

POWELL INDUSTRIES INC  
Form DEF 14A  
January 07, 2019  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**SCHEDULE 14A**  
**Proxy Statement Pursuant to Section 14(a) of the**  
**Securities Exchange Act of 1934**

Filed by the Registrant

Filed by a party other than the Registrant

Check the appropriate box:

Preliminary Proxy Statement

**Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

Definitive Proxy Statement

Definitive Additional Materials

Soliciting Material Under Rule 14a-12

**Powell Industries, Inc.**

**(Name of Registrant as Specified In Its Charter)**

**(Name of Person(s) Filing Proxy Statement, if other than the Registrant)**

Payment of Filing Fee (Check the appropriate box):

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No fee required.

Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

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Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing:

(1) Amount previously paid:

(2) Form, Schedule or Registration Statement No:

(3) Filing party:

(4) Date Filed:

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**POWELL INDUSTRIES, INC.**

**8550 Mosley Road**

**Houston, Texas 77075**

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS**

**to be held February 20, 2019**

To the Stockholders of Powell Industries, Inc.:

Notice is hereby given that the Annual Meeting of the Stockholders (the Annual Meeting ) of Powell Industries, Inc., a Delaware corporation (the Company ), will be held at the offices of the Company at 7232 Airport Boulevard, in Houston, Texas 77061 on Wednesday, February 20, 2019, at 11:00 a.m., Houston time, for the following purposes:

1. To elect three (3) members of the Company s Board of Directors, with terms to expire in 2022;

2. To hold a stockholder advisory vote on the compensation of executives; and

3. To transact such other business as may properly come before the meeting or any adjournment thereof. The stock transfer books will not be closed. Stockholders of record as of the close of business on January 3, 2019, are entitled to notice of, and to vote at, the Annual Meeting or any adjournment thereof, notwithstanding any transfer of stock on the books of the Company after such record date.

You are cordially invited to attend the meeting in person. **YOU ARE URGED TO COMPLETE, DATE AND SIGN THE ENCLOSED PROXY AND TO RETURN IT PROMPTLY IN THE ENCLOSED ENVELOPE, WHETHER OR NOT YOU PLAN TO ATTEND THE MEETING.**

By Order of the Board of Directors

/s/ Thomas W. Powell  
Thomas W. Powell  
*Chairman of the Board*

Houston, Texas

January 7, 2019

**Important Notice Regarding the Availability of Proxy Materials for the Stockholders Meeting to**

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**Be Held on February 20, 2019**

**This Notice, Proxy Statement, Form of Proxy And Annual Report Are Available At:**

**<https://powellindustriesinc.gcs-web.com/annual-reports>**

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**POWELL INDUSTRIES, INC.**

**8550 Mosley Road**

**Houston, Texas 77075**

**PROXY STATEMENT**

**January 7, 2019**

**Annual Meeting of Stockholders**

**February 20, 2019**

**SOLICITATION AND VOTING RIGHTS**

The accompanying proxy is solicited by the Board of Directors (the **Board**) of Powell Industries, Inc., a Delaware corporation (the **Company**), for use at the Annual Meeting of Stockholders of the Company (the **Annual Meeting**) to be held on Wednesday, February 20, 2019, at 11:00 a.m., Houston time, at the offices of the Company at 7232 Airport Boulevard in Houston, Texas 77061, or at any adjournment thereof.

This Proxy Statement, proxy and the accompanying Notice of Annual Meeting and Annual Report on Form 10-K for year ended September 30, 2018, including consolidated financial statements, will be mailed to stockholders on or about January 7, 2019. The Board has fixed January 3, 2019, as the record date for determination of stockholders entitled to receive notice of and to vote at the Annual Meeting. As of January 3, 2019, there were 11,516,148 shares of the Company's Common Stock, par value \$.01 per share (**Common Stock**), outstanding. Each holder of Common Stock will be entitled to one vote for each share owned, except as noted below.

The presence, in person or by proxy, of the holders of a majority of the outstanding shares of Common Stock is necessary to constitute a quorum at the meeting. Brokers holding shares of record for their customers generally are not entitled to vote on certain matters unless they receive voting instructions from their customers. When brokers complete proxy forms, they generally vote on those matters as to which they are entitled to vote. On those matters as to which brokers are not entitled to vote without instructions from their customers and have not received such instructions, brokers generally indicate on their proxies that they lack voting authority as to those matters. As to those matters, such indications are called **broker non-votes**.

The vote of a plurality of the shares entitled to vote and represented at a meeting at which a quorum is present is required for the election of directors. The persons receiving the greatest number of votes cast at the meeting to fill the directorships with terms to expire in 2022 will be elected as directors of the Company, class of 2022. Thus, abstentions and broker non-votes will have no effect on the election of directors. The proposal related to the non-binding approval of executive compensation is advisory only and therefore does not require a particular number of affirmative votes. Although the advisory vote on executive compensation is non-binding, the compensation committee of the Board (the **Compensation Committee**) values the opinions of the Company's stockholders, and will consider the outcome of the vote when making future executive compensation arrangements.

Shares of the Common Stock present or represented at the Annual Meeting that abstain from voting or that are the subject of broker non-votes will be counted as present for purposes of determining a quorum.

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The shares represented by each valid proxy received by the Company on the form solicited by the Board will be voted in accordance with instructions specified on the proxy. A stockholder giving a duly executed proxy



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may revoke it before it is exercised by filing with or transmitting to the Secretary of the Company an instrument or transmission revoking it, or a duly executed proxy bearing a later date.

In addition to the solicitation of proxies by use of this Proxy Statement, directors, officers and employees of the Company may solicit the return of proxies by mail, personal interview, telephone or the Internet. Officers and employees of the Company will not receive additional compensation for their solicitation efforts, but they will be reimbursed for any out-of-pocket expenses incurred. Brokerage houses and other custodians, nominees and fiduciaries will be requested, in connection with the stock registered in their names, to forward solicitation materials to the beneficial owners of such stock.

All costs of preparing, printing, assembling and mailing the Notice of Annual Meeting of Stockholders, this Proxy Statement, the enclosed form of proxy and any additional materials, as well as the cost of forwarding solicitation materials to the beneficial owners of stock and all other costs of solicitation, will be borne by the Company.

### **Delivery of One Proxy Statement and Annual Report to a Single Household to Reduce Duplicate Mailings**

Each year in connection with the annual meeting of stockholders, the Company is required to send to each stockholder of record a proxy statement and annual report, and to arrange for a proxy statement and annual report to be sent to each beneficial stockholder whose shares are held by or in the name of a broker, bank, trust or other nominee. Because some stockholders hold shares of Common Stock in multiple accounts, this process results in duplicate mailings of proxy statements and annual reports to stockholders who share the same address. Stockholders may avoid receiving duplicate mailings and save the Company the cost of producing and mailing duplicate documents as follows:

***Stockholders of Record.*** If your shares are registered in your own name and you are interested in consenting to the delivery of a single proxy statement or annual report, you may contact the Company by mail at 8550 Mosley Road, Houston, Texas 77075 or by telephone at (713) 947-4422.

***Beneficial Stockholders.*** If your shares are not registered in your own name, your broker, bank, trust or other nominee that holds your shares may have asked you to consent to the delivery of a single proxy statement or annual report if there are other stockholders of the Company who share an address with you. If you currently receive more than one proxy statement or annual report at your household, and would like to receive only one copy of each in the future, you should contact your nominee.

***Right to Request Separate Copies.*** If you consent to the delivery of a single proxy statement and annual report but later decide that you would prefer to receive a separate copy of the proxy statement or annual report, as applicable, for each stockholder sharing your address, then please notify the Company or your nominee, as applicable, and the Company or your nominee will promptly deliver such additional proxy statements or annual reports. If you wish to receive a separate copy of the proxy statement or annual report for each stockholder sharing your address in the future, you may contact the Company by mail at 8550 Mosley Road, Houston, Texas 77075 or by telephone at (713) 947-4422.

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**PROPOSAL NO. 1**

**ELECTION OF DIRECTORS**

The terms of three directors are scheduled to expire at the 2019 Annual Meeting or until their successors are duly elected and qualified under the Company's bylaws. The terms of the remaining directors continue after the Annual Meeting. The Nominating and Governance Committee has nominated Brett A. Cope, Thomas W. Powell and Richard E. Williams for election as directors with terms scheduled to expire in fiscal year 2022 or until their successors are duly elected and qualified. Messrs. Cope, Powell and Williams currently serve as directors of the Company.

Although the Board does not contemplate that any nominee will be unable to serve, if such a situation arises prior to the Annual Meeting, the persons named in the enclosed form of proxy will vote in accordance with their best judgment for a substitute nominee.

**RECOMMENDATION OF THE BOARD**

The Board recommends that the stockholders vote **FOR** the election of each of the nominees.

**PROPOSAL NO. 2**

**ADVISORY APPROVAL OF THE COMPANY'S EXECUTIVE COMPENSATION**

In accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Section 14A of the Exchange Act and the preference for annual non-binding advisory votes on executive compensation expressed by the Company's stockholders at the 2017 Annual Meeting of Stockholders, the Board is providing the stockholders with the opportunity to endorse or not endorse the Company's executive compensation (commonly known as "say-on-pay") through consideration of the following non-binding advisory resolution:

Resolved, that the stockholders approve the compensation of executives, as disclosed pursuant to the compensation disclosure rules of the Securities and Exchange Commission, including the compensation discussion and analysis, the compensation tables and any related material disclosed in this proxy statement.

Because your vote is advisory, it will not be binding on the Board. However, the Compensation Committee will consider the outcome of the vote when making decisions regarding future executive compensation arrangements.

**RECOMMENDATION OF THE BOARD**

The Board recommends a vote **FOR** the advisory approval of the Company's executive compensation. Unless otherwise indicated on your proxy, your shares will be voted **FOR** the advisory approval of the Company's executive compensation.

**Table of Contents****BOARD OF DIRECTORS**

The following table sets forth for each nominee and for each director whose term of office continues after the Annual Meeting, his or her name, age as of the date of the Annual Meeting, principal occupation and employment for the past five years, offices held with the Company, the date he or she first became a director, and the date of expiration of his or her current term as director.

<b>Name</b>	<b>Age</b>	<b>Principal Occupation for Past Five Years<sup>(1)</sup></b>	<b>Offices Held with Company</b>	<b>Director Since</b>	<b>Term Expires</b>
Brett A. Cope	50	President and Chief Executive Officer of the Company since October 1, 2016; Sr. Vice President and Chief Operating Officer from December 30, 2015 through September 30, 2016; and Vice President of Sales and Marketing from December 27, 2010 through December 29, 2015	Director, President and Chief Executive Officer	2016	2019
Thomas W. Powell	78	Chairman of the Board since 1984; President and Chief Executive Officer of the Company from 1984 through September 2008; from September 2011, through August 2012; and from December 2015 through September 2016.	Director, Chairman of the Board	1984	2019
Richard E. Williams	60	President of CDM33 Partners since October 2018; President and Chief Executive Officer of Houston Exponential from September 2017 through February 2018; Shell Loaned Executive to the United Way of Greater Houston since October 2015 until his retirement in 2016; Shell Loaned Executive to Wetlands International from 2013 to 2015; President, Shell WindEnergy Inc. from 2008 to 2013.	Director	2016	2019
Christopher E. Cragg	57	Executive Vice President Operations, Oil States International, Inc. since 2016; Senior Vice President Operations, Oil States International, Inc. since 2006 to 2016; President, Oil States Energy Services since 2012.	Director	2008	2020

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<b>Name</b>	<b>Age</b>	<b>Principal Occupation for Past Five Years<sup>(1)</sup></b>	<b>Offices Held with Company</b>	<b>Director Since</b>	<b>Term Expires</b>
Perry L. Elders	57	Staff, Second Baptist Church of Houston since 2015; Sr. Vice President and Chief Financial Officer, McDermott International, Inc. from 2010 to 2014; Executive Vice President and Chief Financial Officer, Bristow Group Inc. from 2006 to 2009.	Director	2017	2020
Bonnie V. Hancock	57	Executive Director of the Enterprise Risk Management Initiative and Professor of Practice at the Poole College of Management at North Carolina State University since 2005; President of Progress Fuels, a Progress Energy subsidiary from 2002 to 2005.	Director	2010	2020
James W. McGill	63	President Electrical Sector Americas, Eaton Corporation from 2015 until his retirement in 2017; President Electrical Products Group, Eaton Corporation from 2013 to 2015; President Electrical Sector Asia Pacific, Eaton Corporation in 2012; Executive Vice President Human Resources, Eaton Corporation from 2010 to 2011.	Director	2018	2021
John D. White	70	Partner, The Southern Funds Group, LLC since 2008; Managing Director of The Wind Alliance from 2009 to 2011; Chairman of the Board and CEO, Standard Renewable Energy Group, LLC since 2006.	Director	2012	2021

<sup>(1)</sup> None of the corporations listed (other than the Company) is an affiliate of the Company.

**Board Structure, Committee Composition and Meetings**

As of the date of this Proxy Statement, the Board was comprised of eight members, divided into three classes.

The Board is comprised of a majority of independent directors. The Board has determined that, as of the date of this Proxy Statement, Ms. Bonnie V. Hancock and Messrs. Christopher E. Cragg, Perry L. Elders, Thomas W. Powell, James W. McGill, John D. White and Mr. Richard E. Williams, are Independent Directors as such term is defined by Listing Rule 5605(a)(2) of The NASDAQ Stock Market, and that the current members

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of the audit committee are also independent for purposes of Section 10A(m)(3) of the Securities Exchange Act of 1934 ( the Exchange Act ). The Board based its determinations of independence primarily on a review of the responses the directors provided to questions regarding employment and compensation history, affiliations and family and other relationships.

Six meetings of the Board were held during the fiscal year ended September 30, 2018 ( Fiscal 2018 ). No incumbent director attended fewer than seventy-five percent (75%) of the aggregate of (1) the total number of meetings of the Board and (2) the total number of meetings held by all committees of the Board during the period that such director served on such committees.

It is the Company s policy that directors attend the Annual Meeting of Stockholders. At the Annual Meeting of Stockholders on February 21, 2018, all of the Company s directors at that date were present. Stockholders may communicate with directors of the Company by writing to them at the Company s headquarters. Communications addressed to the Board will be reviewed by the Secretary of the Company and directed to the members of the Board for their consideration.

## **Committees, Memberships and Meetings**

The Board has a standing Audit Committee, Compensation Committee and Nominating and Governance Committee. The Board may also establish other committees from time to time as necessary to facilitate the management of the business and affairs of the Company and to comply with the corporate governance rules of The NASDAQ Stock Market.

### **Audit Committee**

The Audit Committee assists the Board in fulfilling its fiduciary responsibilities as to accounting policies and reporting practices of the Company and all subsidiaries and the sufficiency of the audits of all Company activities. It is the Board s agent in ensuring the integrity of financial reports of the Company and its subsidiaries, and the adequacy of disclosures to stockholders. The Audit Committee is the focal point for communication among other directors, the Company s independent registered public accounting firm, internal audit and management as their duties relate to financial accounting, reporting and controls. The Audit Committee Charter does not expressly permit the Audit Committee to delegate its authority. The Audit Committee held four meetings during Fiscal 2018 and all meetings of the Audit Committee were separate and apart from meetings of the full Board.

The Audit Committee is comprised of Perry L. Elders, Christopher E. Cragg and Richard E. Williams. The Board has determined that each of Messrs. Elders and Cragg qualify as an audit committee financial expert, as defined in Item 407(5) of Regulation S-K promulgated under the Exchange Act, and that each member of the Audit Committee is an independent director. A copy of the Audit Committee Charter is available on the Company s website, [powellind.com](http://powellind.com), under the section entitled Investor Relations. The Audit Committee has been structured to comply with the requirements of Section 3(a)(58)(A) of the Exchange Act.

### **Compensation Committee**

The Compensation Committee provides oversight on behalf of the full Board on development and administration of the Company s executive compensation program and all subcomponent plans in which officers or directors are eligible to participate. The Compensation Committee regularly reviews the Company s



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compensation practices, including the methodologies for setting the total compensation for senior management and officers. The Compensation Committee is responsible for determining compensation paid to the executive officers and for reviewing and recommending director compensation to the Board.

The Compensation Committee also strives to make the Company's compensation competitive by comparing the Company's practices and compensation levels against the results of surveys of related-industry companies. The Compensation Committee has the authority to directly engage independent consultants and periodically utilizes consultants to provide advice and recommendations regarding executive compensation. The Compensation Committee has the flexibility to exercise its independent judgment when establishing compensation policies, especially when rewarding individual performance. The Compensation Committee Charter does not expressly permit the Compensation Committee to delegate its authority.

The Compensation Committee is comprised of Christopher E. Cragg, Bonnie V. Hancock and James W. McGill. The Compensation Committee held four meetings during Fiscal 2018. A copy of the Compensation Committee Charter is available on the Company's website, [powellind.com](http://powellind.com), under the section entitled "Investor Relations."

## **Nominating and Governance Committee**

The Nominating and Governance Committee is responsible for selecting director nominees for election by the stockholders to fill directorships with expiring terms and for appointing new members to the Board to fill unexpired terms of directorships vacated during the terms. Annually, the Nominating and Governance Committee is also responsible for establishing director qualifications and the selection criteria for new directors. The Nominating and Governance Committee recommends to the Board a slate of directors to serve on each standing committee of the Board and recommends one member of each standing committee to serve as chairman of the committee. The Nominating and Governance Committee is also responsible for reviewing and monitoring the adherence to the Corporate Governance Guidelines adopted by the Board.

The Nominating and Governance Committee is comprised of John D. White, James W. McGill and Richard E. Williams. During Fiscal 2018, the Committee held five meetings. In December 2018, the Nominating and Governance Committee met and discussed the current director candidates, and recommended to the Board the election of the three candidates nominated above. A copy of the Nominating and Governance Committee Charter is available on the Company's website, [powellind.com](http://powellind.com), under the section entitled "Investor Relations."

## **Director Compensation**

The Company uses a combination of cash and equity based compensation in the form of restricted stock to attract and retain qualified candidates to serve on the Board. In setting director compensation, the Company considers the significant amount of time that directors expend in fulfilling their duties to the Company as well as the skill level required by the Company of members of the Board. Only directors who are not employees of the Company or any of its subsidiaries or affiliates are entitled to receive a fee or reimbursement of out-of-pocket expenses for their services as directors.

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For Fiscal 2018, compensation for non-employee directors was comprised of the following components:

		<b>Cash Compensation</b>	<b>Common Stock</b>
Quarterly Retainer	Chairman of the Board	\$ 21,500	
Quarterly Retainer	Audit Committee Chair	\$ 12,000	
Quarterly Retainer	Compensation Committee Chair	\$ 11,000	
Quarterly Retainer	Nominating and Governance Committee Chair	\$ 10,500	
Quarterly Retainer	All other directors	\$ 9,000	
Committee Meeting Fees (For each meeting attended)	Audit Compensation	\$ 1,500 \$ 1,000	
	Nominating and Governance	\$ 1,000	
Annual Restricted Stock Award (shares)			2,000

In addition to the above, the Company reimburses expenses related to attendance at meetings to non-employee directors.

The Company has stock ownership guidelines for its non-employee directors. Under these guidelines, each non-employee director is required to own and hold a minimum of 6,000 vested or unvested shares of the Company. Each non-employee director has three years to comply with the stock ownership guidelines and all non-employee directors are in compliance with the stock ownership guidelines.

The stockholders voted at the February 26, 2014, meeting to approve the 2014 Non-Employee Director Equity Incentive Plan (the Director Plan). The total number of shares of Common Stock reserved under the plan is 150,000 shares. The plan is administered by the Compensation Committee. Eligibility to participate in the plan is limited to those individuals who are members of the Board of the Company and who are not employees of the Company or any affiliate of the Company.

Under the terms of the Director Plan, the maximum number of shares subject to stock options and stock appreciation rights that may be granted during any calendar year to any individual under the Director Plan is 12,000 shares. The total number of shares that may be issued for awards to any single participant during a calendar year for other stock-based awards (excluding stock options and SARs) is 4,000 shares. The Compensation Committee has determined that each non-employee director will receive 2,000 restricted shares of the Company's Common Stock annually.



**Table of Contents****DIRECTOR COMPENSATION FOR FISCAL 2018**

The table below summarizes the compensation paid by the Company to non-employee directors for Fiscal 2018.

<b>Name</b>	<b>Fees Earned or Paid in Cash (\$)</b>	<b>Stock Awards (\$)<sup>(1)(2)</sup></b>	<b>All Other Compensation (\$)<sup>(3)</sup></b>	<b>Total (\$)</b>
Christopher E. Cragg	55,000	55,760		110,760
Perry L. Elders	40,500	55,760		96,260
Bonnie V. Hancock	41,000	55,760		96,760
Thomas W Powell	86,000	55,760	75,000	216,760
James W. McGill <sup>(4)</sup>	21,000	54,300		75,300
John D. White	46,000	55,760		101,760
Richard E. Williams	43,000	55,760		98,760

(1) The amounts in this column reflect the aggregate grant date fair value.

(2) All of the referenced stock awards relate to the annual issuance of 2,000 shares of restricted stock to each of our directors, which vest in two equal installments. The first installment vests upon issuance and the second installment vests on the earlier of first anniversary of the date of the grant or date of the next annual meeting of stockholders.

(3) Mr. Powell is covered by the Company's Executive Benefit Plan. Pursuant to Mr. Powell's Executive Benefit Agreement executed under such Plan, following normal retirement after age 65 and having completed at least ten years of continuous employment, he is entitled to salary continuation payments of \$150,000 per year for five years beginning October 1, 2008, and then \$75,000 per year for ten years beginning October 1, 2013.

(4) Mr. McGill was elected by the stockholders at the Annual Meeting of Stockholders held on February 21, 2018, but began his term on April 1, 2018, his earliest available date.

**CORPORATE GOVERNANCE**

The Company has established Corporate Governance Guidelines, which may be found on the Governance page of the Company's website, [powellind.com](http://powellind.com). The Corporate Governance Guidelines include the definition of independence used by the Company to determine whether its directors and nominees for directors are independent, which are the same qualifications prescribed under the Marketplace Rules of The NASDAQ Stock Market. Pursuant to the Company's Corporate Governance Guidelines, the Company's non-management directors are required to meet in separate sessions without management on a regularly scheduled basis four times a year. Generally, these meetings occur as an executive session without the management director in attendance in conjunction with regularly scheduled meetings of the Board throughout the year. From time to time during executive sessions, the independent directors meet with individual members of senior management. Because the Chairman of the Board is a member of management, the separate non-management sessions are presided over by an independent director elected by a majority of the non-management directors.

**Board Leadership Structure**

The Chairman of the Board is elected by the Board on an annual basis. Mr. Powell currently serves as Chairman. The Board has determined that Mr. Powell should continue to serve in the role of Chairman based on

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various factors. First, as the Company's long-time Chief Executive Officer and Chairman, Mr. Powell's leadership and vision for the Company as well as his extensive knowledge and experience of the electrical manufacturing business derived from his decades of experience as CEO have been instrumental in its development. Second, Mr. Powell is uniquely qualified to be the Company's Chairman because he has years of experience in that role. Third, Mr. Powell has the confidence of the Board, the Company and its stockholders to continue to oversee the implementation of the Company's business plan.

### **Board's Role in Risk Oversight**

The Board utilizes the Company's risk management process to assist in fulfilling its oversight of the Company's risks. In its risk oversight role, the Board has the responsibility to satisfy itself that the risk management processes designed and implemented by management are adequate and functioning as designed. Our Board oversees an enterprise-wide approach to risk management, designed to support the achievement of organizational objectives, including strategic objectives, to improve long-term organizational performance and enhance stockholder value. A fundamental aspect of risk management is not only understanding the risks a company faces and what steps management is taking to manage those risks, but also understanding what level of risk is appropriate for the company. The involvement of the full Board in approving the Company's business plans as promoted by management is a key part of its assessment of management's appetite for risk and also a determination of what constitutes an appropriate level of risk for the Company.

While the Board has the ultimate oversight responsibility for the risk management process, various committees of the Board assist the Board in fulfilling its oversight responsibilities in certain areas of risk. In particular, the Audit Committee focuses on financial risk exposures, including internal controls, and discusses with management and the Company's independent auditor the Company's policies with respect to risk assessment and risk management. The Audit Committee also assists the Board in fulfilling its duties and oversight responsibilities relating to the Company's compliance with applicable laws and regulations and with conflict-of-interest issues that may arise. The Compensation Committee assists the Board in fulfilling its oversight responsibilities with respect to the management of risks arising from our compensation policies and programs. At least annually, the Nominating and Governance Committee considers risks related to corporate governance.

### **Risk Assessment in Compensation Programs**

The Compensation Committee conducts an annual risk assessment to determine whether the Company's compensation policies and practices are reasonably likely to have a material adverse effect on the Company. This risk assessment process for Fiscal 2017 included: a review of program policies and practices; program analysis to identify risk and risk control related to the programs; and determinations as to the sufficiency of risk identification, the balance of potential risk to potential reward, risk control and the support of the programs and their risks to company strategy. Although the Compensation Committee reviewed all compensation programs, it focused on the programs with variability of payout, with the ability of a participant to directly affect payout and the controls on participant action and payout.

The Compensation Committee took the following risk considerations into account in developing the incentive plans:

Incentive plan metrics are aligned with our business strategy;

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Performance objectives are balanced with the quality and sustainability of business results;

The full range of potential payouts under each plan is understood;

Short term incentive payouts are capped;

Long term incentive payouts are capped;

Leverage and ratio of incentive compensation to salary and total compensation are understood;

Performance, structure and target incentive plan opportunities are comparable to those of industry or peers;

The Compensation Committee may exercise discretion where appropriate;

The Company's focus on long-term performance aligns with stockholder interests, and incentives are calculated over a time horizon that takes into account the risk horizon; and

The Compensation Committee reviews and discusses material risks when considering incentive programs. Further to emphasize the alignment of our named executive officers' interest with the interests of our stockholders, the Company has adopted the following policies and programs:

Stock ownership policy for executives ranging from 1 to 5 times base salary;

A policy to recoup compensation paid to an executive in the event the Company's financial statements are restated and such restatement resulted from material non-compliance with financial reporting requirements;

A policy to prohibit an executive from engaging in a transaction to purchase a hedging instrument that protects the executive from downward changes in the Company's stock price;

A policy that generally prohibits an executive from pledging stock of the Company that is otherwise held by him or her;

A policy to prohibit an executive from holding stock of the Company in a margin account;

A policy to prohibit the use of excise tax gross-ups in executive employment agreements, commencing with executive employment agreements entered into on or after October 1, 2013; and

Adoption of a limit on the number of shares that may be earned by each executive under long-term incentive awards, which replaces a prior compensation practice of no share limitation.

The above policies and procedures are designed to, among others, mitigate risk that any of our compensation policies or practices are reasonably likely to have a material adverse effect on the Company.

We believe that our incentive compensation programs provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage significant risks; are compatible with effective internal controls and the risk-management practices of the Company; and are supported by the oversight and administration of the Compensation Committee with regard to executive compensation programs. Based on the foregoing, the Compensation Committee determined that the Company's compensation policies and practices are not reasonably likely to have a material adverse effect on the Company.

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### **Review, Approval or Ratification of Transactions with Related Persons**

The Company reviews any transaction exceeding \$120,000 between the Company or a subsidiary of the Company and any of our directors, executive officers or any of their immediate family members or any nominee for director or a holder of more than 5% of any class of our voting securities. The Company's Code of Business Conduct and Ethics requires disclosure by directors of any situation that involves, or may reasonably be inferred to involve, a conflict between a director's personal interests and the interests of the Company. The Company's practice when such matters have been disclosed has been to refer the matter for consideration and final determination by the Audit Committee or the independent directors of the Board, or both, who then consider the fairness of the transaction to the Company, as well as other factors bearing upon its appropriateness. In all such matters, any director having a conflicting interest abstains from voting on the matters.

### **Code of Ethics**

The Company has adopted a Code of Business Conduct and Ethics that applies to all employees, including its executive officers, and directors. A copy of the Company's Code of Business Conduct and Ethics may be obtained at the Investor Relations section of the Company's website, [powellind.com](http://powellind.com), or by written request addressed to the Secretary, Powell Industries, Inc., 8550 Mosley Road, Houston, Texas 77075. The Company intends to satisfy the requirements under Item 5.05 of Form 8-K regarding disclosure of amendments to, or waivers from, provisions of its Code of Business Conduct and Ethics that apply to the Chief Executive Officer, Chief Financial Officer by posting such information on the Company's website.

### **Communications with the Board**

The Board, comprised of a majority of independent directors, has unanimously approved a process for stockholders, or other interested persons, to communicate with the Board. This process is located on the Governance page of the Company's website, [powellind.com](http://powellind.com). The relevant document is titled "Procedures for Communication with Directors."

In addition, stockholders, or other interested persons, wishing to communicate with the Board for anonymous complaints about accounting, internal accounting control and auditing issues may call the Company's toll-free governance hotline at 1-877-888-0002. The Audit Committee monitors these calls. All calls are documented, and those reports that are deemed to be substantive will be passed on to the Board. Stockholders, or other interested persons, calling the hotline should provide a sufficiently detailed description of the nature of the matter that the person wishes to communicate with the Board, as well as a name, telephone number, email address, or other contact information so that the Company can either respond to the communication or obtain additional information about the matter.

### **Nomination Process**

The Nominating and Governance Committee will consider written recommendations from stockholders for nominees for director. Any such nominations should be submitted to the Nominating and Governance Committee c/o the Secretary, Powell Industries, Inc., 8550 Mosley Road, Houston, TX 77075 and should be accompanied by the following information:

All information relating to such nominee that is required to be disclosed pursuant to Regulation 14A under the Exchange Act (including such person's written consent to being named in the proxy statement as a nominee and

to serving as a director if elected);

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The name(s) and address(es) of the stockholder(s) making the nomination and the number of shares of the Company's Common Stock which are owned beneficially and of record by such stockholder(s); and

Appropriate biographical information and a statement as to the qualifications of the nominee.

The written recommendation should be submitted in the time frame described under the caption "Stockholder Proposals" below.

Nominees for director are selected on the basis of a number of qualifications including their independence, knowledge, judgment, character, leadership skills, education, experience, financial literacy, standing in the community and ability to foster a diversity of backgrounds and views and to complement the Board's existing strengths. The Nominating and Governance Committee initiates the process for identifying and evaluating nominees to the Board by preparing a slate of candidates who meet the criteria for selection as a nominee and have specific qualities or skills being sought based on input from members of the Board. When formulating its recommendations for potential Board nominees, the Nominating and Governance Committee seeks and considers advice and recommendations from management and other members of the Board and may seek or consider advice and recommendations from consultants, outside counsel, accountants or other advisors as the Nominating and Governance Committee or the Board may deem appropriate.

The Nominating and Governance Committee evaluates the candidates by reviewing their biographical information and qualifications, with qualified nominees being interviewed by at least one member of the Nominating and Governance Committee. Members of the Board also have an opportunity to interview qualified nominees. The Nominating and Governance Committee then determines, based on the background information and the information obtained in the interviews, whether to recommend to the Board that a nominee be nominated to fill a directorship with an expiring term. Candidates recommended by the Nominating and Governance Committee to fill a directorship with an expiring term are presented to the Board for selection as nominees to be presented for the approval of the stockholders. The Nominating and Governance Committee anticipates that a similar process will be used to evaluate nominees recommended by stockholders, but has not previously received a stockholder recommendation for a nominee for director. The Nominating and Governance Committee is responsible for appointing new members to the Board to fill the unexpired term of a directorship vacated during the term or new directorships created by any increase in the size of the Board.

Board membership criteria, which are disclosed in the Company's Corporate Governance Guidelines on the Governance page of the Company's website, [powellind.com](http://powellind.com), are determined by the Board with input from the Nominating and Governance Committee. The Board is responsible for periodically determining the appropriate skills, perspectives, experiences and characteristics required of Board candidates, taking into account the Company's needs and current makeup of the Board. This assessment should include appropriate knowledge, experience and skills in areas deemed critical to understanding the Company and its business, the candidate's commitments to the boards of other companies, and personal characteristics, such as integrity and judgment. Each Board member is expected to ensure that other existing and planned future commitments do not materially interfere with the member's service as a director and that he or she devotes the time necessary to discharge his or her duties as a director. It is the Board's opinion that the qualification guidelines included in the Company's Corporate Governance Guidelines are currently appropriate, but it may change these guidelines as the Company's and Board's needs warrant. The Board established the age of 75 as the age after which an independent director will not stand for reelection at the end of such director's then current term and has established five as the maximum number of consecutive terms a director may serve. The Board has waived these restrictions for Mr. Powell.





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**Practices for Considering Diversity**

The minimum criteria for selund-color:#cceeef;padding-top:2px;padding-bottom:2px;border-top:1px solid #000000;">

6,738

Income per common share:

Basic

\$

0.96

\$

0.54

Diluted

\$

0.95

\$

0.54

Weighted-average number of common shares outstanding:

Basic

11,773

12,453

Diluted

11,817

12,548

Cash dividends declared per common share

\$

0.05

\$

0.02

See accompanying notes to consolidated financial statements.

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NATURAL HEALTH TRENDS CORP.  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)  
(In thousands)

	Three Months Ended March 31,	
	2016	2015
Net income	\$11,280	\$6,738
Other comprehensive income, net of tax:		
Foreign currency translation adjustment	52	137
Unrealized gains on available-for-sale securities	8	—
Comprehensive income	\$11,340	\$6,875

See accompanying notes to consolidated financial statements.

NATURAL HEALTH TRENDS CORP.  
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)  
(In thousands)

	Three Months Ended March 31,	
	2016	2015
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 11,280	\$ 6,738
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	89	41
Stock-based compensation	74	15
Changes in assets and liabilities:		
Accounts receivable	(29 )	(69 )
Inventories, net	189	(1,101 )
Other current assets	(16 )	(259 )
Other assets	5	(221 )
Accounts payable	(840 )	352
Income taxes payable	2,620	(59 )
Accrued commissions	(2,923 )	(1,419 )
Other accrued expenses	925	1,808
Deferred revenue	2,445	7,683
Amounts held in eWallets	280	2,897
Other current liabilities	(157 )	212
Long-term incentive	(120 )	(62 )
Net cash provided by operating activities	13,822	16,556
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property and equipment, net	(240 )	(266 )
Net cash used in investing activities	(240 )	(266 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Repurchase of common stock	(18,319 )	(1,082 )
Dividends paid	(576 )	(250 )
Net cash used in financing activities	(18,895 )	(1,332 )
Effect of exchange rates on cash and cash equivalents	30	92
Net (decrease) increase in cash and cash equivalents	(5,283 )	15,050
CASH AND CASH EQUIVALENTS, beginning of period	104,914	44,816
CASH AND CASH EQUIVALENTS, end of period	\$ 99,631	\$ 59,866
<b>NON-CASH FINANCING ACTIVITY:</b>		
Issuance of treasury stock	\$—	\$ 666

See accompanying notes to consolidated financial statements.

NATURAL HEALTH TRENDS CORP.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Nature of Operations

Natural Health Trends Corp. (the “Company”), a Delaware corporation, is an international direct-selling and e-commerce company headquartered in Rolling Hills Estates, California. Subsidiaries controlled by the Company sell personal care, wellness, and “quality of life” products under the “NHT Global” brand. In most markets, the Company sells its products to a network of members referred to the Company by other members.

The Company's wholly-owned subsidiaries have an active physical presence in the following markets: North America; Greater China, which consists of Hong Kong, Taiwan and China; South Korea; Singapore; Japan; and Europe. The Company also operates within certain Commonwealth of Independent States (Russia and Kazakhstan) through an engagement with a local service provider.

Basis of Presentation

The unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. As a result, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. In the opinion of management, the accompanying unaudited interim consolidated financial statements contain all adjustments, consisting of normal recurring adjustments, considered necessary for a fair statement of the Company's financial information for the interim periods presented. The results of operations of any interim period are not necessarily indicative of the results of operations to be expected for the fiscal year. These consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's 2015 Annual Report on Form 10-K filed with the United States Securities and Exchange Commission (SEC) on March 4, 2016.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

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

Use of Estimates

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

The most significant accounting estimates inherent in the preparation of the Company's financial statements include estimates associated with obsolete inventory, the fair value of goodwill, revenue recognition, as well as those used in the determination of liabilities related to sales returns, commissions and income taxes. Various assumptions and other factors prompt the determination of these significant estimates. The process of determining significant estimates is

fact specific and takes into account historical experience and current and expected economic conditions. The actual results may differ materially and adversely from the Company's estimates. To the extent that there are material differences between the estimates and actual results, future results of operations will be affected.

#### Cash and Cash Equivalents

As of March 31, 2016, cash and cash equivalents include \$7.0 million held in banks located within China subject to foreign currency controls.

Additionally, as of March 31, 2016, cash and cash equivalents include the Company's investments in debt securities, comprising municipal notes and bonds and corporate debt, money market funds and time deposits. The Company considers all highly liquid investments with original maturities of three months or less when purchased and have insignificant interest rate risk to be cash equivalents. Debt securities classified as cash equivalents are required to be accounted for in accordance with ASC 320, Investments - Debt and Equity Securities. As such, the Company determined its investments in debt securities held at March 31, 2016 should be classified as available-for-sale and are carried at fair value with unrealized gains and losses reported in accumulated other comprehensive income in stockholders' equity. The cost of debt securities is adjusted for amortization of premiums and discounts to maturity. This amortization is included in other income. Realized gains and losses, as well as interest income, are also included in other income. The fair values of securities are based on quoted market prices.

Cash and cash equivalents at the end of each period were as follows (in thousands):

	March 31, December 31,	
	2016	2015
Cash	\$ 41,175	\$ 47,431
Cash equivalents	58,456	57,483
Total cash and cash equivalents	\$ 99,631	\$ 104,914

#### Restricted Cash

In June 2015, the Company funded a bank deposit account in the amount of CNY 20 million (USD 3.1 million at March 31, 2016) in anticipation of submitting a direct selling license application in China. Such deposit is required by Chinese laws to establish a consumer protection fund.

#### Other Accrued Expenses

Other accrued expenses at the end of each period were as follows (in thousands):

	March 31, December 31,	
	2016	2015
Sales returns	\$ 1,131	\$ 1,552
Employee-related	13,067	11,064
Warehousing, inventory-related and other	3,446	4,087
Total other accrued expenses	\$ 17,644	\$ 16,703

#### Income Taxes

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



As a result of capital return activities approved by the Board of Directors during the first quarter of 2016 and anticipated future capital return activities, the Company determined that half of its current undistributed foreign earnings are no longer deemed reinvested indefinitely by its non-U.S. subsidiaries. As such, an income tax liability of \$2.4 million was recognized during the quarter, which includes the impact of utilization of foreign tax credits.

The Company repatriated \$19.8 million to the U.S. during the three months ended March 31, 2016, of which \$7.7 million was previously taxed in the U.S. and \$8.4 million was offset by U.S. net operating losses. Accordingly, the deferred tax liability previously established for undistributed foreign earnings up to its existing U.S. net operating losses was reduced. The excess amount repatriated was generated from current foreign earnings. The Company will continue to periodically reassess the needs of its foreign subsidiaries and update its indefinite reinvestment assertion as necessary. To the extent that additional foreign earnings are not deemed permanently reinvested, the Company expects to recognize additional income tax provision at the applicable U.S. corporate tax rate.

The Company and its subsidiaries file income tax returns in the United States, various states, and foreign jurisdictions. The Company is no longer subject to U.S. federal income tax examinations for years prior to 2012, and is no longer subject to state income tax examinations for years prior to 2011. No jurisdictions are currently examining any income tax returns of the Company or its subsidiaries.

#### Fair Value of Financial Instruments

The carrying amounts of the Company's financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and accrued expenses, approximate fair value because of their short maturities. The carrying amount of the noncurrent restricted cash approximates fair value since, absent the restrictions, the underlying assets would be included in cash and cash equivalents. The Company's cash equivalents are valued based on level 1 inputs which consist of quoted prices in active markets.

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

Available-for-sale investments included in cash equivalents at the end of each period were as follows (in thousands):

	March 31, 2016			December 31, 2015		
	Adjusted Cost	Gross Unrealized Gains	Fair Value	Adjusted Cost	Gross Unrealized Gains	Fair Value
Municipal bonds and notes	\$24,873	\$ 8	\$24,881	\$35,222	\$ 2	\$35,224
Corporate debt securities	1,345	—	1,345	5,029	(5 )	5,024
Financial institution instruments	32,230	—	32,230	17,235	—	17,235
Total available-for-sale investments	\$58,448	\$ 8	\$58,456	\$57,486	\$ (3 )	\$57,483

Financial institution instruments include instruments issued or managed by financial institutions such as money market fund deposits and time deposits.

#### Accumulated Other Comprehensive Income

The changes in accumulated other comprehensive income by component for the first three months of 2016 were as follows (in thousands):

	Foreign Currency Translation Adjustment	Unrealized Gains on Available-For-Sale Investments	Total
Balance, December 31, 2015	\$ (99 )	\$ (2 )	\$(101)
Other comprehensive income	52	8	60
Balance, March 31, 2016	\$ (47 )	\$ 6	\$(41 )



### Revenue Recognition

Product sales are recorded when the products are shipped and title passes to independent members. Product sales to members are made pursuant to a member agreement that provides for transfer of both title and risk of loss upon the Company's delivery to the carrier that completes delivery to the members, which is commonly referred to as "F.O.B. Shipping Point." The Company primarily receives payment by credit card at the time members place orders. Amounts received for unshipped product are recorded as deferred revenue. The Company's sales arrangements do not contain right of inspection or customer acceptance provisions other than general rights of return.

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

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

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

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

### Income Per Share

Diluted income per share is determined using the weighted-average number of common shares outstanding during the period, adjusted for the dilutive effect of common stock equivalents. The dilutive effect of non-vested restricted stock and warrants is reflected by application of the treasury stock method. Under the treasury stock method, the amount of compensation cost for future service that the Company has not yet recognized and the amount of tax benefit that would be recorded in additional paid-in capital when the award becomes deductible are assumed to be used to repurchase shares.

Warrants to purchase 88,087 shares of common stock were still outstanding at March 31, 2015 and were exercised in April 2015.

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

	Three Months Ended March 31,				Per Share Amount
	2016		2015		
	Income	Shares	Income	Shares	Per Share
	(Numerator)	(Denominator)	(Numerator)	(Denominator)	Amount
Basic EPS:					
Net income available to common stockholders	\$ 11,280	11,773	\$ 6,738	12,453	\$ 0.54
Effect of dilutive securities:					
Warrants to purchase common stock	—	—	—	66	
Non-vested restricted stock	—	44	—	29	
Diluted EPS:					
	\$ 11,280	11,817	\$ 6,738	12,548	\$ 0.54

Net income available to common stockholders plus  
assumed conversions

### Recently Issued and Adopted Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2016-09, Compensation - Stock Compensation: Improvements to Employee Share-Based Payment Accounting, that simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows.

The new standard will be effective for fiscal years beginning after December 15, 2016, including interim periods within those annual years, and early adoption is permitted. The Company is currently assessing the impact that this standard will have on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases, that requires organizations that lease assets, referred to as “lessees”, to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases with lease terms of more than 12 months. ASU 2016-02 will also require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases and will include qualitative and quantitative requirements. The new standard will be effective for fiscal years beginning after December 15, 2018, including interim periods within those annual years, and early application is permitted. The Company is currently assessing the impact that this standard will have on its consolidated financial statements.

Other recently issued accounting pronouncements did not or are not believed by management to have a material impact on the Company’s present or future financial statements.

### 3. STOCK-BASED COMPENSATION

Stock-based compensation expense totaled \$74,000 and \$15,000 for the three months ended March 31, 2016 and 2015, respectively. No tax benefits were attributed to the stock-based compensation because a valuation allowance was maintained for substantially all net deferred tax assets. During March 2016, the Company modified the vesting feature of an award granted to a director who decided to not stand for re-election at the Company's 2016 annual meeting of stockholders. The modification of the award resulted in an additional \$64,000 in stock-based compensation expense for the three months ended March 31, 2016.

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

	Shares	Wtd. Avg. Price at Date of Issuance
Nonvested at December 31, 2015	44,712	\$ 12.15
Granted	—	—
Vested	(5,591 )	12.15
Nonvested at March 31, 2016	39,121	12.15

As of March 31, 2016, total unrecognized stock-based compensation expense related to non-vested restricted stock was \$69,000, which is expected to be recognized over a weighted-average period of 1.7 years.

### 4. STOCKHOLDERS’ EQUITY

Dividends

On March 1, 2016, the Board of Directors declared a cash dividend of \$0.05 on each share of common stock outstanding. Such dividends were payable on March 24, 2016 to stockholders of record on March 16, 2016. Payment of any future dividends on shares of common stock will be at the discretion of the Company's Board of Directors.

### Treasury Stock

On January 12, 2016, the Board of Directors authorized an increase to the Company's stock repurchase program first approved on July 28, 2015 from \$15.0 million to \$70.0 million. Repurchases are expected to be executed to the extent that the Company's earnings and cash-on-hand allow, and will be made in accordance with all applicable securities laws and regulations, including Rule 10b-18 of the Exchange Act. For all or a portion of the authorized repurchase amount, the Company may enter into one or more plans that are compliant with Rule 10b5-1 of the Exchange Act that are designed to facilitate these purchases. The stock repurchase program does not require the Company to acquire a specific number of shares, and may be suspended from time to time or discontinued. During February 2016, pursuant to the stock repurchase program, the Company authorized its broker to proceed with the purchase of shares of the Company's common stock in the open market. During the three months ended March 31, 2016, the Company purchased a total of 720,361 shares of its common stock for an aggregate purchase price of \$18.3 million, plus transaction costs. Pursuant to the Company's stock repurchase program first approved on July 28, 2015, the Company purchased a total of 268,706 shares of its common stock for an aggregate purchase price of \$10.0 million during the year ended December 31, 2015. As of March 31, 2016, \$41.7 million of the \$70.0 million stock repurchase program approved on July 28, 2015 and increased on January 12, 2016 remained available for future purchases.

## 5. COMMITMENTS AND CONTINGENCIES

### Consumer Indemnity

As required by the Door-to-Door Sales Act in South Korea, the Company maintains insurance for consumer indemnity claims with a mutual aid cooperative by possessing a mutual aid contract with Mutual Aid Cooperative & Consumer (the "Cooperative"). The contract secures payment to members in the event that the Company is unable to provide refunds to members. Typically, requests for refunds are paid directly by the Company according to the Company's normal Korean refund policy, which requires that refund requests be submitted within three months. Accordingly, the Company estimates and accrues a reserve for product returns based on this policy and its historical experience. Depending on the sales volume, the Company may be required to increase or decrease the amount of the contract. The maximum potential amount of future payments the Company could be required to make to address actual member claims under the contract is equivalent to three months of rolling sales. At March 31, 2016, non-current other assets include KRW 223 million (USD \$195,000) underlying the contract, which can be utilized by the Cooperative to fund any outstanding member claims. The Company believes that the likelihood of utilizing these funds to provide for members claims is remote.

### Securities Class Action

In January 2016, two purported class action complaints were filed against the Company and its top executives. On March 29, 2016, the court consolidated the purported class actions, appointed two Lead Plaintiffs, Messrs. Dao and Juan, and appointed the Rosen Law Firm and Levi & Korsinsky LLP as co-Lead Counsel for the purported class in the consolidated action. The court also ordered lead plaintiffs to file a consolidated complaint by April 29, 2016. The class action complaints purport to assert claims on behalf of certain of our stockholders under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder against Natural Health Trends Corp., Chris T. Sharng, and Timothy S. Davidson, and to assert claims under Section 20(a) of the Securities Exchange Act of 1934 against Messrs. Sharng and Davidson. The class action complaints allege, inter alia, that the Company made materially false and misleading statements regarding the legality of its business operations in China, including running an allegedly illegal multi-level marketing business. The class action complaints seek an indeterminate amount of damages, plus interest and costs. The Company believes that these claims are without merit and intends to vigorously defend against the allegations in these actions.





### Shareholder Derivative Claim

In February 2016, a purported shareholder derivative complaint was filed in the Superior Court of the State of California, County of Los Angeles: Zhou v. Sharng, Davidson, Broady, Chung, Mason, O'Brien and Chan. In March 2016, a purported shareholder derivative complaint was filed in the United States District Court for the Central District of California: Kleinfeldt v. Sharng, Broady, Chung, Mason, O'Brien and Davidson (collectively the "Derivative Complaints"). The Derivative Complaints purport to assert claims on behalf of the Company for breach of fiduciary duties, unjust enrichment, abuse of control, gross mismanagement and corporate waste against its officers and directors listed above. The Derivative Complaints also purport to assert claims on behalf of the Company for breach of fiduciary duty based on alleged insider selling and conspiring to enter into several stock repurchase agreements, which allegedly harmed the Company and its assets. The Derivative Complaints allege, inter alia, that the Company made materially false and misleading statements regarding the legality of its business operations in China, including running an allegedly illegal multi-level marketing business, and that certain officers and directors sold common stock on the basis of this allegedly material, adverse non-public information. The Derivative Complaints seek an indeterminate amount of damages, plus interest and costs, as well as various equitable remedies. The cases are in their early stages, and the defendants have not yet filed a response. Nevertheless, the defendants believe that these claims are without merit and intend to vigorously defend against the allegations in these actions.

The consolidated class action and the Derivative Complaints, or others filed alleging similar facts, could result in monetary or other penalties that may materially affect the Company's operating results and financial condition.

## 6. RELATED PARTY TRANSACTIONS

### Product Royalties

On April 29, 2015, the Company entered into a Royalty Agreement and License with Broady Health Sciences, L.L.C., a Texas limited liability company, ("BHS") regarding the manufacture and sale of a product called Soothe™. George K. Broady, a director of the Company and beneficial owner of more than 5% of its outstanding common stock, is owner of BHS. The Company began selling this product in the fourth quarter of 2012 with the permission of BHS. Under the agreement, the Company agreed to pay BHS a royalty of 2.5% of sales revenue in return for the right to manufacture (or have manufactured), market, import, export and sell this product worldwide. Royalties recognized during the three months ended March 31, 2016 and 2015 were \$1,200 and \$2,400, respectively. The Company is not required to purchase any product under the agreement, and the agreement may be terminated at any time on 120 days' notice. Otherwise, the agreement terminates March 31, 2020.

In February 2013, the Company entered into a Royalty Agreement and License with BHS regarding the manufacture and sale of a product called ReStor™. Under the agreement, the Company agreed to pay BHS a royalty of 2.5% of sales revenue in return for the right to manufacture (or have manufactured), market, import, export and sell this product worldwide, with certain rights being exclusive outside the United States. On April 29, 2015, the Company and BHS amended the Royalty Agreement and License to change the royalty to a price per unit instead of 2.5% of sales revenue. Such provision was effective retroactively to January 1, 2015. Such royalties were \$139,000 and \$112,000 for the three months ended March 31, 2016 and 2015, respectively. The Company is not required to purchase any product under the agreement, and the agreement may be terminated at any time on 120 days' notice or, under certain circumstances, with no notice. Otherwise, the agreement terminates March 31, 2020.

## 7. SUBSEQUENT EVENTS

On April 21, 2016, the Board of Directors declared a cash dividend of \$0.06 on each share of common stock outstanding. Such dividends are payable on May 20, 2016 to stockholders of record on May 10, 2016. Payment of any

future dividends on shares of common stock will be at the discretion of the Company's Board of Directors.

At the Company's annual meeting of stockholders held on April 7, 2016, the Company's stockholders approved the Natural Health Trends Corp. 2016 Equity Incentive Plan. On April 8, 2016, the Company granted 51,015 shares of restricted common stock to certain employees for the purpose of further aligning their interest with those of its stockholders and settling fiscal 2015 performance incentives. The shares vest on a quarterly basis over the next three years and are subject to forfeiture in the event of their termination of service to the Company under specified circumstances.

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

### Business Overview

We are an international direct-selling and e-commerce company. Subsidiaries controlled by us sell personal care, wellness, and “quality of life” products under the “NHT Global” brand. Our wholly-owned subsidiaries have an active physical presence in the following markets: North America; Greater China, which consists of Hong Kong, Taiwan and China; Commonwealth of Independent States (“CIS”), which consists of Russia and Kazakhstan; South Korea; Japan; Singapore; and Europe. In most markets, we sell our products to a network of members referred to us by other members.

Our member network operates in a seamless manner from market to market, except for the Chinese market, where we sell to consumers through an e-commerce platform, and the CIS market, where we operate through our engagement of a third-party service provider. Our engagement of a third-party service provider in the CIS market results in a different economic structure than our other markets. Otherwise, we believe that all of our other operating segments are similar in the nature of the products sold, the product acquisition process, the types of customers products are sold to, the methods used to distribute the products, and the nature of the regulatory environment. There is no separate segment manager who is held accountable by our chief operating decision-makers, or anyone else, for operations, operating results and planning for neither the Chinese market or CIS market on a stand-alone basis, and neither market is material for the periods presented. As such, we consider ourselves to be in a single reporting segment and operating unit structure.

As of March 31, 2016, we were conducting business through 119,800 active members, compared to 109,360 three months ago and 62,010 a year ago. We consider a member “active” if they have placed at least one product order with us during the preceding year. Our priority is to focus our resources in our most promising markets, which we consider to be Greater China and countries where our existing members have the connections to recruit prospects and sell our products, such as Southeast Asia.

We generate approximately 99% of our net sales from subsidiaries located outside North America, with sales of our Hong Kong subsidiary representing 92% of net sales in the latest fiscal quarter. Because of the size of our foreign operations, operating results can be impacted negatively or positively by factors such as foreign currency fluctuations, and economic, political and business conditions around the world. In addition, our business is subject to various laws and regulations, in particular regulations related to direct selling activities that create uncertain risks for our business, including improper claims or activities by our members and potential inability to obtain necessary product registrations. For further information regarding some of the risks associated with the conduct of our business in China, see generally in Part I, Item 1A, “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2015, and more specifically under the captions “Risk Factors - Because our Hong Kong operations account for a substantial portion of our overall business...” and “Risk Factors - Our operations in China are subject to compliance with a myriad of applicable laws and regulations...”.

China has been and continues to be our most important business development project. We operate an e-commerce direct selling model in Hong Kong that generates revenue derived from the sale of products to members in Hong Kong and elsewhere, including China. Through a separate Chinese entity, we operate an e-commerce retail platform in China. We believe that neither of these activities requires a direct selling license in China, which we do not currently hold. We have previously sought to obtain a direct selling license, and in August 2015 initiated the process for submitting a new preliminary application for a direct selling license in China. If we are able to obtain a direct selling license in China, we believe that the incentives inherent in the direct selling model in China would incrementally benefit our existing business. Increased sales in China that could be derived from obtaining a direct selling license

may be partially offset by the higher fixed costs associated with the establishment and maintenance of required service centers, branch offices, manufacturing facilities, certification programs and other legal requirements. We are unable to predict whether and when we will be successful in obtaining a direct selling license to operate in China, and if we are successful, when we will be permitted to conduct direct selling operations and whether such operations would be profitable.

#### Income Statement Presentation

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

Cost of sales consists primarily of products purchased from third-party manufacturers, freight cost for transporting products to our foreign subsidiaries and shipping products to members, import duties, packing materials, product royalties, costs of promotional materials sold to our members at or near cost, and provisions for slow moving or obsolete inventories. Cost of sales also includes purchasing costs, receiving costs, inspection costs and warehousing costs.

Member commissions are typically our most significant expense and are classified as an operating expense. Under our compensation plan, members are paid weekly commissions, generally in the currency for the country they were registered, for product purchases by their down-line member network across all geographic markets, except China, where our subsidiary maintains an e-commerce retail platform and does not pay any commissions. This “seamless” compensation plan enables a member located in one country to enroll other members located in other countries where we are authorized to conduct our business. Currently, there are basically two ways in which our members can earn income:

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

Each of our products is designated a specified number of bonus volume points. Commissions are based on total personal and group bonus volume points per weekly sales period. Bonus volume points are essentially a percentage of a product’s wholesale price. As the member’s business expands from successfully enrolling other members who in turn expand their own businesses by selling product to other members, the member receives higher commissions from purchases made by an expanding down-line network. In some of our markets, to be eligible to receive commissions, a member may be required to make nominal monthly or other periodic purchases of our products. Certain of our subsidiaries do not require these nominal purchases for a member to be eligible to receive commissions. In determining commissions, the number of levels of down-line members included within the member’s commissionable group increases as the number of memberships directly below the member increases. Under our current compensation plan, certain of our commission payouts may be limited to a hard cap dollar amount per week or a specific percentage of total product sales. In some markets, commissions may be further limited. In some markets, we also pay certain bonuses on purchases by up to three generations of personally enrolled members, as well as bonuses on commissions earned by up to three generations of personally enrolled members. Members can also earn income, trips and other prizes in specific time-limited promotions and contests we hold from time to time. Member commissions are dependent on the sales mix and, for the first three months of 2016 and 2015, represented 47% and 45% of net sales, respectively. From time to time we make modifications and enhancements to our compensation plan to help motivate members, which can have an impact on member commissions. From time to time we also enter into agreements for business or market development, which may result in additional compensation to specific members.

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

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

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

## Results of Operations

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

	Three Months Ended March 31,	
	2016	2015
Net sales	100.0%	100.0 %
Cost of sales	19.2	21.9
Gross profit	80.8	78.1
Operating expenses:		
Commissions expense	47.2	45.2
Selling, general and administrative expenses	14.7	15.8
Depreciation and amortization	0.1	0.1
Total operating expenses	62.0	61.1
Income from operations	18.8	17.0
Other expense, net	—	(0.3 )
Income before income taxes	18.8	16.7
Income tax provision	3.6	0.2
Net income	15.2 %	16.5 %

## Net Sales

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

	Three Months Ended March 31,					
	2016		2015			
North America	\$1,063	1.4 %	\$1,233	3.0 %		
Hong Kong	68,159	91.7	37,339	91.7		
China	3,315	4.5	501	1.2		
Taiwan	1,225	1.6	1,005	2.5		
South Korea	201	0.3	212	0.5		
Japan	20	—	24	0.1		
Singapore	26	—	—	—		
Russia, Kazakhstan and Ukraine	205	0.3	321	0.8		
Europe	132	0.2	74	0.2		
Total	\$74,346	100.0 %	\$40,709	100.0 %		

Net sales were \$74.3 million for the three months ended March 31, 2016 compared with \$40.7 million for the comparable period a year ago, an increase of \$33.6 million, or 83%. Hong Kong net sales increased \$30.8 million, or 83%, over the comparable period a year ago. The sales increase was primarily due to a substantial increase in product sale volumes attributable to the effectiveness of our leadership development, promotional programs, incentives, events, new products, training, commission plans and services.

Outside of our Hong Kong business, net sales increased \$2.8 million, or 84%, over the comparable three month period in the prior year. Double or triple digit sales increases occurred in Taiwan, Europe and the China e-commerce business. These increases were offset by the performance of our Commonwealth of Independent States (“CIS”) market, which continues to be negatively impacted by the political unrest in the region, as well as the devaluation of the Russian ruble, and decreased \$116,000, or 36%, over the comparable period a year ago.





As of March 31, 2016, we had 119,800 active members, compared with 62,010 active members at March 31, 2015. Hong Kong experienced an increase of 56,900 active members, or 105%, from March 31, 2015 to March 31, 2016. This substantial increase in the number of active members is attributable to the same factors that contributed to the increase in net sales and product sale volumes on a period-over-period basis.

As of March 31, 2016, deferred revenue was \$6.5 million, which primarily consisted of \$3.9 million pertaining to unshipped product orders, \$1.9 million pertaining to auto ship advances and \$382,000 pertaining to unamortized enrollment package revenue.

#### Gross Profit

Gross profit was 80.8% of net sales for the three months ended March 31, 2016 compared with 78.1% of net sales for the three months ended March 31, 2015. The gross profit margin percentage increase is primarily attributable to both higher product margins and lower logistics costs.

#### Commissions

Commissions were 47.2% of net sales for the three months ended March 31, 2016, compared with 45.2% of net sales for the three months ended March 31, 2015. The increase as a percentage of net sales for the three months ended March 31, 2016 primarily resulted from increasing estimated costs for on-going cash and other incentive programs.

#### Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$10.9 million for the three months ended March 31, 2016 compared with \$6.4 million in the same period a year ago. Selling, general and administrative expenses increased by 70% during the three month period mainly due to an increase in employee-related costs and incentive program accruals, professional fees, event costs, facility costs, as well as an increase in credit card fees and assessments due to higher net sales as compared to the same periods in the prior year.

#### Income Taxes

An income tax provision of \$2.7 million and \$71,000 was recognized during the three-month periods ended March 31, 2016, and 2015, respectively. As a result of capital return activities approved by the Board of Directors during the first quarter of 2016 and anticipated future capital return activities, we determined that half of our current undistributed foreign earnings are no longer deemed reinvested indefinitely by our non-U.S. subsidiaries. As such, an income tax liability of \$2.4 million was recognized during the quarter, which includes the impact of utilization of foreign tax credits.

We repatriated \$19.8 million to the U.S. during the three months ended March 31, 2016, of which \$7.7 million was previously taxed in the U.S. and \$8.4 million was offset by U.S. net operating losses. The deferred tax liability previously established for undistributed foreign earnings up to its existing U.S. net operating losses was reduced. The excess amount repatriated was generated from current foreign earnings. We will continue to periodically reassess the needs of our foreign subsidiaries and update our indefinite reinvestment assertion as necessary. To the extent that additional foreign earnings are not deemed permanently reinvested, we expect to recognize additional income tax provision at the applicable U.S. corporate tax rate.

#### Liquidity and Capital Resources

At March 31, 2016, our cash and cash equivalents totaled \$99.6 million. Total cash and cash equivalents decreased by \$5.3 million from December 31, 2015 to March 31, 2016. We consider all highly liquid investments with original maturities of three months or less, when purchased, to be cash equivalents. As of March 31, 2016, we had \$58.5 million in available-for-sale investments classified as cash equivalents. In addition, cash and cash equivalents included \$7.0 million held in banks located within China subject to foreign currency controls.

As of March 31, 2016, the ratio of current assets to current liabilities was 1.76 to 1.00 and we had \$48.4 million of working capital. Working capital as of March 31, 2016 decreased \$7.8 million compared to our working capital as of December 31, 2015, due primarily to our stock repurchase activity during the three months ended March 31, 2016.

Cash provided by operations for the first three months of 2016 was \$13.8 million compared with \$16.6 million in the comparable period of 2015. The decrease in operating cash flows resulted primarily from the timing of increased commission-related payments and inventory purchases, and the impact of our members' utilization of our eWallet functionality, offset by our increased net income during the first quarter of 2016.

Cash flows used in investing activities totaled \$240,000 during the first three months of 2016. Buildout costs of \$185,000 were incurred during the first three months of 2016 for the new Canadian Healthy Lifestyle Center in Vancouver, British Columbia. Cash flows used in investing activities totaled \$266,000 during the first three months of 2015.

Cash flows used in financing activities during the first three months of 2016 totaled \$18.9 million. We used \$18.3 million to repurchase shares of our common stock. On January 12, 2016, the Board of Directors authorized an increase to our stock repurchase program first approved on July 28, 2015 from \$15.0 million to \$70.0 million. Repurchases are expected to be executed to the extent that our earnings and cash-on-hand allow, and will be made in accordance with all applicable securities laws and regulations, including Rule 10b-18 of the Exchange Act. For all or a portion of the authorized repurchase amount, we may enter into one or more plans that are compliant with Rule 10b5-1 of the Exchange Act that are designed to facilitate these purchases. The stock repurchase program does not require us to acquire a specific number of shares, and may be suspended from time to time or discontinued. During February 2016, pursuant to the stock repurchase program, we authorized our broker to proceed with the purchase of shares of our common stock in the open market. The stock repurchase program resulted in our purchasing a total of 720,361 shares of our common stock for an aggregate purchase price of \$18.3 million, plus transaction costs. As of March 31, 2016, \$41.7 million of the \$70.0 million stock repurchase program approved on July 28, 2015 and increased on January 12, 2016 remained available for future purchases. Cash flows used in financing activities during the first three months of 2015 totaled \$1.3 million, and consisted primarily of \$1.1 million in stock repurchases.

On March 1, 2016, the Board of Directors declared a cash dividend of \$0.05 on each share of common stock outstanding. Such dividends were payable on March 24, 2016 to stockholders of record on March 16, 2016.

On April 21, 2016, the Board of Directors declared a cash dividend of \$0.06 on each share of common stock outstanding. Such dividends are payable on May 20, 2016 to stockholders on record on May 10, 2016. Payment of any future dividends on shares of common stock will be at the discretion of our Board of Directors.

We believe that our existing internal liquidity, supported by cash on hand and cash flows from operations should be adequate to fund normal business operations and address our financial commitments for the foreseeable future.

We do not have any significant unused sources of liquid assets. If necessary, we may attempt to generate more funding from the capital markets, but currently we do not believe that will be necessary.

Our priority is to focus our resources on investing in our most important markets, which we consider to be Greater China and countries where our existing members may have the connections to recruit prospects and sell our products, such as Southeast Asia. We will continue to invest in our Mainland China entity for such purposes as establishing China-based manufacturing capabilities, increasing public awareness of our brand and our products, sourcing more Chinese-made products, building a chain of service stations, opening additional Healthy Lifestyle Centers or branch offices, adding local staffing and other requirements for a China direct selling license application.

#### Critical Accounting Policies and Estimates

A summary of our significant accounting policies is provided in Note 1 of the Notes to Consolidated Financial Statements in Item 1 of our Annual Report on Form 10-K filed with the United States Securities and Exchange

Commission (SEC) on March 4, 2016. The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reported period. The process of determining significant estimates is fact specific and takes into account historical experience and current and expected economic conditions. To the extent that there are material differences between the estimates and actual results, future results of operations will be affected.

Critical accounting policies and estimates are defined as both those that are material to the portrayal of our financial condition and results of operations and as those that require management's most subjective judgments. Management believes our critical accounting policies and estimates are those related to obsolete inventory and the fair value of goodwill, revenue recognition, as well as those used in the determination of liabilities related to sales returns, member commissions and income taxes.

**Inventory Valuation.** We review our inventory carrying value and compare it to the net realizable value of our inventory and any inventory value in excess of net realizable value is written down. In addition, we review our inventory for obsolescence and any inventory identified as obsolete is reserved or written off. Our determination of obsolescence is based on assumptions about the demand for our products, product expiration dates, estimated future sales, and management's future plans. Also, if actual sales or management plans are less favorable than those originally projected by management, additional inventory reserves or write-downs may be required. At March 31, 2016 and December 31, 2015, our inventory value was \$10.3 million and \$10.5 million, respectively, net of reserves of \$14,000 and \$29,000 at March 31, 2016 and December 31, 2015, respectively. No significant provision was recorded during the periods presented.

**Valuation of Goodwill.** We assess qualitative factors in order to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, through this qualitative assessment, the conclusion is made that it is more likely than not that a reporting unit's fair value is less than its carrying amount, a two-step impairment test is performed. Our policy is to test for impairment annually during the fourth quarter. At March 31, 2016 and December 31, 2015, goodwill of \$1.8 million was reflected on our balance sheet. No impairment of goodwill was recognized during the periods presented.

**Allowance for Sales Returns.** An allowance for sales returns is provided during the period the product is shipped. The allowance is based upon the return policy of each country, which varies from 14 days to one year, and their historical return rates, which range from 1% to 7% of sales. Sales returns were 1% of sales for the three-month periods ended March 31, 2016 and 2015, respectively. The allowance for sales returns was \$1.1 million and \$1.6 million at March 31, 2016 and December 31, 2015, respectively. No material changes in estimates have been recognized during the periods presented.

**Revenue Recognition.** Product sales are recorded when the products are shipped and title passes to independent members. Product sales to members are made pursuant to a member agreement that provides for transfer of both title and risk of loss upon our delivery to the carrier that completes delivery to the members, which is commonly referred to as "F.O.B. Shipping Point." We primarily receive payment by credit card at the time members place orders. Our sales arrangements do not contain right of inspection or customer acceptance provisions other than general rights of return. Amounts received for unshipped product are recorded as deferred revenue. Such amounts totaled \$3.9 million and \$1.8 million at March 31, 2016 and December 31, 2015, respectively. Shipping charges billed to members are included in net sales. Costs associated with shipments are included in cost of sales.

**Enrollment package revenue,** including any nonrefundable set-up fees, is deferred and recognized over the term of the arrangement, generally twelve months. Enrollment packages provide members access to both a personalized marketing website and a business management system. No upfront costs are deferred as the amount is nominal. At March 31, 2016 and December 31, 2015, enrollment package revenue totaling \$382,000 and \$331,000 was deferred, respectively. Although we have no immediate plans to significantly change the terms or conditions of enrollment packages, any changes in the future could result in additional revenue deferrals or could cause us to recognize the deferred revenue over a longer period of time. Additionally, deferred revenue includes advances for auto ship orders. In certain markets, when a member's cumulative commission income reaches a certain threshold, a percentage of the member's weekly commission is held back as an advance and applied to an auto ship order once the accumulated amount of the advances is sufficient to pay for the pre-selected auto ship package of the member. Such advances were \$1.9 million and \$1.6 million at March 31, 2016 and December 31, 2015, respectively.

**Member Commissions.** Independent members earn commissions based on total personal and group bonus volume points per weekly sales period. Each of our products are designated a specified number of bonus volume points, which is essentially a percentage of the product's wholesale price. We accrue member commissions when earned and

pay commissions on product sales generally two weeks following the end of the weekly sales period.

In some markets, we also pay certain bonuses on purchases by up to three generations of personally enrolled members, as well as bonuses on member commissions earned by up to three generations of personally enrolled members. Independent members may also earn incentives based on meeting certain qualifications during a designated incentive period, which may range from several weeks to up to a year. These incentives may be both monetary and non-monetary in nature. We estimate and accrue the costs associated with incentives over the duration of the qualification period based on member achievement of the qualification requirements. Accrued commissions, including the estimated cost of our international recognition incentive program and other supplemental programs, totaled \$16.7 million and \$19.6 million at March 31, 2016 and December 31, 2015, respectively.

Income Taxes. We evaluate the probability of realizing the future benefits of any of our deferred tax assets and record a valuation allowance when we believe a portion or all of our deferred tax assets may not be realized. During the third quarter of 2015, the valuation allowance against U.S. net operating losses was removed, and a corresponding deferred tax liability was recognized as we determined that a portion of our undistributed foreign earnings were no longer deemed reinvested indefinitely. During the first quarter of 2016, these net operating losses were fully utilized to offset the repatriation of foreign earnings. As of March 31, 2016, a valuation allowance remained against the existing U.S. deferred tax assets and certain deferred tax assets of non-U.S. subsidiaries. The valuation allowance will be reduced at such time as management believes it is more likely than not that the deferred tax assets will be realized.

Provision for income taxes depends on the statutory tax rates in each of the jurisdictions in which we operate. An income tax provision of \$2.7 million and \$71,000 was recognized during the three-month periods ended March 31, 2016 and 2015, respectively. As a result of capital return activities approved by the Board of Directors during the first quarter of 2016 and anticipated future capital return activities, we determined that half of our current undistributed foreign earnings are no longer deemed reinvested indefinitely by our non-U.S. subsidiaries. We will continue to periodically reassess the needs of our foreign subsidiaries and update our indefinite reinvestment assertion as necessary. To the extent that additional foreign earnings are not deemed permanently reinvested, we expect to recognize additional income tax provision at the applicable U.S. corporate tax rate.

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



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

We have operations both internationally and within the United States, and we are exposed to market risks in the ordinary course of our business. These risks include primarily interest rate, foreign exchange and inflation risks.

#### Interest Rate Fluctuation Risk

Our cash and cash equivalents consist of cash, available-for-sale securities, comprising municipal notes, bonds and corporate debt, money market funds and time deposits. The primary objective of our investment in available-for-sale securities is to preserve principal while maximizing income without significantly increasing risk. Because our cash and cash equivalents have a relatively short maturity, our portfolio's fair value is relatively insensitive to interest rate changes. In future periods, we will continue to evaluate our investment policy relative to our overall objectives.

#### Foreign Currency Exchange Risk

We have foreign currency risks related to our revenue and expenses denominated in currencies other than the U.S. dollar. Our most significant foreign exchange exposure, the Hong Kong dollar, is for now pegged to the U.S. dollar.

Our foreign currency exchange rate exposure to South Korean won, Taiwan dollar, Japanese yen, Chinese yuan, Russian ruble, Kazakhstani tenge, Singaporean dollar and European euro represented approximately 7% and 5% of our revenue during the three months ended March 31, 2016 and 2015, respectively. We have experienced and will continue to experience fluctuations in our net income as a result of transaction gains and losses related to translating certain balances denominated in currencies other than the U.S. dollar.

Our foreign currency exchange rate exposure may increase in the near future as we develop opportunities in Southeast Asia, Canada and Europe. Additionally, our foreign currency exchange rate exposure would significantly increase if the Hong Kong dollar were no longer pegged to the U.S. dollar. Given our inability to predict the degree of exchange rate fluctuations, we cannot estimate the effect these fluctuations may have upon future reported results, product pricing or our overall financial condition. Further, to date we have not attempted to reduce our exposure to short-term exchange rate fluctuations by using foreign currency exchange contracts.

#### Inflation Risk

We do not believe that inflation has had a material effect on our business, financial condition or results of operations.

If our costs were to become subject to significant inflationary pressures, we might not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations.

### Item 4. CONTROLS AND PROCEDURES

#### Disclosure Controls and Procedures

Management, with the participation of the Company's principal executive officer and principal financial officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of March 31, 2016. The Company's disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to management, including the Company's principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required

disclosure. Based on this evaluation, the principal executive officer and principal financial officer concluded that, as of March 31, 2016, the Company's disclosure controls and procedures were effective.

#### Changes in Internal Control over Financial Reporting

There were no changes in internal control over financial reporting that occurred during the fiscal quarter ended March 31, 2016 that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

## PART II — OTHER INFORMATION

### Item 1. LEGAL PROCEEDINGS

#### Securities Class Action

In January 2016, two purported class action complaints were filed against us and our top executives in the United States District Court for the Central District of California: *Ford v. Natural Health Trends Corp. et al.* and *Li v. Natural Health Trends Corp. et al.* On March 29, 2016, the court consolidated the various purported class actions, appointed two Lead Plaintiffs, Messrs. Dao and Juan, in the consolidated action and appointed the Rosen Law Firm and Levi & Korsinsky LLP as co-Lead Counsel for the purported class in the consolidated action. The court also ordered lead plaintiffs to file a consolidated complaint by April 29, 2016. The class action complaints purport to assert claims on behalf of certain of our stockholders under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder against Natural Health Trends Corp., Chris T. Sharng, and Timothy S. Davidson, and to assert claims under Section 20(a) of the Securities Exchange Act of 1934 against Messrs. Sharng and Davidson. The class action complaints allege, inter alia, that we made materially false and misleading statements regarding the legality of our business operations in China, including running an allegedly illegal multi-level marketing business. The class action complaints seek an indeterminate amount of damages, plus interest and costs. We believe that these claims are without merit and intend to vigorously defend against the allegations in these actions.

#### Shareholder Derivative Claim

In February 2016, a purported shareholder derivative complaint was filed in the Superior Court of the State of California, County of Los Angeles: *Zhou v. Sharng, Davidson, Broady, Chung, Mason, O'Brien and Chan*. In March 2016, a purported shareholder derivative complaint was filed in the United States District Court for the Central District of California: *Kleinfeldt v. Sharng, Broady, Chung, Mason, O'Brien and Davidson* (collectively the “Derivative Complaints”). The Derivative Complaints purport to assert claims on our behalf for breach of fiduciary duties, unjust enrichment, abuse of control, gross mismanagement and corporate waste against our officers and directors listed above. The Derivative Complaints also purport to assert claims on our behalf for breach of fiduciary duty based on alleged insider selling and conspiring to enter into several stock repurchase agreements, which allegedly harmed us and our assets. The Derivative Complaints allege, inter alia, that we made materially false and misleading statements regarding the legality of our business operations in China, including running an allegedly illegal multi-level marketing business, and that certain officers and directors sold common stock on the basis of this allegedly material, adverse non-public information. The Derivative Complaints seek an indeterminate amount of damages, plus interest and costs, as well as various equitable remedies. The cases are in their early stages, and the defendants have not yet filed a response. Nevertheless, the defendants believe that these claims are without merit and intend to vigorously defend against the allegations in these actions.

### Item 1A. RISK FACTORS

Our operations and financial results are subject to various risks and uncertainties, including those described in Part I, Item 1A, “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2015, which could adversely affect our business, financial condition, results of operations, cash flows, and the trading price of our common stock. There have been no material changes to our risk factors since our Annual Report on Form 10-K for the year ended December 31, 2015.

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

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

A summary of the Company's purchases of shares of its common stock during the quarter ended March 31, 2016 is as follows:

Period	Total Number of Shares Purchased (a)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (b)	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs (c) (in thousands)
January 1-31, 2016	—	\$ —	—	\$ 60,013
February 1-29, 2016	507,797	\$ 23.83	507,797	\$ 47,913
March 1-31, 2016	212,564	\$ 29.22	212,564	\$ 41,701

(a) The shares were purchased in open market transactions as described in footnote (b) below.

On January 12, 2016, the Board of Directors authorized an increase to our stock repurchase program first approved on July 28, 2015 from \$15.0 million to \$70.0 million. Repurchases are expected to be executed to the extent that our earnings and cash-on-hand allow, and will be made in accordance with all applicable securities laws and regulations, including Rule 10b-18 of the Exchange Act. For all or a portion of the authorized repurchase amount, we may enter into one or more plans that are compliant with Rule 10b5-1 of the Exchange Act that are designed to (b) facilitate these purchases. The stock repurchase program does not require us to acquire a specific number of shares, and may be suspended from time to time or discontinued. During February 2016, pursuant to the stock repurchase program, we authorized our broker to proceed with the purchase of shares of our common stock in the open market. During the three months ended March 31, 2016, we purchased a total of 720,361 shares of our common stock for an aggregate purchase price of \$18.3 million, plus transaction costs, under the stock repurchase program.

(c) As of March 31, 2016, \$41.7 million of the \$70.0 million stock repurchase program first approved on July 28, 2015 and increased on January 12, 2016 remained available for future purchases.

## Item 3. DEFAULTS UPON SENIOR SECURITIES

None.

## Item 4. MINE SAFETY DISCLOSURES

Not applicable.

## Item 5. OTHER INFORMATION

None.

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Item 6. EXHIBITS

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

SIGNATURES

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

NATURAL HEALTH TRENDS CORP.

Date: April 27, 2016 /s/ Timothy S. Davidson  
Timothy S. Davidson  
Senior Vice President and Chief Financial Officer  
(Principal Financial Officer)

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