

NU SKIN ENTERPRISES INC
Form 10-K
February 16, 2018
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, 2017

or

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

For the transition period from _____ to _____

Commission file number: 001-12421

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

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

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

Title of each class	Name of exchange on which registered
Class A Common Stock, \$.001 par value	New York Stock Exchange

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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

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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 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 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," "smaller reporting company," and "emerging growth 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 ☐ Emerging growth company ☐

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

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

Based on the closing sales price of the Class A common stock on the New York Stock Exchange on June 30, 2017, 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 \$3.27 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, 2018, 52,750,931 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 2018 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 1. BUSINESS" AND "ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION," 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, PRODUCTS, PRODUCT INTRODUCTIONS AND OFFERINGS, PRODUCT SOURCING, GROWTH, ACQUISITIONS, 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 OUR MARKETS, SALES FORCE, CUSTOMER BASE AND SALES COMPENSATION PLAN; STATEMENTS REGARDING THE PAYMENT OF FUTURE DIVIDENDS AND STOCK REPURCHASES; STATEMENTS REGARDING THE OUTCOME OF LITIGATION AND OTHER LEGAL MATTERS; 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," "COMMIT," "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 and ageLOC 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

Founded more than 30 years ago, Nu Skin Enterprises, Inc. develops and distributes innovative consumer products, offering a comprehensive line of premium-quality beauty and wellness solutions in approximately 50 markets worldwide. In 2017, our revenue of \$2.3 billion was primarily generated by our two category brands: our beauty and personal care category brand known as Nu Skin and our nutritional products category brand, Pharmanex. We have also leveraged our scientific expertise in the area of anti-aging to develop our ageLOC brand that features innovative products in both of these categories. We operate in the direct selling channel, primarily utilizing person-to-person marketing to promote and sell our products.

About 90% of our revenue came from outside of the United States in 2017, with approximately 32% of our revenue coming from Mainland China, our largest revenue market. Given 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 can be impacted by global economic, political, demographic and business trends and conditions.

Our operations are subject to various laws and regulations globally, particularly with respect to our product categories and our distribution channel. See Item 1A. Risk Factors for a more detailed description of the risks associated with our business.

We have historically acquired ingredients and contracted production of most of our products from third-party suppliers and manufacturers, except in Mainland China, where we manufacture the majority of our products. However, we recently acquired companies that we believe will help to integrate some of our product sourcing and production functions into our corporate structure, and we may continue to review additional acquisition targets in the future. For more information, see "Sourcing and Production," below.

PRODUCTS

We offer a branded, differentiated product platform. We believe our innovative approach to product development and distribution 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 brand, which features innovative, premium-quality anti-aging products. We also are increasingly focused on developing and offering products that are conducive to social selling, including cosmetics and other socially demonstrable and shareable products. We believe that our acquired and licensed technologies, research collaborations and in-house research expertise enable us to introduce innovative, proprietary products. We source and produce nearly all our proprietary products through trusted third parties and manufacturing partners, except in Mainland China, where we manufacture the majority of our products.

During 2015 and 2016, and continuing into 2017, we launched our ageLOC Youth nutritional supplement and our ageLOC Me customized skin care system. Beginning in the fourth quarter of 2017 and continuing into 2018, we are launching our ageLOC LumiSpa skin treatment and cleansing device.

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. We also offer products under other brands, particularly products in our Nu Skin category brand that are conducive to social selling.

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, 2015, 2016, and 2017. This table should be read in conjunction with the information presented in Item 7. 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,					
	2015		2016		2017	
Nu Skin	\$1,363.5	60.7%	\$1,308.2	59.3%	\$1,456.4	63.9%
Pharmanex	877.9	39.1%	892.7	40.4%	817.2	35.9%
Other ⁽²⁾	5.6	0.2%	6.9	0.3%	5.5	0.2%
	\$2,247.0	100.0%	\$2,207.8	100.0%	\$2,279.1	100.0%

In 2017, 90% of our sales were transacted in foreign currencies that were then converted to U.S. dollars for (1) financial reporting purposes at weighted-average exchange rates. Foreign-currency fluctuations negatively impact reported revenue by less than 1% in 2017 compared to 2016 and by 2% in 2016 compared to 2015.

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

Nu Skin. Our strategy for the Nu Skin category brand 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. In 2017, our three top-selling products in this category were our innovative skin care devices: our ageLOC Spa systems, ageLOC Me customized skin care system, and ageLOC LumiSpa skin treatment and cleansing device. Our ageLOC skin care products accounted for 32% of our total revenue and 50% of our Nu Skin product category revenue in 2017. 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. We tested and introduced a number of these products—particularly products that are conducive to social selling, such as Powerlips Fluid lip color and Dr. Dana® nail care system—at our global distributor convention in October 2017.

Pharmanex. Our strategy for the Pharmanex category brand 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 nutritional supplements, ageLOC Youth nutritional supplement, and ageLOC TR90 weight management and body shaping system. Our ageLOC nutritional products accounted for 19% of our total revenue and 52% of our Pharmanex product category revenue in 2017. We also offer a number of other anti-aging nutritional solutions and weight management products.

Product Development

We are committed to developing and marketing innovative products. We have several products in development, including next-generation skin care products and nutritional supplements. In our research and product development, we seek to better understand the sources of aging, including the influence of certain ingredients on gene expression, to enhance our ability to innovate in our development of anti-aging products. We also are increasingly focused on

developing and offering products that are conducive to social selling, including cosmetics and other socially demonstrable and shareable products.

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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, among others, natural product chemistry, biochemistry, dermatology, pharmacology and clinical studies. Our expenses for internal research and development activities and joint research projects and collaborations were \$20.1 million, \$24.3 million and \$22.0 million in 2015, 2016 and 2017, respectively.

We also work to identify and assess innovative technologies developed by third parties for potential licensing, supply or acquisition 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 all of the upfront costs and uncertainty associated with internal development. We have also invested in acquisitions to supplement our research capabilities and to acquire technologies, including our acquisition of Pharmanex in 1998; 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 the early 2000s; and the acquisition of assets related to the genetic sources of aging from LifeGen Technologies, LLC in 2011. We incur expenses for royalties and amortization for previous technology-related acquisitions.

Intellectual Property

Our major trademarks are registered in the United States and in each market 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®, Epoch®, ageLOC Me® and LumiSpa®. In addition, a number of our products, including our facial spas, ageLOC Body Spa, LumiSpa, TR90, 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 products and other products.

Sourcing and Production

Nu Skin. For markets other than Mainland China, in 2017, we acquired ingredients and contracted production of nearly all our Nu Skin personal care products from third-party partners, suppliers and manufacturers. In Mainland China, we operate manufacturing facilities where we produce the majority of our personal care products sold in Mainland China, and some products exported to other markets.

We acquired ingredients and products from three suppliers that represented more than 10% of our Nu Skin personal care purchases in 2017. We maintain a good relationship with 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, 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. We procure our ageLOC Spa systems 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. Please refer to Item 1A. 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, in 2017, we sourced 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.

Four of our suppliers manufactured products representing more than 10% of our Pharmanex nutritional supplement purchases in 2017. We maintain a good relationship with 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 Item 1A. 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.

In January and February 2018, we acquired three companies that we believe will help to integrate some of our product sourcing and production functions into our corporate structure:

• Treviso, LLC, which primarily develops and manufactures personal care products;

• Innuate Health Sciences LLC, which primarily develops and manufactures nutritional supplements; and

• L&W Holdings, Inc., which primarily sources and procures product packaging.

We may continue to review acquisition targets that would complement our current product offerings, increase the size and geographic scope of our operations or otherwise offer growth and operating efficiency opportunities.

DISTRIBUTION CHANNEL

We operate in the direct selling channel, primarily utilizing person-to-person marketing to promote and sell our products. We support these personal marketing efforts with marketing content, websites, events and technology solutions. We believe our distribution channel is an effective vehicle to distribute our products because:

- our sales force can personally educate consumers about our products, which we believe is more effective for differentiating our products than using traditional mass-media advertising;

- our distribution channel allows for 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, independent direct sellers and independent marketers to market our products.

In many of our markets, our sales force has had success with social selling, in which they use online or social media platforms to find new customers and promote and sell our products. We seek to support these efforts with products that are conducive to social selling and with technology solutions to facilitate this model. Social selling presents certain risks to our business, as discussed further in Item 1A. Risk Factors.

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 direct selling associations globally, we promote and abide by the industry's codes of ethics and consumer protective standards to support and protect those who sell and purchase our products through the direct selling channel.

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 sellers. 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 desire and ability to develop both a consumer group and a team of sellers, including through sales compensation and incentives.

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 ("Customers"). We believe a significant majority of Customers 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. Our Customer numbers do not include retail consumers who purchase products directly from members of our sales force.

To monitor the growth in our sales network, we track the number of independent distributors, and sales employees and independent marketers in Mainland China, who achieve certain qualification requirements ("Sales Leaders"). The following chart sets forth information concerning our Customers and Sales Leaders for the last three years.

Total Number of Customers and Sales Leaders by Region⁽¹⁾

	As of December 31, 2015		As of December 31, 2016		As of December 31, 2017	
	Customers	Sales Leaders	Customers	Sales Leaders	Customers	Sales Leaders
Mainland China	142,000	20,900	175,000	22,000	193,000	40,600
South Korea	214,000	9,700	192,000	9,600	173,000	8,400
Americas	176,000	8,700	166,000	6,700	222,000	8,000
South Asia/Pacific	119,000	10,500	116,000	7,600	144,000	8,900
Japan	152,000	7,700	137,000	6,700	132,000	6,600
Hong Kong/Taiwan	81,000	6,100	73,000	4,600	71,000	