2004, and the results of their operations and their cash flows for the periods presented. All of the adjustments which have been made in these condensed consolidated financial statements are of a normal recurring nature. Operating results for the three and nine months ended September 30, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004.

We re-evaluated our financial statement presentation of volume incentive payments made to our independent Distributors and Managers during the year ended December 31, 2003. These payments consist of (1) commissions paid for purchases made by the Distributors and Managers down-line organizations, and (2) rebates paid to Distributors and Managers for purchases of products for their own use or for resale. In accordance with Emerging Issue Task Force Issue 01-9 (EITF 01-9), we determined it was appropriate to present the portion of volume incentive payments representing rebates as reductions to sales revenue rather than as operating expenses. As a result, we have reclassified the appropriate amounts for all periods presented in this Form 10-Q, including all quarterly and segment data, by reducing sales revenue and volume incentives (operating expense) by equal amounts. These reclassifications had no effect on operating income, net income, or earnings per basic or diluted common share.

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, 2003.

(2) RECENT ACCOUNTING PRONOUNCEMENTS

In January 2003, the Financial Accounting Standards Board, or FASB, issued FASB Interpretation (FIN) No. 46, Consolidation of Variable Interest Entities - An Interpretation of ARB No. 51 (FIN)

No. 46). FIN No. 46 addresses consolidation and reporting by business enterprises of variable interest entities. All enterprises with variable interests in variable interest entities created after January 31, 2003 apply the provisions of FIN No. 46 to those entities immediately. A public entity with a variable interest in a variable interest entity created before February 1, 2003 applies the provisions of FIN No. 46 to that entity no later than the beginning of the first interim or annual reporting period beginning after June 15, 2003. In addition, FIN No. 46R delayed the effective date for application of FIN No. 46 by public companies, until periods ending after March 15, 2004 for all types of variable interest entities other than special-purpose entities. The adoption of FIN No. 46 did not have an effect on our results of operations, liquidity, or financial position.

(3) INVENTORIES

Inventories consist of the following:

| | September 30, 2004 | December 31, 2003 |
|-----------------|-----------------------|----------------------|
| Raw materials | \$ 9,286 | \$ 6,940 |
| Work in process | 743 | 914 |
| Finished goods | 25,058 | 18,674 |
| | \$ 35,087 | \$ 26,528 |

(4) DEFINITE-LIVED INTANGIBLE ASSETS

The composition of the Company's definite-lived intangible assets is as follows:

| | As of September 30, 2004 | | | As of December 31, 2003 | | |
|----------------------------------|--------------------------|-----------------------------|----------|-------------------------|-----------------------------|----------|
| | Carrying Amount | Accumulated Amortization | Net | Carrying Amount | Accumulated Amortization | Net |
| Acquired Distributor Networks | \$ 3,213 | \$ 1,381 | \$ 1,832 | \$ 3,213 | \$ 1,119 | \$ 2,094 |

As of September 30, 2004, the Company determined that none of its intangible assets are impaired. Amortization expense for intangible assets for the nine months ended September 30, 2004 was \$262. Estimated amortization expense for the remainder of 2004 and the five succeeding fiscal years is as follows:

| | Estimated Amortization Expense |
|------------------|--------------------------------------|
| 2004 (remainder) | \$ 75 |
| 2005 | 299 |
| 2006 | 299 |
| 2007 | 299 |
| 2008 | 299 |
| Thereafter | 561 |

\$ 1,832

(5) NET INCOME PER COMMON 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 common stock equivalents that would have an anti-dilutive effect on net income per common share. For periods in which the Company incurs losses, Diluted EPS does not assume the exercise or conversion of common stock equivalents.

As of September 30, 2004, the Company had a total of 2,228 common stock options outstanding. These options were granted at fair market value and have a weighted-average exercise price of \$8.53 per share.

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 nine months ended September 30, 2004 and 2003.

| | Net Income (Numerator) | Shares (Denominator) | Per Share Amount |
|---|---------------------------|-------------------------|---------------------|
| <u>Three Months Ended September 30, 2004</u> | | | |
| Basic EPS | \$ 4,607 | 15,076 | \$ 0.31 |
| Effect of stock options | | 578 | (0.02) |
| Diluted EPS | \$ 4,607 | 15,654 | \$ 0.29 |
| <u>Three Months Ended September 30, 2003</u> | | | |
| Basic EPS | \$ (564) | 13,930 | \$ (0.04) |
| Effect of stock options | | | |
| Diluted EPS | \$ (564) | 13,930 | \$ (0.04) |
| <u>Nine Months Ended September 30, 2004</u> | | | |
| Basic EPS | \$ 12,417 | 14,846 | \$ 0.84 |
| Effect of stock options | | 549 | (0.03) |
| Diluted EPS | \$ 12,417 | 15,395 | \$ 0.81 |
| <u>Nine Months Ended September 30, 2003</u> | | | |
| Basic EPS | \$ 2,165 | 14,237 | \$ 0.15 |
| Effect of stock options | | 174 | |
| Diluted EPS | \$ 2,165 | 14,411 | \$ 0.15 |

For the three months ended September 30, 2004 and 2003, there were outstanding options to purchase 47 and 3,430 shares of common stock, respectively, that were not included in the computation of Diluted EPS, as their effect would have been anti-dilutive. For the nine months ended September 30, 2004 and 2003, there were options to purchase 36 and 497 shares of common stock, respectively, that were not included in the computation of diluted EPS, as their effect would have been anti-dilutive.

(6) EQUITY TRANSACTIONS

The Company has declared consecutive quarterly cash dividends since 1988. During the third quarter, the Company paid a dividend of 5 cents per common share on August 19, 2004 to shareholders of record on August 9, 2004.

Common shares held as treasury stock totaled 4,352 at September 30, 2004 compared to 5,267 at December 31, 2003. Common shares held as treasury stock decreased as a result of common shares issued from treasury stock for the exercise of stock options.

(7) OPERATING LINE OF CREDIT

The Company has an operating line of credit with an interest rate equal to LIBOR plus 1.5 percent, which provides for borrowings of up to \$15,000. Borrowings under this line of credit may be used to repurchase shares of the Company's outstanding common stock under Board-authorized repurchase programs as well as to fund working capital, capital expenditures, and related costs. The Company amended the terms of the line of credit during the second quarter to extend the maturity date to July 1, 2006. The line of credit had an original maturity of July 1, 2004. There were no outstanding borrowings under this line of credit at September 30, 2004. The line of credit contains various terms and conditions, including affirmative and negative financial covenants. As of September 30, 2004, the Company was in compliance with these covenants.

(8) ACCUMULATED OTHER COMPREHENSIVE LOSS

The composition of accumulated other comprehensive loss, net of tax, is as follows:

| | Foreign Currency Translation Adjustments | Unrealized Gains On Available-For- Sale Securities | Total Accumulated Other Comprehensive Loss |
|----------------------------------|--|--|---|
| Balance as of December 31, 2003 | \$ (18,428) | \$ 169 | \$ (18,259) |
| Period Change | (1,573) | (46) | (1,619) |
| Balance as of September 30, 2004 | \$ (20,001) | \$ 123 | \$ (19,878) |

(9) STOCK-BASED COMPENSATION

The Company accounts for stock-based compensation plans for employees and directors under Accounting Principles Board Opinion No. 25, under which no compensation cost has been recognized in the accompanying condensed consolidated statements of income for the three and nine months ended September 30, 2004 and 2003. Had compensation cost been determined consistent with SFAS No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, the Company's net income (loss) and net income (loss) per share would have been reduced to the following pro forma amounts:

| | | Three Months Ended September 30, | |
|------------------------------------|--|---|-------------|
| | | 2004 | 2003 |
| Net Income (Loss) | As reported | \$ 4,607 | \$ (564) |
| | Stock option expense, net of related tax effects | (131) | (64) |
| | Pro forma | \$ 4,476 | \$ (628) |
| Basic Net Income (Loss)Per Share | As reported | \$ 0.31 | \$ (0.04) |
| | Stock option expense, net of related tax effects | (0.01) | (0.01) |
| | Pro forma | \$ 0.30 | \$ (0.05) |
| Diluted Net Income (Loss)Per Share | As reported | \$ 0.29 | \$ (0.04) |
| | Stock option expense, net of related tax effects | (0.00) | (0.01) |
| | Pro forma | \$ 0.29 | \$ (0.05) |

| | | Nine Months Ended September 30, | |
|------------------------------|--|--|-------------|
| | | 2004 | 2003 |
| Net Income | As reported | \$ 12,417 | \$ 2,165 |
| | Stock option expense, net of related tax effects | (331) | (177) |
| | Pro forma | \$ 12,086 | \$ 1,988 |
| Basic Net Income Per Share | As reported | \$ 0.84 | \$ 0.15 |
| | Stock option expense, net of related tax effects | (0.03) | (0.01) |
| | Pro forma | \$ 0.81 | \$ 0.14 |
| Diluted Net Income Per Share | As reported | \$ 0.81 | \$ 0.15 |
| | Stock option expense, net of related tax effects | (0.02) | (0.01) |
| | Pro forma | \$ 0.79 | \$ 0.14 |

(10) SEGMENT INFORMATION

The Company has three operating segments. These operating segments are components of the Company for which separate information is available that is evaluated regularly by management in deciding how to allocate resources and assess performance. The Company evaluates performance based on operating income.

The Company has three operating segments, which includes a United States segment, an international segment that operates under the Nature's Sunshine Products name, and a third operating segment that operates under the Synergy Worldwide name. The segments have similar business characteristics and each offers similar products through similar methods of distribution. Inter-segment sales, eliminated in consolidation, are not material. The Company evaluates performance based on operating income (loss) by segment before consideration of certain inter-segment transfers and expenses. This information is used by the Chief Operating Decision Maker to assess the segments performance and in allocating the Company's resources. During the three-month period ended September 30, 2004, the Company changed the composition of its operating segments as a result of converting certain locations from Nature's Sunshine to Synergy Operations and has restated the corresponding items of segment information for prior periods.

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Operating segment information is as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|---|------------------------------------|---|
| | 2004 | 2003 (As Restated, See Note 1 and 10) | 2004 | 2003 (As Restated, See Note 1 and 10) |
| Net Sales Revenue: | | | | |
| Nature's Sunshine Products: | | | | |
| United States | \$ 32,886 | \$ 33,969 | \$ 103,336 | \$ 107,786 |
| International | 26,383 | 22,937 | 76,646 | 65,499 |
| | 59,269 | 56,906 | 179,982 | 173,285 |
| Synergy Worldwide: | 24,348 | 6,564 | 60,118 | 16,440 |
| | 83,617 | 63,470 | 240,100 | 189,725 |
| Operating Expenses: | | | | |
| Nature's Sunshine Products: | | | | |
| United States | 30,843 | 33,870 | 98,273 | 103,282 |
| International | 23,521 | 23,287 | 69,450 | 63,728 |
| | 54,364 | 57,157 | 167,723 | 167,010 |
| Synergy Worldwide: | 22,471 | 7,361 | 57,218 | 18,816 |
| | 76,835 | 64,518 | 224,941 | 185,826 |
| Operating Income (Loss): | | | | |
| Nature's Sunshine Products: | | | | |
| United States | 2,043 | 99 | 5,063 | 4,504 |
| International | 2,862 | (350) | 7,196 | 1,771 |
| | 4,905 | (251) | 12,259 | 6,275 |
| Synergy Worldwide: | 1,877 | (797) | 2,900 | (2,376) |
| | 6,782 | (1,048) | 15,159 | 3,899 |
| Other Income (Expense), net | 175 | 220 | 903 | (715) |
| Income (Loss) Before Provision for Income Taxes | \$ 6,957 | \$ (828) | \$ 16,062 | \$ 3,184 |

Segment assets as of September 30, 2004 and December 31, 2003, are as follows:

| | September 30, 2004 | December 31, 2003 (As Restated, See Note 10) |
|-----------------------------|-----------------------|---|
| Assets: | | |
| Nature's Sunshine Products: | | |
| United States | \$ 91,889 | \$ 79,840 |
| International | 40,302 | 34,368 |
| | 132,191 | 114,208 |
| Synergy Worldwide: | 18,277 | 11,350 |
| Total Assets | \$ 150,468 | \$ 125,558 |

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

The following discussion should be read in conjunction with the interim financial information included in this Form 10-Q 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, 2003.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

The following Management's Discussion and Analysis of Financial Condition and Results of Operations and other sections of this Form 10-Q 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. Such statements may relate but not be limited to projections of revenues, income or loss, capital expenditures, plans for growth and future operations, financing needs, product liability claims and availability of insurance, as well as assumptions relating to the foregoing. Forward-looking statements are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified. When used in Management's Discussion and Analysis of Financial Condition and Results of Operations, and elsewhere in this Form 10-Q the words estimates, expects, anticipates, projects, plans, intends and variations of such words and similar expressions intended to identify forward-looking statements that involve risks and uncertainties. Future events and actual results could differ materially from those set forth in, contemplated by, or underlying the forward-looking statements. For factors which could affect such results, see the description of our business contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2003.

CRITICAL ACCOUNTING POLICIES

Revenue Recognition

We recognize sales revenue when products are shipped and title passes to our independent distributors. For most product sales, the sales price is received in the form of cash or credit card payment, which accompanies or precedes the shipment of the orders. As products are shipped, persuasive evidence of an arrangement exists, delivery has occurred, the price to the buyer is fixed, and collectibility is reasonably assured. A reserve for product returns, which reduces revenue, is accrued based on historical experience. From time to time, our United States operation extends short-term credit associated with product promotions. For certain of our international operations, we offer credit terms consistent with industry standards within the country of operation. Amounts received for unshipped merchandise are not recognized as revenue but rather they are recorded as customer deposits and are included in accrued liabilities.

Volume Incentives Accrual

We accrue for volume incentives expense associated with our net sales revenue. Volume incentives are a significant part of our direct sales marketing program and represent commission payments made to our independent Distributors and Managers. We specifically analyze volume incentives based on historical and current sales trends when evaluating the adequacy of the accrued volume incentives. We have re-evaluated our financial statement presentation of volume incentive payments made to our independent Distributors and Managers. These payments consist of (1) commissions paid for purchases made by the Distributors and Managers down-line organizations, and (2) rebates paid to Distributors and Managers for purchases of products for their own use or for resale. In accordance with EITF 01-9, we present the portion of volume incentive payments representing rebates as reductions to sales revenue rather than as operating expenses. As a result, we have reclassified the appropriate amounts for all periods presented in this Form 10-Q, including all segment data, by reducing sales revenue and volume incentives (operating expense) by equal amounts. These reclassifications had no effect on operating income, net income, or earnings per basic or diluted common shares.

Self-insurance Liabilities

We self-insure for certain employee medical and specific product liabilities. 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

We accrue for expenses of 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.

RESULTS OF OPERATIONS

The following table identifies for the three-month periods (i) the relationship that net income items disclosed in the condensed consolidated financial statements have to total sales, and (ii) the amount and percent of change of such items compared to the corresponding prior period.

(Dollar Amounts in Thousands)

(Unaudited)

| Income and Expense Items | (i) Income and Expense Items as a Percent of Net sales Three Months Ended September 30, | | Amount of Increase (Decrease) | Percent of Change |
|---|---|--------|-------------------------------------|-------------------------|
| | 2004 | 2003 | | |
| Net sales | 100.0% | 100.0% | \$ 20,147 | 31.7% |
| Cost of goods sold | 18.3 | 20.8 | 2,084 | 15.8 |
| Volume incentives | 39.9 | 37.0 | 9,860 | 42.0 |
| SG&A expenses | 33.7 | 43.9 | 373 | 1.3 |
| Total operating expenses | 91.9 | 101.7 | 12,317 | 19.1 |
| Operating income | 8.1 | (1.7) | 7,830 | 747.2 |
| Other income (expense), net | 0.2 | 0.4 | (45) | (20.5) |
| Income before provision for income taxes | 8.3 | (1.3) | 7,785 | 940.2 |
| Provision (benefit) for income taxes | 2.8 | (0.4) | 2,614 | 990.2 |
| Net income | 5.5% | (0.9)% | \$ 5,171 | 916.8% |

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The following table identifies for the nine-month periods (i) the relationship that net income items disclosed in the condensed consolidated financial statements have to total sales, and (ii) the amount and percent of change of such items compared to the corresponding prior period.

(Dollar Amounts in Thousands)

(Unaudited)

| Income and Expense Items | (i) Income and Expense Items as a Percent of Net sales Nine Months Ended September 30, | | (ii) Nine Months Ended September 30, 2004 to 2003 | |
|--|--|--------|--|-------------------------|
| | 2004 | 2003 | Amount of Increase (Decrease) | Percent of Change |
| Net sales | 100.0% | 100.0% | \$ 50,375 | 26.6% |
| Cost of goods sold | 18.7 | 20.6 | 5,659 | 14.5 |
| Volume incentives | 38.7 | 36.3 | 24,058 | 34.9 |
| SG&A expenses | 36.3 | 41.0 | 9,398 | 12.1 |
| Total operating expenses | 93.7 | 97.9 | 39,115 | 21.1 |
| Operating income | 6.3 | 2.1 | 11,260 | 288.8 |
| Other income (expense), net | 0.4 | (0.4) | 1,618 | 226.3 |
| Income before provision for income taxes | 6.7 | 1.7 | 12,878 | 404.5 |
| Provision for income taxes | 1.5 | 0.6 | 2,626 | 257.7 |
| Net income | 5.2% | 1.1% | \$ 10,252 | 473.5% |

Net Sales Revenue

Net sales revenue for the three months ended September 30, 2004, was \$83.6 million compared to \$63.5 million for the same period in the prior year, an increase of approximately 31.7 percent. Net sales revenue for the nine months ended September 30, 2004, was \$240.1 million compared to \$189.7 million for the same period in the prior year, an increase of approximately 26.6 percent. The increase in net sales revenue for the three and nine months ended September 30, 2004, primarily reflects higher net sales revenue in our Synergy Worldwide and international operations due to an increased number of distributors which resulted in an increased number of units sold.

United States net sales revenue for the third quarter totaled \$32.9 million, compared with \$34.0 million in the same period of the prior year, a decline of 3.2 percent. For the nine months ended September 30, 2004, United States net sales revenue totaled \$103.3 million, a decline of 4.1 percent from the same period of the prior year. Net sales revenue in the United States, which includes sales revenue from the Dominican Republic, continues to be negatively impacted by the devaluation of the Dominican Republic peso. Year to date operating income in the United States totaled \$5.1 million compared to \$4.5 million in the prior year.

Nature's Sunshine's international net sales revenue for the third quarter totaled \$26.4 million, compared to \$22.9 million in the same period of the prior year, an increase of 15.0 percent. For the first nine months, international net sales revenue totaled \$76.6 million, a 17.0 percent increase over the same period of the prior year. Third quarter performances were particularly strong in the Russian Federation, the United Kingdom and Ireland, Canada, Colombia and Central America. The increase in net sales revenue reflects the continued increase in distributors and managers in the Company's international operations. Year to date operating income for the Company's international division totaled \$7.2 million compared to \$1.8 million for the prior year.

Synergy Worldwide, which operates principally in Asia, is experiencing continued rapid growth this year. In the third quarter, net sales revenue totaled \$24.3 million, compared with \$6.6 million in the same period of the prior year, and for the nine months ended September 30, 2004, net sales revenue totaled \$60.1 million, up from \$16.4 million in the same period of the prior year. The increase in net sales revenue is a result of continued expansion of Synergy Worldwide into the Asian markets, particularly Japan. During the third quarter Synergy began operations in Australia and converted Nature's Sunshine Singapore and Nature's Sunshine Korea to Synergy Operations. Year to date operating income for Synergy Worldwide totaled \$2.9 million compared to an operating loss of \$2.4 million for the prior year.

Our independent sales force consists of Managers and Distributors. A Distributor interested in earning additional income by committing more time and effort to selling our products may attain the rank of Manager. Appointment as a Manager is dependent upon attaining certain volume levels and demonstrating leadership abilities. The number of Managers as of September 30, 2004, was approximately 18,100 compared to approximately 15,150 as of December 31, 2003. The number of Distributors at September 30, 2004, was approximately 652,000 compared to approximately 562,000 as of December 31, 2003. Our Synergy division, Mexico and Russian operations account for the majority of the increase in Managers and Distributors since December 31, 2003 due to favorable sales trends in recent months.

Cost of Goods Sold

For the three and nine months ended September 30, 2004, cost of goods sold decreased slightly, as a percent of net sales revenue, compared to the same periods in the prior year primarily as a result of the increase in Synergy Worldwide net sales revenue where cost of goods sold are slightly lower. We expect cost of goods sold to decrease slightly, as a percent of net sales revenue during the remainder of 2004 compared to the three and nine months ended September 30, 2004 due to the price increase we implemented in the United States market effective April 1, 2004 and also due to the anticipated growth in net sales revenue from Synergy Worldwide.

Volume Incentives

Volume incentives are commissions paid to independent sales force members for reaching certain levels of net sales revenue performance and organizational development and are an integral part of our direct sales marketing program. Volume incentives vary slightly, on a percentage basis, by product due to our pricing policies and commission plans in place in our international operations. For the three and nine months ended September 30, 2004, volume incentives, as a percent of net sales, increased compared to the same periods in the prior year primarily as a result of the increase in the Synergy Worldwide net sales revenue where volume incentives are slightly higher. We expect volume incentives to increase slightly, as a percent of net sales, during the remainder of 2004 compared to the three and nine months ended September 30, 2004 as a result of anticipated increases in net sales revenue from Synergy Worldwide.

We re-evaluated our financial statement presentation of volume incentive payments made to our independent Distributors and Managers during the year ended December 31, 2003. These payments consist of (1) commissions paid for purchases made by the Distributors and Managers down-line organizations, and (2) rebates paid to Distributors and Managers for purchases of products for their own use or for resale. In accordance with EITF 01-9, we determined to present the portion of volume incentive payments representing rebates as reductions to sales revenue rather than as operating expenses. As a result, we have reclassified the appropriate amounts for all periods presented in this Form 10-Q, including all quarterly and segment data, by reducing sales revenue and volume incentives (operating expense) by equal amounts. These reclassifications had no effect on operating income (loss), net income (loss), or earnings per basic or diluted common share.

Selling, General and Administrative

Selling, general and administrative expenses for the three and nine months ended September 30, 2004, increased \$0.4 million and \$9.4 million, respectively, compared to the same periods of the prior year primarily as a result of increased selling, general and administrative expenses associated with the expansion of Synergy Worldwide. For the remaining quarters of 2004, we expect selling, general and administrative expenses, as a percent of net sales, to decrease as compared to the three and nine months ended September 30, 2004, as a result of benefits from cost controls implemented during the quarter ended September 30, 2003, as well as continued growth in net sales revenue.

Other Income (Expense)

Other income (expense) for the nine months ended September 30, 2004, increased \$1.6 million compared to the same period of the prior year primarily as a result of an impairment of an equity investment in HealthTech Corporation of \$1.8 million in the second quarter of 2003.

Income Tax

The effective income tax rate for the three and nine months ended September 30, 2004, was approximately 33.8 percent and 22.7 percent, respectively. During the second quarter of 2004 the Company completed a detailed income tax study of its foreign tax assets which resulted in a benefit of approximately \$2.2 million, the majority of which was recognized in the second quarter of 2004. The income tax rate in effect as of September 30, 2004 is not indicative of the expected income tax rate for the remainder of 2004.

Product Liability

Similar to other manufacturers and distributors 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. As a result of increased regulatory scrutiny of products that contain ephedrine alkaloids and kava, we have not been able to obtain product liability insurance covering such products. However, effective April 12, 2004, we complied with the U.S. Food and Drug Administration's ban on the ingredient ephedra. During the year ended December 31, 2003, less than 2 percent of our products contained some amount of ephedrine alkaloids and kava. On June 1, 2003, we established a wholly owned captive insurance company to provide us with product liability insurance coverage. We have accrued an amount using the assistance of a third party actuary that we believe is sufficient to cover probable and reasonably estimable liabilities related to product liability claims based on our history of such claims. 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 financial position, results of operations or liquidity.

We self-insure for certain employee medical and product liabilities. 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.

Balance Sheet

Inventories

Inventories increased \$8.6 million as of September 30, 2004, compared to December 31, 2003 as a result of additional inventory purchases to support the growth of our Synergy Worldwide division.

Accrued Liabilities

Accrued liabilities increased approximately \$7.0 million as of September 30, 2004 compared to December 31, 2003, primarily as a result of the timing of incentive trip accruals associated with our direct sales marketing program, which rewards independent Distributors and Managers with paid attendance at our conventions as well as accruals associated with employee compensation in accordance with the Company's compensation program.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents increased approximately \$8.9 million as of September 30, 2004 compared to December 31, 2003. The increase in cash and cash equivalents is primarily the result of cash provided by operating activities of \$16.8 million and proceeds of \$7.2 million from the exercise of stock options. These cash inflows were offset, in part by the payment of \$5.0 million associated with our operating line of credit, \$1.2 million for the purchase of long term investments, \$2.2 million for the payment of cash dividends, and \$6.1 million for the purchase of property, plant and equipment.

During 2002, the Company entered into an unsecured operating line of credit with an interest rate equal to LIBOR plus 1.5 percent, which provides for borrowings of up to \$15.0 million. Borrowings under this line of credit may be used to repurchase common shares of the Company's outstanding stock under Board-authorized repurchase programs as well as to fund working capital, capital expenditures, and related costs. The Company amended the terms of the line of credit during the second quarter to extend the maturity date to July 1, 2006. The line of credit had an original maturity of July 1, 2004. There were no outstanding borrowings under this line of credit at September 30, 2004. The line of credit contains various terms and conditions, including affirmative and negative financial covenants. As of September 30, 2004, the Company was in compliance with these covenants.

On October 27, 2004, the Company commenced a Dutch auction tender offer for up to 1,000,000 shares of its common stock, at a price not greater than \$16.50 nor less than \$14.20 per share. The tender offer will expire at Midnight on November 24, 2004 unless the Company extends the tender offer. Assuming the Company purchases the maximum of 1,000,000 shares that it is obligated to purchase pursuant to the offer at a purchase price of \$16.50 per share, the Company expects the aggregate cost of such purchase to be approximately \$16,885,000, including estimated fees and expenses of approximately \$385,000. The tender offer is expected to be funded with available cash and borrowings under the Company's \$15 million unsecured line of credit. The Company does not expect the tender offer to affect its capital expenditures.

The complete terms and conditions of the Dutch auction tender offer are contained in an Offer to Purchase and Letter of Transmittal, which are filed as exhibits (a)(1) and (a)(2) to a Tender Offer Statement on Schedule TO that was filed by the Company on October 27, 2004, which is available free of charge by accessing the Securities and Exchange Commission site on the World Wide Web at www.sec.gov.

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

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We conduct our business in several countries and intend to continue to expand our foreign 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 foreign operations, including changes in the laws and policies that govern foreign investment in countries where we have operations as well as, to a lesser extent, changes in United States laws and regulations relating to foreign trade and investment.

Foreign Currency Risk

During the nine months ended September 30, 2004, approximately 57.0 percent of our revenue and 56.3 percent of our 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 considered its functional currency, and all sales and expenses are translated at average exchange rates for the reported periods. Therefore, our operating results generally will be positively impacted by a weakening of the U.S. dollar and will be negatively impacted by a strengthening of the U.S. dollar. Given the uncertainty of exchange rate fluctuations, we cannot estimate the effect of these fluctuations on our future business, product pricing, results of operations or financial condition. Changes in 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.

The following table sets forth average currency exchange rates of one U.S. dollar into local currency for each of the countries in which net sales revenue exceeded \$10.0 million during any of the previous two years.

| | Nine months ended September 30, | |
|-------------|---------------------------------|---------|
| | 2004 | 2003 |
| Mexico | 11.3 | 10.7 |
| South Korea | 1,162.8 | 1,194.7 |
| Venezuela | 1,869.2 | 1,623.4 |

Interest Rate Risk

We have investments included in cash and cash equivalents and long term investments, which by nature are subject to market risk. At September 30, 2004, we had investments totaling \$11.0 million. Approximately \$8.6 million of such investments were held as municipal obligations and carried a fixed rate of interest. Of the \$8.6 million held as municipal obligation, \$5.2 million mature over a one to five year period and carry an average fixed rate of 4.9 percent. A hypothetical one percent change in interest rates would not have a material affect on our liquidity, financial position, or results of operations. Our remaining investments of \$2.4 million are not subject to interest rate risk but by their nature are subject to market risk.

The Company's line of credit carries a variable interest rate. As of September 30, 2004, the Company had no borrowings on this line. The Company does not hedge against changes in interest rates. An increase in the effective interest rate of 1.0 percent would increase interest expense by \$10,000 for every \$1.0 million that the Company had outstanding on its line of credit for a full year.

Item 4. DISCLOSURE CONTROLS AND PROCEDURES

(a) **Evaluation of disclosure controls and procedures.** Our management, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, have evaluated the effectiveness of our controls and procedures related to our reporting and disclosure obligations as of September 30, 2004, which is the end of the period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are sufficient to provide that (a) material information relating to us, including our consolidated subsidiaries, is made known to these officers by other employees of us and our consolidated subsidiaries, particularly material information related to the period for which this periodic report is being prepared; and (b) this information is recorded, processed, summarized, evaluated and reported, as applicable, within the time periods specified in the rules and forms of the Securities and Exchange Commission.

(b) **Changes in internal controls.** In preparation for the Company's first management report on internal controls over financial reporting, which will be included in their Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2004, the Company has effected a number of enhancements in its internal controls over financial reporting..

PART II OTHER INFORMATION

Item 1. *LEGAL PROCEEDINGS*

We are a defendant in various lawsuits which are incidental to our business. After consultation with legal counsel, we believe that the ultimate disposition of these matters will not have a material adverse effect upon our consolidated results of operations, financial position, or liquidity.

Item 6. *EXHIBITS*

- 31.1 Rule 13a-14(a) and 15d-14(a) Certification of Chief Executive Officer
- 31.2 Rule 13a-14(a) and 15d-14(a) Certification of Chief Financial Officer
- 32.1 Certification of Chief Executive Officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002

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.

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Date: November 9, 2004

/s/ Douglas Faggioli
Douglas Faggioli, President & Chief Executive Officer

Date: November 9, 2004

/s/ Craig D. Huff
Craig D. Huff, Executive Vice President, Chief Financial
Officer & Treasurer