

MANNATECH INC  
Form 10-Q  
November 13, 2013

---

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

---

FORM 10-Q  
(Mark One)

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

For the quarterly period ended: September 30, 2013

OR

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

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

Commission File No. 000-24657

MANNATECH, INCORPORATED  
(Exact Name of Registrant as Specified in its Charter)

Texas 75-2508900  
(State or other Jurisdiction of Incorporation or Organization) (I.R.S. Employer Identification No.)

600 S. Royal Lane, Suite 200, Coppell, Texas 75019  
(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, including Area Code: (972) 471-7400

---

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

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Edgar Filing: MANNATECH INC - Form 10-Q

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

As of October 31, 2013, the number of shares outstanding of the registrant's sole class of common stock, par value  
\$0.0001 per share, was 2,653,913.

---

1

---

MANNATECH, INCORPORATED  
TABLE OF CONTENTS

<u>Special Note Regarding Forward-Looking Statements</u>	3
Part I – FINANCIAL INFORMATION	
Item 1. <u>Financial Statements</u>	4
<u>Consolidated Balance Sheets - Unaudited</u>	4
<u>Consolidated Statements of Operations - Unaudited</u>	5
<u>Consolidated Statements of Comprehensive Income - Unaudited</u>	5
<u>Consolidated Statement of Shareholders' Equity - Unaudited</u>	6
<u>Consolidated Statements of Cash Flows - Unaudited</u>	7
<u>Notes to Unaudited Consolidated Financial Statements</u>	8
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	18
<u>Company Overview</u>	18
<u>Results of Operations</u>	19
<u>Liquidity and Capital Resources</u>	27
<u>Critical Accounting Policies and Estimates</u>	30
<u>Recent Accounting Pronouncements</u>	33
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	33
Item 4. <u>Controls and Procedures</u>	34
Part II – OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	36
Item 1A. <u>Risk Factors</u>	36
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	36
Item 3. <u>Defaults Upon Senior Securities</u>	36
Item 4. <u>Mine Safety Disclosure</u>	36
Item 5. <u>Other Information</u>	36
Item 6. <u>Exhibits</u>	36
<u>Signatures</u>	37

Table of Contents

Special Note Regarding Forward-Looking Statements

Certain disclosures and analyses in this Form 10-Q, including information incorporated by reference, may include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and the Private Securities Litigation Reform Act of 1995 that are subject to various risks and uncertainties. Opinions, forecasts, projections, guidance, or other statements other than statements of historical fact are considered forward-looking statements and reflect only current views about future events and financial performance. Some of these forward-looking statements include statements regarding:

- management’s plans and objectives for future operations;
- existing cash flows being adequate to fund future operational needs;
- future plans related to budgets, future capital requirements, market share growth, and anticipated capital projects and obligations;
- the realization of net deferred tax assets;
- the ability to curtail operating expenditures;
- global statutory tax rates remaining unchanged;
- the impact of future market changes due to exposure to foreign currency translations;
- the possibility of certain policies, procedures, and internal processes minimizing exposure to market risk;
- the impact of new accounting pronouncements on financial condition, results of operations, or cash flows;
- the outcome of new or existing litigation matters;
- the outcome of new or existing regulatory inquiries or investigations; and
- other assumptions described in this report underlying such forward-looking statements.

Although we believe that the expectations included in these forward-looking statements are reasonable, these forward-looking statements are subject to certain events, risks, assumptions, and uncertainties, including those discussed below, the “Risk Factors” section in Part I, Item 1A of our Form 10-K for the year ended December 31, 2012, and the “Risk Factors” section in Part II, Item 1A of this Form 10-Q, and elsewhere in this Form 10-Q and the documents incorporated by reference herein. If one or more of these risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results and developments could materially differ from those expressed in or implied by such forward-looking statements. For example, any of the following factors could cause actual results to vary materially from our projections:

- overall growth or lack of growth in the nutritional supplements industry;
- plans for expected future product development;
- changes in manufacturing costs;

- shifts in the mix of packs and products;
- the future impact of any changes to global associate career and compensation plans or incentives;
- the ability to attract and retain independent associates and members;
- new regulatory changes that may affect operations or products;
  - the competitive nature of our business with respect to products and pricing;
- publicity related to our products or network-marketing; and
- the political, social, and economic climate.

Forward-looking statements generally can be identified by use of phrases or terminology such as “may,” “will,” “should,” “could,” “would,” “expects,” “plans,” “intends,” “anticipates,” “believes,” “estimates,” “approximates,” “predicts,” “projects,” “continues” or other similar words or the negative of such terms and other comparable terminology. Similarly, descriptions of Mannatech’s objectives, strategies, plans, goals, or targets contained herein are also considered forward-looking statements. Readers are cautioned when considering these forward-looking statements to keep in mind these risks, assumptions, and uncertainties and any other cautionary statements in this report, as all of the forward-looking statements contained herein speak only as of the date of this report.

Unless stated otherwise, all financial information throughout this report and in the Consolidated Financial Statements and related Notes include Mannatech, Incorporated and all of its subsidiaries on a consolidated basis and may be referred to herein as “Mannatech,” “the Company,” “its,” “we,” “our,” or “their.”

Our products are not intended to diagnose, cure, treat, or prevent any disease, and any statements about our products contained in this report have not been evaluated by the Food and Drug Administration, also referred to herein as the “FDA”.

Table of Contents

## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements

MANNATECH, INCORPORATED AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS – (UNAUDITED)  
(in thousands, except share and per share amounts)

	September 30, 2013 (unaudited)	December 31, 2012
<b>ASSETS</b>		
Cash and cash equivalents	\$ 19,441	\$ 14,377
Restricted cash	1,527	1,515
Accounts receivable, net of allowance of \$40 and \$20 in 2013 and 2012, respectively	402	324
Income tax receivable	188	884
Inventories, net	14,733	15,154
Prepaid expenses and other current assets	3,614	2,487
Deferred commissions	2,240	562
Deferred tax assets	647	561
Total current assets	42,792	35,864
Property and equipment, net	3,614	4,825
Construction in progress	30	8
Long-term restricted cash	5,035	3,736
Other assets	2,938	3,187
Long-term deferred tax assets	633	502
Total assets	\$ 55,042	\$ 48,122
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current portion of capital leases	\$ 653	\$ 780
Accounts payable	6,784	4,154
Accrued expenses	7,598	6,348
Commissions and incentives payable	9,195	7,935
Taxes payable	1,972	3,901
Current deferred tax liability	291	179
Deferred revenue	5,284	1,486
Total current liabilities	31,777	24,783
Capital leases, excluding current portion	583	938
Long-term deferred tax liabilities	10	2
Other long-term liabilities	1,706	2,178
Total liabilities	34,076	27,901
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, \$0.01 par value, 1,000,000 shares authorized, no shares issued or outstanding	—	—
Common stock, \$0.0001 par value, 99,000,000 shares authorized, 2,773,972 shares issued and 2,653,913 shares outstanding as of September 30, 2012 and 2,768,972 shares issued and 2,647,735 shares outstanding as of December 31, 2012	—	—
Additional paid-in capital	42,556	42,614

Edgar Filing: MANNATECH INC - Form 10-Q

Accumulated deficit	(6,293 )	(6,920 )
Accumulated other comprehensive loss	(646 )	(677 )
Less treasury stock, at cost, 120,059 and 121,237 shares in 2013 and 2012, respectively	(14,651 )	(14,796 )
Total shareholders' equity	20,966	20,221
Total liabilities and shareholders' equity	\$ 55,042	\$ 48,122

See accompanying notes to unaudited consolidated financial statements.

4

---

Table of ContentsMANNATECH, INCORPORATED AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS – (UNAUDITED)

(in thousands, except per share information)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Net sales	\$44,432	\$43,049	\$130,899	\$131,162
Cost of sales	9,225	8,698	25,616	25,824
Gross profit	35,207	34,351	105,283	105,338
Operating expenses:				
Commissions and incentives	19,640	18,658	56,362	56,280
Selling and administrative	8,497	8,640	25,669	28,240
Depreciation and amortization	474	703	1,699	4,082
Other operating costs	6,167	5,261	18,919	19,109
Total operating expenses	34,778	33,262	102,649	107,711
Income (loss) from operations	429	1,089	2,634	(2,373 )
Interest income (expense)	25	6	29	(26 )
Other income (expense), net	(275 )	455	(1,278 )	542
Income (loss) before income taxes	179	1,550	1,385	(1,857 )
(Provision for) benefit from income taxes	(980 )	663	(758 )	215
Net income (loss)	\$(801 )	\$2,213	\$627	\$(1,642 )
Income (loss) per share:				
Basic	\$(0.30 )	\$0.84	\$0.24	\$(0.62 )
Diluted	\$(0.30 )	\$0.83	\$0.23	\$(0.62 )
Weighted-average common shares outstanding:				
Basic	2,650	2,648	2,649	2,648
Diluted	2,650	2,681	2,717	2,648

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) – (UNAUDITED)

(in thousands)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Net income (loss)	\$(801)	\$2,213	\$627	\$(1,642)
Foreign currency translations	829	(181 )	31	(542 )
Comprehensive income (loss)	\$28	\$2,032	\$658	\$(2,184)

See accompanying notes to unaudited consolidated financial statements.



Table of ContentsMANNATECH, INCORPORATED AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

– (UNAUDITED)

(in thousands)

	Common stock Par value	Additional paid in capital	Accumulated deficit	Accumulated other comprehensive loss	Treasury stock	Total shareholders' equity
Balance at December 31, 2012	\$	—\$ 42,614	\$ (6,920 )	\$ (677 )	\$(14,796)	\$ 20,221
Net income		—	627	—	—	627
Charge related to stock-based compensation		— 137	—	—	—	137
Stock options exercised		— 22	—	—	145	167
Tax shortfall from expiration of stock options		— (84 )	—	—	—	(84 )
Tax benefit from exercise		— (133 )	—	—	—	(133 )
Foreign currency translations		—	—	31	—	31
Balance at September 30, 2013	\$	—\$ 42,556	\$ (6,293 )	\$ (646 )	\$(14,651)	\$ 20,966

See accompanying notes to unaudited consolidated financial statements.

6

Table of Contents

MANNATECH, INCORPORATED AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF CASH FLOWS – (UNAUDITED)  
 (in thousands)

	Nine months ended September 30,	
	2013	2012
<b><u>CASH FLOWS FROM OPERATING ACTIVITIES:</u></b>		
Net income (loss)	\$627	\$(1,642 )
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	1,699	4,082
Provision for inventory losses	318	928
Provision for doubtful accounts	222	30
(Loss) gain on disposal of assets	(1 )	63
Accounting charge related to stock-based compensation expense	137	167
Deferred income taxes	(203 )	(63 )
Changes in operating assets and liabilities:		
Accounts receivable	(313 )	(41 )
Income tax receivable	702	(4 )
Inventories	151	(1,106 )
Prepaid expenses and other current assets	(410 )	630
Other assets	(1,495 )	(1,125 )
Accounts payable	2,645	72
Accrued expenses and other liabilities	947	(3,394 )
Taxes payable	(1,933 )	(1,046 )
Commissions and incentives payable	1,364	(1,272 )
Deferred revenue	3,758	613
Net cash provided by (used in) operating activities	8,215	(3,108 )
<b><u>CASH FLOWS FROM INVESTING ACTIVITIES:</u></b>		
Acquisition of property and equipment	(524 )	(273 )
Proceeds from sales of assets	1	86
Change in restricted cash	(1,238 )	(331 )
Net cash used in investing activities	(1,761 )	(518 )
<b><u>CASH FLOWS FROM FINANCING ACTIVITIES:</u></b>		
Proceeds from stock options exercised	22	-
Repurchase of fractional shares from reverse stock split	-	(3 )
Repayment of capital lease obligations	(1,157 )	(813 )
Net cash used in financing activities	(1,135 )	(816 )
Effect of currency exchange rate changes on cash and cash equivalents	(255 )	(834 )
Net increase (decrease) in cash and cash equivalents	5,064	(5,276 )
Cash and cash equivalents at the beginning of the period	14,377	18,057
Cash and cash equivalents at the end of the period	\$19,441	\$12,781
<b><u>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</u></b>		
Income taxes paid, net	\$(2,187 )	\$(843 )
Interest paid on capital leases	\$(108 )	\$(127 )
<b><u>Summary of non-cash investing and financing activities:</u></b>		
Note receivable, net relating to sale of property and equipment	\$195	\$237
Assets acquired through financing	\$685	\$—

See accompanying notes to unaudited consolidated financial statements.

7

---

Table of Contents

MANNATECH, INCORPORATED AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Mannatech, Incorporated (together with its subsidiaries, the “Company”), located in Coppell, Texas, was incorporated in the state of Texas on November 4, 1993 and is listed on the NASDAQ Global Select Market (“Nasdaq”) under the symbol “MTEX”. The Company develops, markets, and sells high-quality, proprietary nutritional supplements, topical and skin care products, and weight-management products. The Company currently sells its products in three regions: (i) North America (the United States, Canada, and Mexico); (ii) Europe/the Middle East/Africa (“EMEA”) (Austria, the Czech Republic, Denmark, Estonia, Finland, Germany, the Republic of Ireland, Namibia, the Netherlands, Norway, South Africa, Sweden, Ukraine, and the United Kingdom); (iii) Asia/Pacific (Australia, Hong Kong, Japan, New Zealand, the Republic of Korea, Singapore, and Taiwan). In December 2012, the Company commenced the shipment of its products to Hong Kong and officially launched Hong Kong operations in April 2013. In November 2012, the Company commenced the shipment of its products to Ukraine and officially launched Ukrainian operations in July 2013.

Independent associates (“associates”) purchase the Company’s products at published wholesale prices to either sell to retail customers or for personal use. Members purchase the Company’s products at a discount from published retail prices primarily for personal use. The Company cannot distinguish products sold for personal use from other sales because it is not involved with the products after delivery, other than usual and customary product warranties and returns. Only associates are eligible to earn commissions and incentives.

The accompanying unaudited 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 instructions for Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, the Company’s consolidated financial statements and footnotes contained herein do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America (“GAAP”) to be considered “complete financial statements”. However, in the opinion of the Company’s management, the accompanying unaudited consolidated financial statements and footnotes contain all adjustments, including normal recurring adjustments, considered necessary for a fair presentation of the Company’s consolidated financial information as of, and for, the periods presented. The Company cautions that its consolidated results of operations for an interim period are not necessarily indicative of its consolidated results of operations to be expected for its fiscal year. The December 31, 2012 consolidated balance sheet was included in the audited consolidated financial statements in the Company’s annual report on Form 10-K for the year ended December 31, 2012 and filed with the United States Securities and Exchange Commission (the “SEC”) on March 28, 2013 (the “2012 Annual Report”), which includes all disclosures required by GAAP. Therefore, these unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements of the Company included in the 2012 Annual Report.

Principles of Consolidation

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

Reclassifications

Certain reclassifications have been made to the financial statements for prior periods to conform to the current period presentation.

Table of Contents

MANNATECH, INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (continued)

Use of Estimates

The preparation of the Company's consolidated financial statements in accordance with generally accepted accounting principles requires the use of estimates that affect the reported value of assets, liabilities, revenues and expenses. These estimates are based on historical experience and various other factors. The Company continually evaluates the information used to make these estimates as the business and economic environment changes. Historically, actual results have not varied materially from the Company's estimates, and the Company does not currently anticipate a significant change in its assumptions related to these estimates. However, actual results may differ from these estimates under different assumptions or conditions.

The use of estimates is pervasive throughout the consolidated financial statements, but the accounting policies and estimates considered the most significant are described in this note to the consolidated financial statements, Organization and Summary of Significant Accounting Policies.

Cash and Cash Equivalents

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. The Company includes in its cash and cash equivalents credit card receivables due from its credit card processor, as the cash proceeds from credit card receivables are received within 24 to 72 hours of submission to the credit card processor. Credit card receivables were \$3.3 million at September 30, 2013 and \$1.7 million at December 31, 2012. Cash and cash equivalents held in bank accounts in foreign countries totaled \$14.3 million and \$10.8 million, respectively. The Company invests cash in liquid instruments, such as money market funds and interest bearing deposits. The Company also holds cash in high quality financial institutions and does not believe it has an excessive exposure to credit concentration risk.

Restricted Cash

The Company is required to restrict cash for: (i) direct selling insurance premiums and credit card sales in the Republic of Korea; (ii) reserve on credit card sales in the United States and Canada; and (iii) the Australia building lease collateral. As of September 30, 2013 and December 31, 2012, our total restricted cash was \$6.6 million and \$5.3 million, respectively.

Accounts Receivable

Accounts receivable are carried at their estimated collectible amounts. Receivables are created upon shipment of an order if the credit card payment is rejected or does not match the order total. As of September 30, 2013 and December 31, 2012, receivables consisted primarily of amounts due from members and associates. The Company periodically evaluates its receivables for collectability based on historical experience, recent account activities, and the length of time receivables are past due and writes-off receivables when they become uncollectible. At each of September 30, 2013 and December 31, 2012, the Company held an allowance for doubtful accounts of less than \$0.1 million.

Inventories

Inventories consist of raw materials, finished goods, and promotional materials that are stated at the lower of cost or market (using standard costs that approximate average costs). The Company periodically reviews inventories for obsolescence, and any inventories identified as obsolete are reserved or written off.



Table of Contents

MANNATECH, INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (continued)

Other Assets

As of September 30, 2013 and December 31, 2012, other assets were \$2.9 million and \$3.2 million, respectively, and primarily consisted of deposits for building leases in various locations of \$1.5 million and \$1.8 million, respectively. Additionally, included in the September 30, 2013 and December 31, 2012 balances was \$1.0 million, representing a deposit with Mutual Aid Cooperative and Consumer in the Republic of Korea, an organization established by the Republic of Korea's Fair Trade Commission to protect consumers who participate in network marketing activities. Also included in the September 30, 2013 and December 31, 2012 balances was \$0.2 million of indefinite lived intangible assets relating to the Manapol ® powder trademark.

Other Long-Term Liabilities

Certain operating leases for the Company's regional office facilities contain a restoration clause that requires the Company to restore the premises to its original condition. As of September 30, 2013 and December 31, 2012, accrued restoration costs related to these leases amounted to \$0.2 million and \$0.5 million, respectively. Also included in long-term liabilities at September 30, 2013 and December 31, 2012 was an estimated defined benefit obligation related to a non-U.S. defined benefit plan for its Japan operations of \$0.7 million.

In August 2003, the Company entered into a Long-Term Post-Employment Royalty Agreement with Dr. Bill McAnalley, the Company's former Chief Science Officer, pursuant to which the Company is required to pay Dr. McAnalley, or his heirs, royalties for ten years beginning September 2005 and continuing through August 2015. Quarterly payments related to this Long-Term Post-Employment Royalty Agreement are based on certain applicable annual global product sales by the Company in excess of \$105.4 million. At the time the Company entered into this Long-Term Post-Employment Royalty Agreement, it was considered a post-employment benefit and the Company was required to measure and accrue the present value of the estimated future royalty payments related to this benefit and recognize it over the life of Dr. McAnalley's employment agreement, which was two years. As of September 30, 2013 and December 31, 2012, the Company's liability related to this royalty agreement was \$0.1 million and \$0.2 million, respectively.

Revenue Recognition and Deferred Commissions

The Company's revenue is derived from sales of individual products, sales of its starter and renewal packs, and shipping fees. Substantially all of the Company's product and pack sales are made to associates at published wholesale prices and to members at discounted published retail prices. The Company records revenue net of any sales taxes and records a reserve for expected sales returns based on its historical experience.

The Company recognizes revenue from shipped packs and products upon receipt by the customer. Corporate-sponsored event revenue is recognized when the event is held. The Company defers certain components of its revenue. At each of September 30, 2013 and December 31, 2012, the Company's deferred revenue was \$5.3 million and \$1.5 million, respectively. During the third quarter of 2013, the Company started a loyalty program where customers earn loyalty points from qualified automatic orders, which can be applied to future purchases. The Company defers the dollar equivalent in revenue of these points until the points are applied or forfeited. The deferred revenue associated with the loyalty program at September 30, 2013 was \$2.5 million. Deferred revenue consisted primarily of: (i) sales of packs and products shipped but not received by the customers by the end of the respective period; (ii) revenue from the loyalty program and (iii) prepaid registration fees from customers planning to attend a future corporate-sponsored event. In total current assets, the Company defers commissions on (i) the sales of packs and products shipped but not received by the customers by the end of the respective period and (ii) the loyalty

program. Deferred commissions were \$2.2 million and \$0.6 million at September 30, 2013 and December 30, 2012, respectively.

We estimate a sales return reserve for expected sales refunds based on our historical experience over a rolling six-month period. If actual results differ from our estimated sales return reserve due to various factors, the amount of revenue recorded for each period could be materially affected. Historically, our sales returns have not materially changed through the years, as the majority of our customers who return their merchandise do so within the first 90 days after the original sale. Sales returns have historically averaged 1.5% or less of our gross sales. For the nine months ended September 30, 2013 our sales return reserve consisted of the following (in thousands):

10

---



Table of Contents

## MANNATECH, INCORPORATED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (continued)

	September 30, 2013
Sales reserve as of January 1, 2013	\$ 156
Provision related to sales made in current period	882
Adjustment related to sales made in prior periods	3
Actual returns or credits related to current period	(706 )
Actual returns or credits related to prior periods	(159 )
Sales reserve as of September 30, 2013	\$ 176

## Shipping and Handling Costs

The Company records freight and shipping fees collected from its customers as revenue. The Company records inbound freight as a component of inventory and cost of sales. To improve the matching of costs associated with the revenue from freight and shipping fees collected, beginning December 31, 2012, freight charges associated with shipping products to our customers were reclassified to cost of sales from selling and administrative expenses with prior periods' presentations adjusted accordingly. Total revenue from freight and shipping fees were approximately \$1.9 million and \$1.6 million for the three months ended September 30, 2013 and 2012, respectively, and \$5.7 million and \$4.6 million for the nine months ended September 30, 2013 and 2012, respectively. Total freight costs for shipping products to our customers included in cost of sales were approximately \$1.7 million and \$1.9 million for the three months ended September 30, 2013 and 2012, respectively, and \$5.0 million and \$5.6 million for the nine months ended September 30, 2013 and 2012, respectively.

## Commissions and Incentives

Associates earn commissions and incentives based on their direct and indirect commissionable net sales over 13 business periods each year. Each business period equals 28 days. The Company accrues commissions and incentives when earned by associates and pays commissions on product sales three weeks following the business period end and pays commissions on its pack sales five weeks following the business period end.

In order to more closely conform to the financial presentation of our competitors, beginning December 31, 2012, commissions and incentive expenses were reclassified to operating expenses from cost of sales with prior periods' presentations adjusted accordingly. Total commissions and incentive expenses reclassified to operating expenses were approximately \$19.6 million and \$18.7 million for the three months ended September 30, 2013 and 2012, respectively, and \$56.4 million and \$56.3 million for the nine months ended September 30, 2013 and 2012, respectively.

## Comprehensive Income (loss) and Accumulated Other Comprehensive Income (loss)

Comprehensive income (loss) is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources and includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. The Company's comprehensive income (loss) consists of the Company's net income (loss), foreign currency translation adjustments from its Japan, Republic of Korea, Taiwan, Singapore, Norway, Sweden, Mexico, and Ukraine operations, and changes in the pension obligation for its Japanese employees.

Table of Contents

## MANNATECH, INCORPORATED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (continued)

## NOTE 2: INVENTORIES

Inventories consist of raw materials and finished goods, which also includes promotional materials. The Company provides an allowance for any slow-moving or obsolete inventories. Inventories at September 30, 2013 and December 31, 2012, consisted of the following (in thousands):

	September 30, 2013	December 31, 2012
Raw materials	\$ 4,766	\$ 6,071
Finished goods	11,217	10,702
Inventory reserves for obsolescence	(1,250 )	(1,619 )
Total	\$ 14,733	\$ 15,154

## NOTE 3: INCOME TAXES

For the three and nine months ended September 30, 2013, the Company's effective tax rate was 548.26% and 54.72%, respectively. For the three and nine months ended September 30, 2012, the Company's effective income tax rate was 42.8% and 11.6%, respectively. For the three and nine months ended September 30, 2013 and 2012, the Company's effective tax rate was determined based on the estimated annual effective tax rate.

The examination of our 2005-2009 tax years by the IRS for U.S. federal tax purposes was settled during the second quarter of 2013. In connection with the audit, the IRS and the Company agreed to a net tax deficiency of \$0.8 million and the payment of interest accrued through June 30, 2013 of \$0.2 million, without any penalties. The tax payment and related interest were made during the third quarter of 2013. In connection with the settlement of the audit, the Company reclassified amounts owed to the IRS and previously recorded as uncertain tax positions as taxes payable, resulting in a \$1.0 million tax benefit through September 30, 2013.

Excluding the release of uncertain income tax positions in connection with the settlement of the IRS audit, the effective tax rate for the three and nine months ended September 30, 2013 would have been 1,122.52% and 128.78%. These rates are higher than what would have been expected if the federal statutory income tax rate were applied to income before taxes primarily from the unfavorable differences from foreign operations.

On July 11, 2013, the Company was issued an assessment notice from the Busan Custom Office in Korea in the amount of KRW 2,147,034,680 (approximately \$1.9 million) resulting from an audit covering fiscal years 2008 through 2012. At September 30, 2013, we have recorded \$0.9 million in taxes payable on our consolidated balance sheet related to this assessment, with \$0.5 million related to customs charges being recorded as cost of sales and \$0.4 million related to surtaxes on customs and VAT being recorded as other expense. An additional amount of approximately \$0.7 million is recoverable VAT, which has no effect on the Company's statement of operations. The amounts being accrued are based on our current estimate of the possible outcome of our appeal of the assessment through the administrative review processes.

There are other ongoing income tax audits in various international jurisdictions that are not material to our financial statements.

## NOTE 4: EARNINGS (LOSS) PER SHARE

The Company calculates basic Earnings Per Share (“EPS”) by dividing net income (loss) by the weighted-average number of common shares outstanding for the period. Diluted EPS also reflects the potential dilution that could occur if common stock were issued for awards outstanding under the 2008 Stock Incentive Plan. The Company reported a net loss and net income for the three months ended September 30, 2013 and 2012, respectively. In determining the potential dilution effect of outstanding stock options during the three months ended September 30, 2013 and 2012, the Company used the quarter’s average common stock close price of \$19.48 and \$6.22 per share, respectively. The Company reported net income and net loss for the nine months ended September 30, 2013 and 2012, respectively. For each of the periods, approximately 0.1 million shares of the Company’s common stock subject to options were excluded from the diluted EPS calculation, as the effect would have been antidilutive. In determining the potential dilution effect of outstanding stock options during the nine months ended September 30, 2013 and 2012, the Company used the nine month average common stock close price of \$11.68 and \$5.12 per share, respectively.

12

---

Table of Contents

## MANNATECH, INCORPORATED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (continued)

## NOTE 5: STOCK-BASED COMPENSATION

The Company currently has one active stock-based compensation plan, which was approved by shareholders. The Company grants stock options to employees, consultants, and board members at the fair market value of its common stock, on the date of grant, with a term no greater than ten years. The majority of stock options vest over two or three years. Shareholders who own 10% or more of the Company's outstanding stock are granted incentive stock options at an exercise price that may not be less than 110% of the fair market value of the Company's common stock on the date of grant and have a term no greater than five years.

In February 2008, the Company's Board of Directors approved the Mannatech, Incorporated 2008 Stock Incentive Plan, as amended (the "2008 Plan"), which reserves up to 200,000 shares for issuance of stock options and restricted stock to our employees, board members, and consultants, plus any shares reserved under the Company's then-existing, unexpired stock plans for which options had not yet been issued, and any shares underlying outstanding options under the then-existing stock option plans that terminate without having been exercised in full. The 2008 Plan was approved by the Company's shareholders at the 2008 Annual Shareholders' Meeting and was amended at the 2012 Annual Shareholders' Meeting to increase the number of shares of common stock subject to the plan by 100,000. As of September 30, 2013, the 2008 Plan had 72,371 stock options available for grant before the plan expires on February 20, 2018.

The Company records stock-based compensation expense related to granting stock options in selling and administrative expenses. During the three months ended September 30, 2013, the Company granted 2,500 stock options with a fair value of \$11.71 to an employee. The stock options have an exercise price of \$18.81 per share, vest over 3 years, and expire on August 19, 2023. During the three months ended September 30, 2012, the Company did not grant stock options. During the nine months ended September 30, 2013 and 2012, the Company granted 82,500 and 20,000 stock options, respectively. The fair value of stock options granted during the nine months ended September 30, 2013 ranged from \$3.53 to \$11.71 per share. The Company recognized compensation expense as follows for the three and nine months ended September 30 (in thousands):

	Three months		Nine months	
	2013	2012	2013	2012
Total gross compensation expense	\$41	\$43	\$137	\$167
Total tax benefit associated with compensation expense	6	7	27	37
Total net compensation expense	\$35	\$36	\$110	\$130

As of September 30, 2013, the Company expects to record compensation expense in the future as follows (in thousands):

	Three months ending December 31, 2013	2014	2015	Year ending December 31, 2016
Total gross unrecognized compensation expense	\$ 35	\$119	\$100	\$ 21
Tax benefit associated with unrecognized compensation expense	6	20	15	2
Total net unrecognized compensation expense	\$ 29	\$99	\$85	\$ 19

NOTE 6: SHAREHOLDERS' EQUITY

Equity Line

On September 16, 2010, the Company entered into an Investment Agreement (as amended, the "Investment Agreement") with Dutchess Opportunity Fund, II, LP, a Delaware limited partnership (the "Investor"), whereby the Company may sell up to \$10 million of the Company's common stock to the Investor over a period of 36 months from the first trading day following the effectiveness of a registration statement registering the resale of shares pursuant to the Investment Agreement (the "Equity Line").

13

---

Table of Contents

MANNATECH, INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (continued)

The Company may draw on the Equity Line from time to time, as and when it determines appropriate in accordance with the terms and conditions of the Investment Agreement. The Company is not permitted to draw on the Equity Line unless there is an effective registration statement to cover the resale of the shares. The Company filed a registration statement with the SEC, and on October 28, 2010, the SEC declared effective the Company's Registration Statement on Form S-3 (File No. 333-169774), which registers up to 500,000 shares of common stock (as adjusted for a 1-for-10 reverse stock split effected January 13, 2012) that may be resold by the Investor pursuant to the Investment Agreement.

Investors should read the Investment Agreement together with the other information concerning the Company that the Company publicly files in reports and statements with the SEC.

No shares of common stock were issued pursuant to the Investment Agreement as of October 28, 2013, when the Investment Agreement expired.

Treasury Stock

The Company is authorized to repurchase the lesser of (i) 131,756 shares and (ii) \$1.3 million in shares pursuant to a stock repurchase plan adopted by the Company's Board of Directors on June 30, 2004 (as amended, the "June 2004 Plan"). On August 28, 2006, a second program permitting the Company to purchase, in the open market, up to \$20 million of its outstanding shares was approved by our Board of Directors (the "August 2006 Plan").

As of September 30, 2013, the maximum number of shares available for repurchase under the June 2004 Plan was 19,084, and the total number of shares purchased in the open market under the June 2004 Plan was 112,672. No shares were repurchased under the June 2004 Plan during the third quarter of 2013 and no shares have ever been purchased under the August 2006 Plan. The Company does not have any stock repurchase plans or programs other than the June 2004 Plan and the August 2006 Plan.

NOTE 7: LITIGATION

Pending Litigation

Natalie Clark v. Mannatech, Incorporated, Case No. DC-13-05038, 192nd Judicial District Court, Dallas County, Texas

On May 10, 2013 the Company was served notice of a lawsuit filed by Ms. Natalie Clark, a former executive with the Company, in the 192nd Judicial District Court, Dallas County, Texas (the "Court") alleging discrimination and harassment based on gender. Ms. Clark alleges that she was stripped of her duties and wrongfully discharged as part of an alleged "purge of females in key positions" within the Company. Ms. Clark is seeking damages in excess of \$1,000,000. The Company has retained counsel and filed its answer denying Ms. Clark's allegations. This case is set for jury trial on June 2, 2014. Additionally, the Court issued a standard mediation order and mediation must be conducted no later than May 2, 2014.

The parties are engaged in the discovery process. It is not possible at this time to predict whether the Company will incur any liability, or to estimate the ranges of damages, if any, which may be incurred in connection with this matter. However, the Company believes it has a valid defense and will vigorously defend this claim.

Administrative Proceedings

The examination of our 2005-2009 tax years by the IRS for U.S. federal tax purposes was settled during the second quarter of 2013. On May 13, 2013, the IRS and the Company concluded the audit and agreed to a net tax deficiency of \$0.8 million and the payment of interest accrued through June 30, 2013 of \$0.2 million, without any penalties. In connection with the settlement of the audit, the Company reclassified amounts owed to the IRS and previously recorded as uncertain income tax positions as taxes payable, resulting in a \$1.0 million tax benefit during the three months ended June 30, 2013. There are other ongoing income tax audits in various international jurisdictions that are not expected to have a material effect on our financial statements.

On July 11, 2013 the Company was issued an assessment notice from the Busan Custom Office in Korea in the amount of KRW 2,147,034,680 (approximately \$1.9 million) resulting from an audit covering fiscal years 2008 through 2012. We are pursuing relief through the administrative review processes available in the jurisdiction. Additionally, we have created a reserve of approximately \$0.9 million which reflects our current estimate of the probable outcome of our appeal.

There are other ongoing audits in various international jurisdictions that are not expected to have a material effect on our financial statements.

14

---

Table of Contents

MANNATECH, INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (continued)

Litigation in General

The Company has incurred several claims in the normal course of business. The Company believes such claims can be resolved without any material adverse effect on its consolidated financial position, results of operations, or cash flows.

The Company maintains certain liability insurance; however, certain costs of defending lawsuits are not covered by or are only partially covered by its insurance policies, including claims that are below insurance deductibles.

Additionally, insurance carriers could refuse to cover certain claims in whole or in part. The Company accrues costs to defend itself from litigation as they are incurred or as they become determinable.

The outcome of litigation is uncertain, and despite management's views of the merits of any litigation, or the reasonableness of the Company's estimates and reserves, the Company's financial statements could nonetheless be materially affected by an adverse judgment. The Company believes it has adequately reserved for related legal fees and the contingencies arising from the above legal matters where an outcome was deemed to be probable, and the loss amount could be reasonably estimated.

NOTE 8: RECENT ACCOUNTING PRONOUNCEMENTS

In February 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. Under this standard, entities will be required to disclose additional information with respect to changes in accumulated other comprehensive income ("AOCI") balances by component and significant items reclassified out of AOCI. Expanded disclosures for presentation of changes in AOCI involve disaggregating the total change of each component of other comprehensive income (for example, unrealized gains or losses on available for sale marketable securities) as well as presenting separately for each such component the portion of the change in AOCI related to (1) amounts reclassified into income and (2) current-period other comprehensive income. Additionally, for amounts reclassified into income, disclosure in one location would be required, based upon each specific AOCI component, of the amounts impacting individual income statement line items. Disclosure of the income statement line item impacts will be required only for components of AOCI reclassified into income in their entirety. This ASU is effective beginning January 1, 2013. Because this standard only impacts presentation and disclosure requirements, its adoption did not have a material impact on the Company's consolidated results of operations or financial condition. No additional disclosures were presented during the quarter as there were no material reclassifications from AOCI during the periods presented.

NOTE 9: FAIR VALUE

The Company utilizes fair value measurements to record fair value adjustments to certain financial assets and to determine fair value disclosures.

Fair Value Measurements and Disclosure Topic 820 of the FASB Accounting Standard Codification ("ASC") establishes a fair value hierarchy that requires the use of observable market data, when available, and prioritizes the inputs to valuation techniques used to measure fair value in the following categories:

- Level 1 – Quoted unadjusted prices for identical instruments in active markets.
- Level 2 – Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-derived valuations in which all observable inputs and significant value drivers are observable in active markets.



· Level 3 – Model-derived valuations in which one or more significant inputs or significant value drivers are unobservable, including assumptions developed by the Company.

The primary objective of the Company's investment activities is to preserve principal while maximizing yields without significantly increasing risk. The investment instruments held by the Company are money market funds and interest bearing deposits for which quoted market prices are readily available. The Company considers these highly liquid investments to be cash equivalents. These investments are classified within Level 1 of the fair value hierarchy because they are valued based on quoted market prices in active markets. The Company does not have any material financial liabilities that were required to be measured at fair value on a recurring basis at September 30, 2013.

15

---

Table of Contents

## MANNATECH, INCORPORATED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (continued)

The table below presents the recorded amount of financial assets measured at fair value (in thousands) on a recurring basis as of September 30, 2013.

	Level 1	Level 2	Level 3	Total
Assets				
Money Market Funds – Fidelity, US	\$ 192	\$ —	\$ —	\$ 192
Interest bearing deposits – various banks, Korea	3,716	—	—	3,716
Total assets	\$3,908	\$ —	\$ —	\$3,908
Amounts included in:				
Cash and cash equivalents	\$ 192	\$ —	\$ —	\$ 192
Long-term restricted cash	3,716	—	—	3,716
Total	\$3,908	\$ —	\$ —	\$3,908

## NOTE 10: SEGMENT INFORMATION

The Company conducts its business as a single operating segment, consolidating all of its business units into a single reportable entity, as a seller of proprietary nutritional supplements, topical and skin care products, and weight-management products through its network marketing distribution channels operating in twenty-four countries. Each of the Company's business units sells similar packs and products and possesses similar economic characteristics, such as selling prices and gross margins. In each country, the Company markets its products and pays commissions and incentives in similar market environments. The Company's management reviews its financial information by country and focuses its internal reporting and analysis of revenues by packs and product sales. The Company sells its products through its associates and distributes its products through similar distribution channels in each country. No single associate has ever accounted for more than 10% of the Company's consolidated net sales.

The Company operates facilities in eleven countries and sells product in twenty-four countries around the world. These facilities are located in the United States, Canada, Switzerland, Australia, the United Kingdom, Japan, the Republic of Korea (South Korea), Taiwan, South Africa, Mexico, and Ukraine. Each facility services different geographic areas. We currently sell our products in three regions: (i) North America (the United States, Canada, and Mexico); (ii) EMEA (Austria, the Czech Republic, Denmark, Estonia, Finland, Germany, the Republic of Ireland, Namibia, the Netherlands, Norway, South Africa, Sweden, Ukraine, and the United Kingdom); (iii) Asia/Pacific (Australia, Hong Kong, Japan, New Zealand, the Republic of Korea, Singapore, and Taiwan). In December 2012, the Company commenced the shipment of its products to Hong Kong and officially launched Hong Kong operations in April 2013. In November 2012, the Company commenced the shipment of its products to Ukraine and officially launched Ukrainian operations in July 2013. The Switzerland office was created to manage certain day-to-day business needs of non-North American markets.

Consolidated net sales shipped to customers in these regions, along with pack and product information for the three and nine months ended September 30, are as follows (in millions, except percentages):

Region	Three months			Nine months		
	2013	2012	%	2013	2012	%
North America	\$18.7	\$20.7	42.2 %	\$60.5	\$66.0	46.2 %
Asia/Pacific	22.0	17.8	49.5 %	59.7	53.0	45.6 %
EMEA	3.7	4.5	8.3 %	10.7	12.1	8.2 %
Totals	\$44.4	\$43.0	100.0 %	\$130.9	\$131.1	100.0 %

	Three months		Nine months	
	2013	2012	2013	2012
Consolidated product sales	\$31.7	\$38.3	\$108.0	\$117.1
Consolidated pack sales	10.9	3.0	17.1	9.1
Consolidated other, including freight	1.8	1.7	5.8	4.9
Consolidated total net sales	\$44.4	\$43.0	\$130.9	\$131.1

Long-lived assets, which include property, equipment and construction in progress for the Company and its subsidiaries, reside in the following regions (in millions):

16

---

Table of Contents

## MANNATECH, INCORPORATED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (continued)

<u>Region</u>	September 30, 2013	December 31, 2012
North America	\$ 2.7	\$ 3.8
Asia/Pacific	0.5	0.7
EMEA	0.4	0.3
Total	\$ 3.6	\$ 4.8

Inventory balances by region, which consists of raw materials, work in progress, finished goods, and promotional materials, as offset by obsolete inventories, were as follows (in millions):

<u>Region</u>	September 30, 2013	December 31, 2012
North America	\$ 8.2	\$ 9.5
Asia/Pacific	4.5	4.2
EMEA	2.0	1.5
Total	\$ 14.7	\$ 15.2

17

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion is intended to assist in the understanding of our consolidated financial position and results of operations for the three and nine months ended September 30, 2013 as compared to the same period in 2012, and should be read in conjunction with Item I "Financial Statements" in Part I of this quarterly report on Form 10-Q. Unless stated otherwise, all financial information presented below, throughout this report, and in the consolidated financial statements and related notes includes Mannatech and all of our subsidiaries on a consolidated basis.

COMPANY OVERVIEW

Since November 1993, we have continued to develop innovative, high-quality, proprietary nutritional supplements, topical and skin care products, and weight-management products that are sold through a global network marketing system. We operate in three regions: (i) North America (the United States, Canada, and Mexico); (ii) EMEA (Austria, the Czech Republic, Denmark, Estonia, Finland, Germany, the Republic of Ireland, Namibia, the Netherlands, Norway, South Africa, Sweden, Ukraine, and the United Kingdom); (iii) Asia/Pacific (Australia, Hong Kong, Japan, New Zealand, the Republic of Korea, Singapore, and Taiwan). In December 2012, we announced the shipment of our products to Hong Kong and officially launched Hong Kong operations in April 2013. In November 2012, we commenced the shipment of our products to Ukraine and officially launched Ukrainian operations in July 2013.

We conduct our business as a single operating segment and primarily sell our products through a network of approximately 239,000 active independent associates and members who have purchased our products and/or packs within the last 12 months, who we refer to as active associates and members. New recruits and pack sales are leading indicators for the long-term success of our business. New recruits include new associates and members purchasing our packs and products for the first time. We operate as a seller of nutritional supplements, topical and skin care products, and weight-management products through our network marketing distribution channels operating in twenty-four countries. We review and analyze net sales by geographical location and by packs and products on a consolidated basis. Each of our subsidiaries sells similar products and exhibits similar economic characteristics, such as selling prices and gross margins.

Because we sell our products through network marketing distribution channels, the opportunities and challenges that affect us most are: recruitment of new and retention of associates and members; entry into new markets and growth of existing markets; niche market development; new product introduction; and investment in our infrastructure.

Current Economic Conditions and Recent Developments

During the third quarter of 2013 we continued to observe the improvements we experienced during the first and second quarters of 2013. We increased the number of active associates and members by 2.6% as compared to the same period in 2012. This increase was due to an increase in the recruitment of both associates and members as the phased introduction of compensation plan changes targeting associates was implemented primarily during the second quarter of 2013. We implemented enhancements to our sign-up packs globally, which we believe will lead to increases in the recruitment of business- building associates. The number of new independent associates for the third quarter of 2013 increased 33.3% to approximately 22,800 as compared to approximately 17,100 for the same period in 2012. This increase led to an overall increase in revenue of \$1.4 million, or 3.3%, during the three months ended September 30, 2013 as compared to the same period in 2012. In July 2013, we launched the final phases of the compensation plan, which enhance the compensation received by associates for the sale of finished products. These changes were fully implemented world-wide in July 2013. During third quarter of 2013, we started a loyalty program where customers earn loyalty points from qualified automatic orders, which can be applied to future purchases.

We experienced a \$1.6 million unfavorable impact on our net sales due to fluctuations in foreign currency exchange rates for the three months ended September 30, 2013. For the nine months ended September 30, 2013, we experienced

a \$3.5 million unfavorable impact on our net sales due to fluctuations in foreign currency exchange rates. The majority of the unfavorable impact on our net sales is in the Asia/Pacific region due to the weakening of the Japanese Yen.

For the three months ended September 30, 2013, our operating expenses (excluding depreciation, commissions, and incentives) increased by \$0.8 million as compared to the same period in 2012. This increase is due primarily to a prior year reduction in transactional sales tax expense accruals of \$0.8 million relating to the expiration of certain statute of limitations, otherwise there would not be a significant change.

For the nine months ended September 30, 2013, our operating expenses (excluding depreciation, commissions, and incentives) decreased by \$2.8 million as compared to the same period in 2012. The decrease in other operating costs was primarily due to a reduction in payroll and payroll-related costs. These continued improvements in our operational efficiencies generated \$2.6 million of operating income for the nine months ended September 30, 2013, as compared to an operating loss of \$2.4 million during the same period in 2012.

18

---

Table of Contents

## RESULTS OF OPERATIONS

The table below summarizes our consolidated operating results in dollars and as a percentage of net sales for the three months ended September 30, 2013 and 2012 (in thousands, except percentages):

	2013		2012		Change from 2013 to 2012		
	Total	% of	Total	% of	Dollar	Percentage	
	dollars	net sales	dollars	net sales			
Net sales	\$44,432	100.0%	\$43,049	100.0%	\$1,384	3.2	%
Cost of sales	9,225	20.8 %	8,698	20.2 %	528	6.1	%
Gross profit	35,207	79.2 %	34,351	79.8 %	856	2.5	%
Operating expenses:							
Commissions and incentives	19,640	44.2 %	18,658	43.3 %	983	5.3	%
Selling and administrative expenses	8,497	19.1 %	8,640	20.1 %	(143 )	(1.7 )	)%
Depreciation and amortization	474	1.1 %	703	1.6 %	(230 )	(32.7 )	)%
Other operating costs	6,167	13.9 %	5,261	12.2 %	906	17.2	%
Total operating expenses	34,778	78.3 %	33,262	77.2 %	1,516	4.6	%
Income from operations	429	0.9 %	1,089	2.6 %	(660 )	(60.6 )	)%
Interest income	25	0.1 %	6	0.0 %	19	316.7	%
Other income (expense), net	(275 )	(0.6 )%	455	1.1 %	(730 )	(160.4 )	)%
Income before income taxes	179	0.4 %	1,550	3.7 %	(1,371)	(88.5 )	)%
(Provision) benefit for income taxes	(980 )	(2.2 )%	663	1.5 %	(1,643)	(247.8 )	)%
Net income (loss)	\$(801 )	(1.8 )%	\$2,213	5.2 %	\$(3,014)	(136.2 )	)%

The table below summarizes our consolidated operating results in dollars and as a percentage of net sales for the nine months ended September 30, 2013 and 2012 (in thousands, except percentages):

	2013		2012		Change from 2013 to 2012		
	Total	% of	Total	% of	Dollar	Percentage	
	dollars	net sales	dollars	net sales			
Net sales	\$130,899	100.0%	\$131,162	100.0%	\$(263 )	(0.2 )	)%
Cost of sales	25,616	19.6 %	25,824	19.7 %	(208 )	(0.8 )	)%
Gross profit	105,283	80.4 %	105,338	80.3 %	(55 )	(0.1 )	)%
Operating expenses:							
Commissions and incentives	56,362	43.1 %	56,280	42.9 %	82	0.1	%
Selling and administrative expenses	25,669	19.6 %	28,240	21.5 %	(2,570)	(9.1 )	)%
Depreciation and amortization	1,699	1.3 %	4,082	3.1 %	(2,383)	(58.4 )	)%
Other operating costs	18,919	14.4 %	19,109	14.6 %	(190 )	(1.0 )	)%
Total operating expenses	102,649	78.4 %	107,711	82.1 %	(5,061)	(4.7 )	)%
Income (loss) from operations	2,634	2.0 %	(2,373 )	(1.8 )%	5,006	211.0	%
Interest income (expense)	29	0.0 %	(26 )	0.0 %	55	211.5	%
Other income (expense), net	(1,278 )	(0.9 )%	542	0.4 %	(1,820)	(335.8 )	)%
Income (loss) before income taxes	1,385	1.1 %	(1,857 )	(1.4 )%	3,241	174.5	%
(Provision) benefit for income taxes	(758 )	(0.6 )%	215	0.2 %	(973 )	(452.6 )	)%

Edgar Filing: MANNATECH INC - Form 10-Q

Net income (loss)	\$627	0.5	%	\$(1,642 )	(1.2 )%	\$2,268	138.1	%
19								

---



Table of Contents

Consolidated net sales by region for the three months ended September 30, 2013 and 2012 were as follows (in millions, except percentages):

## Net Sales in Dollars and as a Percentage of Consolidated Net Sales

<u>Region</u>	2013			2012		
North America	\$18.7	42.2 %		\$20.7	48.1 %	
Asia/Pacific	22.0	49.5 %		17.8	41.4 %	
EMEA	3.7	8.3 %		4.5	10.5 %	
Total	\$44.4	100.0%		\$43.0	100.0%	

Consolidated net sales by customer location for the nine months ended September 30, 2013 and 2012 were as follows (in millions, except percentages):

## Net Sales in Dollars and as a Percentage of Consolidated Net Sales

<u>Region</u>	2013			2012		
North America	\$60.5	46.2 %		\$66.0	50.3 %	
Asia/Pacific	59.7	45.6 %		53.0	40.4 %	
EMEA	10.7	8.2 %		12.1	9.3 %	
Total	\$130.9	100.0%		\$131.1	100.0%	

## Net Sales

Consolidated net sales for the three months ended September 30, 2013 increased by \$1.4 million, or 3.3%, to \$44.4 million as compared to the same period in 2012. Consolidated net sales for the nine months ended September 30, 2013 decreased by \$0.2 million, or 0.2%, to \$130.9 million as compared to the same period in 2012. During the third quarter, we started a loyalty program where customers earn loyalty points from qualified automatic orders, which can be applied to future purchases. We defer the dollar equivalent in revenue of these points until the points are applied or forfeited.

North American sales decreased by \$2.0 million, or 9.7%, to \$18.7 million for the three months ended September 30, 2013 as compared to the same period in 2012. North American sales decreased by \$5.5 million, or 8.3%, to \$60.5 million for the nine months ended September 30, 2013 as compared to the same period in 2012. The decline in revenue for both the three and nine months ended September 30, 2013 as compared to the same periods in 2012 is primarily due to \$1.2 million in loyalty program deferred revenue at September 30, 2013. During the third quarter, a reduction in active associates was partially offset by an increase in active members, resulting in a net 5.6% net reduction in active associates and members.

For the three and nine months ended September 30, 2013, our operations outside of North America accounted for approximately 57.8% and 53.8%, respectively, of our consolidated net sales, whereas in the same period in 2012, our operations outside of North America accounted for approximately 51.9% and 49.7%, respectively, of our consolidated net sales.

Asia/Pacific sales increased by \$4.2 million, or 23.6%, to \$22.0 million for the three months ended September 30, 2013 as compared to the same period in 2012. Asia/Pacific sales increased by \$6.7 million, or 12.6%, to \$59.7 million for the nine months ended September 30, 2013 as compared to the same period in 2012. The increase in revenue for the three months and nine months ended September 30, 2013 as compared to the same periods in 2012 was due to an increase in the number of active associates and members. During the three months ended September 30, 2013, the revenue generated per active associate and member increased. These improvements were partially offset by the \$1.2

million loyalty program deferred revenue at September 30, 2013. Also, we experienced a \$1.2 million unfavorable impact on our net sales due to fluctuations in foreign currency exchange rates for the three months ended September 30, 2013. For the nine months ended September 30, 2013, we experienced a \$2.6 million unfavorable impact on our net sales due to fluctuations in foreign currency exchange rates. The majority of the unfavorable impact on our net sales in the Asia/Pacific region was due to the weakening of the Japanese Yen.

EMEA sales decreased by \$0.8 million, or 17.8%, to \$3.7 million for the three months ended September 30, 2013 as compared to the same period in 2012. Increases in active associates and members were offset by the decrease in revenue per associate and member. EMEA sales decreased by \$1.4 million, or 11.6%, to \$10.7 million for the nine months ended September 30, 2013 as compared to the same period in 2012. Increases in sales due to the increase in the number of active associates and members were offset by the decrease in revenue per associate and member. Also, we experienced a \$0.4 million unfavorable impact on our net sales due to fluctuations in foreign currency exchange rates for the three months ended September 30, 2013. For the nine months ended September 30, 2013, we experienced a \$0.9 million unfavorable impact on our net sales due to fluctuations in foreign currency exchange rates. The majority of the unfavorable impact on our net sales in the EMEA region was due to the weakening of the South African Rand.

20

---

Table of Contents

Fluctuation in foreign currency exchange rates for the three months ended September 30, 2013 had an overall unfavorable impact on our net sales of approximately \$1.6 million. For the nine months ended September 30, 2013, fluctuation in foreign currency exchange had an overall unfavorable impact on our net sales of approximately \$3.5 million. The net sales impact is calculated as the difference between (1) the current period's net sales in USD and (2) the current period's net sales in local currencies converted to USD by applying average exchange rates for the same periods ended September 30, 2012.

Our total sales and sales mix could be influenced by any of the following:

- changes in our sales prices;
- changes in consumer demand;
- changes in the number of associates and members;
- changes in competitors' products;
- changes in economic conditions;
- changes in regulations;
- announcements of new scientific studies and breakthroughs;
- introduction of new products;
- discontinuation of existing products;
- adverse publicity;
- changes in our commissions and incentives programs;
- direct competition; and
- fluctuations in foreign currency exchange rates.

Our sales mix for the three and nine months ended September 30, was as follows (in millions, except percentages):

	Three		Change		
	2013	2012	Dollar	Percentage	
Consolidated product sales	\$31.7	\$38.3	\$(6.6)	(17.2	)%
Consolidated pack sales	10.9	3.0	7.9	263.3	%
Consolidated other, including freight	1.8	1.7	0.1	5.9	%
Total consolidated net sales	\$44.4	\$43.0	\$1.4	3.3	%
	Nine Months		Change		
	2013	2012	Dollar	Percentage	
Consolidated product sales	\$108.0	\$117.1	\$(9.1)	(7.8	)%
Consolidated pack sales	17.1	9.1	8.0	87.9	%
Consolidated other, including freight	5.8	4.9	0.9	18.4	%

Total consolidated net sales                    \$130.9   \$131.1   \$(0.2)   (0.2   )%

Pack sales correlate to new associates who purchase starter packs and to continuing associates who purchase upgrade or renewal packs. However, there is no direct correlation between product sales and the number of new and continuing associates and members because associates and members utilize products at different volumes.

#### Product Sales

Substantially all of our product sales are made to associates at published wholesale prices. We also sell our products to members at discounted published retail prices.

21

---

Table of Contents

Product sales for the three months ended September 30, 2013 were \$31.7 million, down \$6.6 million from the same period in 2012. The average order value for the three months ended September 30, 2013 was \$150 as compared to \$153 for the same period in 2012 and this decrease resulted in a \$0.7 million reduction in revenue. The number of orders processed during the three months ended September 30, 2013 decreased by 7.7%, as compared to the same period in 2012, resulting in a \$2.9 million reduction in revenue. A \$3.0 million reduction in product sales is attributed to deferred revenue and fluctuations in foreign currency exchange rates.

Product sales for the nine months ended September 30, 2013 decreased by \$9.1 million, or 7.8%, as compared to the same period in 2012. The decrease in product sales was primarily due to the reduction in the average order size. The average order value for the nine months ended September, 2013 was \$152, as compared to \$155 for the same period in 2012 and this decrease resulted in a \$2.4 million reduction in revenue. The number of orders processed during the nine months ended September 30, 2013 decreased by 2.9%, as compared to the same period in 2012, resulting in a \$3.3 million reduction in revenue. A \$3.4 million reduction in product sales is attributed to deferred revenue and fluctuations in foreign currency exchange rates.

**Pack Sales**

Packs may be purchased by our associates who wish to build a Mannatech business. These packs are offered to our associates at a discount from published retail prices. There are several pack options available to our associates. In certain markets, pack sales are completed during the final stages of the registration process and can provide new associates with valuable training and promotional materials, as well as products for resale to retail customers, demonstration purposes, and personal consumption. Business-building associates can also purchase an upgrade pack, which provides the associate with additional promotional materials, additional products, and eligibility for additional commissions and incentives. Many of our business-building associates also choose to purchase renewal packs to satisfy annual renewal requirements to continue to earn various commissions.

The dollar amount of pack sales associated with new and continuing associates was as follows, for the three and nine months ended September 30 (in millions, except percentages):

	Three Months		Change		
	2013	2012	Dollar	Percentage	
New	\$2.9	\$2.0	\$0.9	45.0	%
Continuing	8.0	1.0	7.0	700.0	%
Total	\$10.9	\$3.0	\$7.9	263.3	%

	Nine Months		Change		
	2013	2012	Dollar	Percentage	
New	\$6.8	\$6.3	\$0.5	7.9	%
Continuing	10.3	2.8	7.5	267.9	%
Total	\$17.1	\$9.1	\$8.0	87.9	%

Total pack sales for the three months ended September 30, 2013 increased by \$7.9 million, or 263.3%, to \$10.9 million, as compared to \$3.0 million for the same period in 2012. Average pack value for the three months ended September 30, 2013 was \$274 as compared to \$159 for the same period in 2012. The total number of packs sold increased by 20,600, or 108.4%, to 39,600, and the average pack value increased by \$115, or 72.3%, for the three months ended September 30, 2013, as compared to the same period in 2012. The increase in the average pack value is due to a change in the sales mix of the type of packs purchased.

The number of new independent associates and members for the third quarter of 2013 increased 4.4% to approximately 28,800 as compared to approximately 27,600 for the same period in 2012.

Total pack sales for the nine months ended September 30, 2013 increased by \$8.0 million, or 87.9%, to \$17.1 million, as compared to \$9.1 million for the same period in 2012. Average pack value for the nine months ended September 30, 2013 was \$198, as compared to \$160 for the same period in 2012. The total number of packs sold increased by 28,600, or 49.7%, to 86,200, and the average pack value increased by \$38, or 23.8%, for the nine months ended September 30, 2013, as compared to the same period in 2012. The increase in the average pack value is due to a change in the sales mix of the type of packs purchased.

22

---

Table of Contents

The approximate number of new and continuing associates and members who purchased our packs or products during the twelve months ended September 30, 2013 and 2012 were as follows:

	2013		2012	
New	109,000	46.0 %	95,000	41.0 %
Continuing	130,000	54.0 %	138,000	59.0 %
Total	239,000	100.0%	233,000	100.0%

There was an overall increase of 6,000 or 2.6%, for the twelve months ended September 30, 2013 in the number of associates and members who purchased our products as compared to the same period in 2012, which was due to an increase in the number of new associates and members.

During 2012 and the first nine months of 2013, we took the following actions to recruit and retain associates and members:

- registered our products with the appropriate regulatory agencies in all countries of operations;
- explored new international markets;
- launched marketing and educational campaigns;
- continued to strengthen compliance initiatives;
- initiated additional incentives;
- explored new advertising and educational tools to broaden name recognition; and
- implemented changes to our global associate career and compensation plan.

## Other Sales

Other sales consisted of: (i) freight revenue charged to our associates and members; (ii) sales of promotional materials; (iii) monthly fees collected for Success Tracker™ and Navig8™ customized electronic business-building and educational materials, databases and applications; (iv) training and event registration fees; and (v) a reserve for estimated sales refunds and returns. Promotional materials, training, database applications and business management tools support our independent associates, which in turn helps stimulate product sales.

For the three months ended September 30, 2013, other sales increased by \$0.1 million, or 5.9%, to \$1.8 million, as compared to \$1.7 million for the same period in 2012. Other sales for the nine months ended September 30, 2013 increased by \$0.9 million, or 18.4%, to \$5.8 million, as compared to \$4.9 million for the same period in 2012. The increase was primarily due to an increase in freight fees charged on our products and pack shipments.

## Gross Profit

For the three months ended September 30, 2013, gross profit increased by \$0.9 million, or 2.5%, to \$35.2 million, as compared to \$34.3 million for the same period in 2012 due to higher revenue. For the three months ended September 30, 2013, gross profit as a percentage of net sales decreased to 79.2%, as compared to 79.8% for the same period in 2012.

To improve the matching of costs associated with revenue from freight and shipping fees, beginning December 31, 2012, freight costs associated with shipping products to our customers were reclassified to cost of sales from selling and administrative expenses with prior periods' presentations adjusted accordingly. Total freight costs included in cost of sales were approximately \$1.7 million and \$1.9 for the three months ended September 30, 2013 and 2012, respectively. Additionally, to more closely conform to the financial presentation of our competitors, royalty costs were reclassified to cost of sales from selling and administrative expenses beginning in December 31, 2012. Total royalty costs included in cost of sales were approximately \$0.1 million for each of the three months ended September 30, 2013 and 2012.

Cost of sales during the three months ended September 30, 2013 increased by 6.1%, or \$0.5 million, to \$9.2 million, as compared to \$8.7 million for the same period in 2012. The increase in cost of sales was primarily due to an increase in inventory and freight. Cost of sales as a percentage of net sales for the three months ended September 30, 2013 was 20.8%, as compared to 20.2% for the same period in 2012.

23

---



## Table of Contents

For each of the nine months ended September 30, 2013 and 2012, gross profit was \$105.3 million. For the nine months ended September 30, 2013, gross profit as a percentage of net sales increased to 80.4%, as compared to 80.3% for the same period in 2012.

Total freight costs associated with shipping products to our customers included in cost of sales were approximately \$5.0 million and \$5.6 million for the nine months ended September 30, 2013 and 2012, respectively. Total royalty costs included in cost of sales were approximately \$0.2 million for each of the nine months ended September 30, 2013 and 2012.

Cost of sales during the nine months ended September 30, 2013 decreased by 0.8%, or \$0.2 million, to \$25.6 million, as compared to \$25.8 million for the same period in 2012 due to improvements in inventory management resulting in less obsolescence. Cost of sales as a percentage of net sales for the nine months ended September 30, 2013 was 19.6%, as compared to 19.7% for the same period in 2012.

## Commission and Incentives

In order to more closely conform to the financial presentations of our competitors, beginning December 31, 2012, commission and incentive expenses were reclassified to operating expenses from cost of sales with prior periods' presentations adjusted accordingly. Total commission and incentive expenses reclassified to operating expenses were approximately \$19.6 million and \$18.7 million for the three months ended September 30, 2013 and 2012, respectively.

Commission costs for the three months ended September 30, 2013 increased by 5.0%, or \$0.9 million, to \$18.8 million, as compared to \$17.9 million for the same period in 2012. The increase in commissions was due to the increase in commissionable net sales. For the three months ended September 30, 2013, commissions as a percentage of net sales increased to 42.3% from 41.6% for the same period in 2012.

Commission costs for the nine months ended September 30, 2013 decreased by 0.6%, or \$0.3 million, to \$53.4 million, as compared to \$53.7 million for the same period in 2012. The decrease in commissions was due to the decrease in commissionable net sales. For the nine months ended September 30, 2013, commissions as a percentage of net sales decreased to 40.8% from 41.0% for the same period in 2012.

Incentive costs for the three months ended September 30, 2013 remained relatively the same at approximately \$0.8 million, as compared to the same period in 2012. The costs of incentives as a percentage of net sales decreased to 1.8% from 1.9% for the same period in 2012.

Incentive costs for the nine months ended September 30, 2013 increased by 15.4%, or \$0.4 million, to \$3.0 million, as compared to \$2.6 million for the same period in 2012. The costs of incentives as a percentage of net sales increased during this period to 2.3%, as compared to 2.1% for the same period in 2012. Incentive costs for both the three months and nine months ended September 30, 2013 increased as the number of associates qualifying for the travel incentive in U.S. and Canada exceeded the levels achieved during the same period in 2012.

## Selling and Administrative Expenses

Selling and administrative expenses include a combination of both fixed and variable expenses. These expenses consist of compensation and benefits for employees, temporary and contract labor, and marketing-related expenses, such as monthly magazine development costs and costs related to hosting our corporate-sponsored events.

For the three months ended September 30, 2013, selling and administrative expenses decreased by \$0.1 million, or 1.7%, to \$8.5 million, as compared to \$8.6 million for the same period in 2012. The decrease in selling and administrative expenses consisted primarily of a \$0.6 million decrease in payroll and payroll-related costs offset by a

\$0.5 million increase in marketing costs. Selling and administrative expenses as a percentage of net sales for the three months ended September 30, 2013 decreased to 19.1% from 20.1% for the same period in 2012.

For the nine months ended September 30, 2013, selling and administrative expenses decreased by \$2.6 million, or 9.1%, to \$25.7 million, as compared to \$28.2 million for the same period in 2012. The decrease in selling and administrative expenses consisted primarily of a \$3.4 million decrease in payroll and payroll-related costs offset by a \$0.8 million increase in marketing costs. Selling and administrative expenses as a percentage of net sales for the nine months ended September 30, 2013 decreased to 19.6% from 21.5% for the same period in 2012.

24

---

Table of Contents

Other Operating Costs

Other operating costs include travel, accounting, legal and consulting fees, credit card processing fees, banking fees, off-site storage fees, utilities, and other miscellaneous operating expenses. Changes in other operating costs are associated with changes in our net sales.

For the three months ended September 30, 2013, other operating costs increased by \$0.9 million, or 17.2%, to \$6.2 million, as compared to \$5.3 million for the same period in 2012. For the three months ended September 30, 2013, other operating costs as a percentage of net sales increased to 13.9% from 12.2% for the same period in 2012. The increase in other operating costs was primarily due to transaction tax adjustments of \$0.8 million.

For the nine months ended September 30, 2013, other operating costs decreased by \$0.2 million, or 1.0%, to \$18.9 million, as compared to \$19.1 million for the same period in 2012. For the nine months ended September 30, 2013, other operating costs as a percentage of net sales decreased to 14.4% from 14.6% for the same period in 2012. The decrease in other operating costs was primarily due to a \$1.0 million reduction in office expenses and a \$0.2 million reduction in legal costs, partially offset by increases in travel costs and taxes.

Depreciation and Amortization Expense

Depreciation and amortization expense for the three months ended September 30, 2013 decreased by 32.7%, or \$0.2 million, to \$0.5 million, as compared to \$0.7 million for the same period in 2012. The decrease is due to a significant computer hardware asset becoming fully depreciated during the third quarter of 2013. As a percentage of net sales, depreciation and amortization expense was 1.1%, as compared to 1.6% for the same period in 2012.

Depreciation and amortization expense for the nine months ended September 30, 2013 decreased by 58.4%, or \$2.4 million, to \$1.7 million, as compared to \$4.1 million for the same period in 2012. The decrease was due to our enterprise resource planning software system becoming fully depreciated at the end of the first quarter of 2012. As a percentage of net sales, depreciation and amortization expense was 1.3%, as compared to 3.1% for the same period in 2012.

Other Income (Expense), Net

Other income (expense), net primarily consists of foreign currency gains and losses related to the remeasurement of our foreign subsidiaries' assets, liabilities, revenues, and expenses to the United States dollar and revaluing monetary accounts in the United States, Switzerland, Japan, Republic of Korea, Taiwan, Norway, Sweden, Mexico, and Ukraine using current and weighted-average currency exchange rates. Net foreign currency transaction gains and losses are the result of the United States dollar fluctuating in value against foreign currencies.

Other income (expense), net for the three months ended September 30, 2013 was (\$0.3) million, as compared to other income (expense), net of \$0.5 million for the same period in 2012. The increase in other expense is associated with an increase in the unfavorable foreign currency exchange during the three months ended September 30, 2013, as compared to the same period in 2012.

Other income (expense), net for the nine months ended September 30, 2013 was (\$1.3) million, as compared to other income, net of \$0.5 million for the same period in 2012. The increase in Other expense is associated with an increase in the unfavorable foreign currency exchange during the nine months ended September 30, 2013, as compared to the same period in 2012.

(Provision) Benefit for Income Taxes

(Provision) benefit for income taxes includes current and deferred income taxes for both our domestic and foreign operations. Our statutory income tax rates by jurisdiction are as follows for the three and nine months ended September 30:

25

---

Table of Contents

<u>Country</u>	2013	2012
Australia	30.0%	30.0%
Canada	26.5%	26.0%
Cyprus	12.5%	N/ A
Denmark	25.0%	25.0%
Hong Kong	16.5%	N/ A
Japan	39.4%	42.0%
Mexico	30.0%	30.0%
Norway	28.0%	28.0%
Republic of Korea	22.0%	22.0%
Singapore	17.0%	17.0%
South Africa	28.0%	28.0%
Sweden	22.0%	26.3%
Switzerland	16.2%	16.2%
Taiwan	17.0%	17.0%
Ukraine	19.0%	N/ A
United Kingdom	23.0%	24.0%
United States	37.5%	37.5%

Income from our international operations is subject to taxation in the countries in which we operate. Although we may receive foreign income tax credits that would reduce the total amount of income taxes owed in the United States, we may not be able to fully utilize our foreign income tax credits in the United States.

We use the recognition and measurement provisions of FASB ASC Topic 740, Income Taxes, to account for income taxes. The provisions of the Income Tax Topic require a company to record a valuation allowance when the “more likely than not” criterion for realizing net deferred tax assets cannot be met. Furthermore, the weight given to the potential effect of such evidence should be commensurate with the extent to which it can be objectively verified. As a result, we reviewed the operating results, as well as all of the positive and negative evidence related to realization of such deferred tax assets to evaluate the need for a valuation allowance in each tax jurisdiction.

For each of the periods ended September 30, 2013 and December 31, 2012, we maintained the following valuation allowances for deferred tax assets totaling \$8.7 million as we believe the “more likely than not” criterion for recognition and realization purposes, as defined in FASB ASC Topic 740, cannot be met:

<u>Country</u>	September 30, 2013	December 31, 2012
	(in millions)	
Mexico	\$2.6	\$ 2.3
Norway	0.2	0.2
Sweden	0.1	0.1
Switzerland	1.3	1.0
Taiwan	1.3	1.2
United States	3.2	3.7
Total	\$8.7	\$ 8.5

The dollar amount of the provisions for income taxes is directly related to our profitability and changes in the taxable income among countries. For the three and nine months ended September 30, 2013, our effective tax rate was 548.26% and 54.72%, respectively, as compared to 42.8% and 11.6% for the same periods in 2012, respectively. For

the three months ended September 30, 2013 and 2012, our effective income tax rate was determined based on the estimated annual effective income tax rate.

The examination of our 2005-2009 tax years by the IRS for U.S. federal tax purposes was settled during the second quarter of 2013. In connection with the audit, the IRS and we agreed to a net tax deficiency of \$0.8 million and the payment of interest accrued through June 30, 2013 of \$0.2 million, without any penalties. The tax and related interest payments were made during the third quarter of 2013. In connection with the settlement of the audit, we reclassified amounts owed to the IRS and previously recorded as uncertain tax positions as taxes payable, resulting in a \$1.0 million tax benefit through September 30, 2013.

26

---

Table of Contents

Excluding the release of uncertain income tax positions in connection with the settlement of the IRS audit, the effective tax rate for the three and nine months ended September 30, 2013 would have been 1,122.52% and 128.78%. These rates are higher than what would have been expected if the federal statutory income tax rate were applied to income before taxes primarily from the unfavorable differences from foreign operations.

## LIQUIDITY AND CAPITAL RESOURCES

## Cash and Cash Equivalents

As of September 30, 2013, our cash and cash equivalents increased by 35.2%, or \$5.0 million, to \$19.4 million from \$14.4 million as of December 31, 2012. Our restricted cash balance increased during the period ending September 30, 2013 by \$1.3 million. Finally, fluctuations in currency rates produced a decline of \$0.3 million in cash and cash equivalents.

Our principal use of cash is to pay for operating expenses, including commissions and incentives, capital assets, inventory purchases, and international expansion. In August 2009, the quarterly cash dividend was suspended and remained suspended as of September 30, 2013. We fund our business objectives, operations, and expansion of our operations through net cash flows from operations rather than incurring long-term debt.

## Working Capital

Working capital represents total current assets less total current liabilities. At September 30, 2013, our working capital decreased by \$0.1 million, or 0.6%, to \$11.0 million from \$11.1 million at December 31, 2012. The decrease in working capital is primarily related to an increase in deferred revenue.

## Net Cash Flows

Our net consolidated cash flows consisted of the following, for the nine months ended September 30 (in millions):

Used in:	2013	2012
Operating activities	\$8.2	\$(3.1)
Investing activities	\$(1.8)	\$(0.5)
Financing activities	\$(1.1)	\$(0.8)

## Operating Activities

Due to improvements in profitability and the cash used in working capital, cash provided in operating activities was \$8.2 million for the nine months ended September 30, 2013 compared to cash used in operating activities of \$3.1 million for the same period in 2012.

We expect that our net operating cash flows for the remainder of the year will be sufficient to fund our current operations. There can be no assurance, however, that we will continue to generate cash flows at or above current levels. Certain events, such as the uncertainty of the worldwide economic environment, could impact our available cash or our ability to generate cash flows from operations.

## Investing Activities

For the nine months ended September 30, 2013, our net investing activities used cash of \$1.8 million compared to cash used of \$0.5 million for the same period of 2012. During the nine months ended September 30, 2013, we used cash of \$0.5 million to purchase capital assets as compared to purchasing \$0.3 million in capital assets for the same

period in 2012. In the first three quarters of 2013, we had an increase in restricted cash of \$1.2 million as compared to a \$0.3 million increase for the same period in 2012.

#### Financing Activities

For the nine months ended September 30, 2013 and 2012, we used cash of \$1.2 million and \$0.8 million, respectively, primarily to repay capital lease obligations.

27

---



Table of Contents

General Liquidity and Cash Flows

Short Term Liquidity

We believe our existing liquidity and anticipated return to positive cash flows from operations are adequate to fund our normal expected future business operations and possible international expansion costs for the next 12 months. As our primary source of liquidity is our cash flow from operations, this will be dependent on our ability to maintain and increase revenue and/or continue to reduce operational expenses. However, if our existing capital resources or cash flows become insufficient to meet current business plans, projections, and existing capital requirements, we may be required to raise additional funds, which may not be available on favorable terms, if at all.

We entered into an Investment Agreement with Dutchess Opportunity Fund, II, LP, a Delaware limited partnership on September 16, 2010. Dutchess committed to purchase, subject to certain restrictions and conditions, up to \$10 million of our common stock, over a period of 36 months from the first trading following the effectiveness of the registration statement, which was October 28, 2010. We may draw funds from the Equity Line by selling shares of common stock to Dutchess from time to time. We will not receive any proceeds from the resale of these shares of common stock offered by Dutchess. We will however, receive proceeds from the sale of shares to Dutchess pursuant to the Equity Line. The proceeds will be used for general working capital needs and for other general corporate purposes. For more information on the Equity Line, see Note 6 “Shareholders’ Equity”, to our consolidated financial statements. No shares of common stock were issued pursuant to the Investment Agreement as of October 28, 2013, when the Investment Agreement expired.

We are engaged in ongoing audits in various tax jurisdictions and other disputes in the normal course of business. It is impossible at this time to predict whether we will incur any liability, or to estimate the ranges of damages, if any, in connection with these matters. Adverse outcomes on these uncertainties may lead to substantial liability or enforcement actions that could adversely affect our cash position. For more information, see Note 3 “Income Taxes” and Note 7 “Litigation” to our consolidated financial statements.

Long Term Liquidity

We believe our return to positive cash flows from operations should be adequate to fund our normal expected future business operations and possible international expansion costs for the long term. As our primary source of liquidity is from our cash flow from operations, this will be dependent on our ability to maintain and increase revenue and/or continue to reduce operational expenses.

However, if our existing capital resources or cash flows become insufficient to meet anticipated business plans and existing capital requirements, we may be required to raise additional funds, which may not be available on favorable terms, if at all.

Our future access to the capital markets may be adversely impacted if we fail to maintain compliance with the Nasdaq Marketplace Rules for the continued listing of our stock. We continuously monitor our compliance with the Nasdaq continued listing rules and as of the date of the issuance of this report, we are in compliance with the Nasdaq Marketplace Rules.

Table of Contents

## CONTRACTUAL OBLIGATIONS

The following summarizes our future commitments and obligations associated with various agreements and contracts as of September 30, 2013, for the years ending December 31 (in thousands):

	Remaining							Total
	2013	2014	2015	2016	2017	2018	Thereafter	
Capital lease obligations and other financing arrangements	\$ 332	\$545	\$346	\$135	\$12	\$—	\$ —	\$1,370
Purchase obligations (1) (2)	3,514	1,200	1,200	324	—	—	—	6,238
Operating leases	444	1,653	1,547	1,289	1,176	582	--	6,691
Post-employment royalty	51	66	33	—	—	—	—	150
Employment agreements	698	876	—	—	—	—	—	1,574
Royalty agreement	21	84	66	—	—	—	—	171
Tax liability (3)(4)	897	84	129	—	—	—	—	1,110
Other obligations(5)	55	296	282	114	31	26	676	1,480
Total commitments and obligations	\$ 6,012	\$4,804	\$3,603	\$1,862	\$1,219	\$608	\$ 676	\$18,784

For purposes of the table, a purchase obligation is defined as “an agreement to purchase goods or services that is non-cancelable, enforceable and legally binding on the Company that specifies all significant terms, including: (1) fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction.”

(2) Excludes approximately \$13.8 million of finished product purchase orders that may be cancelled or with delivery dates that have changed as of September 30, 2013.

(3) Represents the tax liability associated with uncertain tax positions, see Note 3 "Income Taxes" to our consolidated financial statements.

(4) Includes approximately \$0.9 million associated with the Korean customs audit assessment.

Other obligations are composed of pension obligations related to the Company's Japan operations (approximately (5) \$1.0 million), lease restoration obligations (approximately \$0.2 million), and McAnnalley royalty obligations (approximately \$0.2 million).

We have maintained purchase commitments with certain raw material suppliers to purchase minimum quantities and to ensure exclusivity of our raw materials and the proprietary nature of our products. Currently, we have two supply agreements that require minimum purchase commitments. We also maintain other supply agreements and manufacturing agreements to protect our products, regulate product costs, and help ensure quality control standards. These agreements do not require us to purchase any set minimums. We have no present commitments or agreements with respect to acquisitions or purchases of any manufacturing facilities; however, management from time to time explores the possible benefits of purchasing a raw material manufacturing facility to help control costs of our raw materials and help ensure quality control standards.

Table of Contents

OFF-BALANCE SHEET ARRANGEMENTS

We do not have any special-purpose entity arrangements, nor do we have any off-balance sheet arrangements.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. The application of GAAP requires us to make estimates and assumptions that affect the reported values of assets and liabilities at the date of our financial statements, the reported amounts of revenues and expenses during the reporting period, and the related disclosures of contingent assets and liabilities. We use estimates throughout our financial statements, which are influenced by management's judgment and uncertainties. Our estimates are based on historical trends, industry standards, and various other assumptions that we believe are applicable and reasonable under the circumstances at the time the consolidated financial statements are prepared. Our Audit Committee reviews our critical accounting policies and estimates. We continually evaluate and review our policies related to the portrayal of our consolidated financial position and consolidated results of operations that require the application of significant judgment by our management. We also analyze the need for certain estimates, including the need for such items as allowance for doubtful accounts, inventory reserves, long-lived fixed assets and capitalization of internal-use software development costs, reserve for uncertain income tax positions and tax valuation allowances, revenue recognition, sales returns, and deferred revenues, accounting for stock-based compensation, and contingencies and litigation. Historically, actual results have not materially deviated from our estimates. However, we caution readers that actual results could differ from our estimates and assumptions applied in the preparation of our consolidated financial statements. If circumstances change relating to the various assumptions or conditions used in our estimates, we could experience an adverse effect on our financial position, results of operations, and cash flows. We have identified the following applicable critical accounting policies and estimates as of September 30, 2013:

Inventory Reserves

Inventory consists of raw materials, finished goods, and promotional materials that are stated at the lower of cost (using standard costs that approximate average costs) or market. We record the amounts charged by the vendors as the costs of inventory. Typically, the net realizable value of our inventory is higher than the aggregate cost. Determination of net realizable value can be complex and, therefore, requires a high degree of judgment. In order for management to make the appropriate determination of net realizable value, the following items are considered: inventory turnover statistics, current selling prices, seasonality factors, consumer demand, regulatory changes, competitive pricing, and performance of similar products. If we determine the carrying value of inventory is in excess of estimated net realizable value, we write down the value of inventory to the estimated net realizable value.

We also review inventory for obsolescence in a similar manner, 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 general future plans. We monitor actual sales compared to original projections, and if actual sales are less favorable than those originally projected by us, we record an additional inventory reserve or write-down. Historically, our estimates have been close to our actual reported amounts. However, if our estimates regarding inventory obsolescence are inaccurate or consumer demand for our products changes in an unforeseen manner, we may be exposed to additional material losses or gains in excess of our established estimated inventory reserves.

Long Lived Fixed Assets and Capitalization of Software Development Costs

In addition to capitalizing long lived fixed asset costs, we also capitalize costs associated with internally-developed software projects (collectively "fixed assets") and amortize such costs over the estimated useful lives of such fixed assets. Fixed assets are carried at cost, less accumulated depreciation computed using the straight-line method over the

assets' estimated useful lives. Leasehold improvements are amortized over the shorter of the remaining lease terms or the estimated useful lives of the improvements. Expenditures for maintenance and repairs are charged to operations as incurred. If a fixed asset is sold or otherwise retired or disposed of, the cost of the fixed asset and the related accumulated depreciation or amortization is written off and any resulting gain or loss is recorded in other operating costs in our consolidated statement of operations.

We review our fixed assets for impairment whenever an event or change in circumstances indicates the carrying amount of an asset or group of assets may not be recoverable, such as plans to dispose of an asset before the end of its previously estimated useful life. Our impairment review includes a comparison of future projected cash flows generated by the asset, or group of assets, with its associated net carrying value. If the net carrying value of the asset or group of assets exceeds expected cash flows (undiscounted and without interest charges), an impairment loss is recognized to the extent the carrying amount exceeds the fair value. The fair value is determined by calculating the discounted expected future cash flows using an estimated risk-free rate of interest. Any identified impairment losses are recorded in the period in which the impairment occurs. The carrying value of the fixed asset is adjusted to the new carrying value, and any subsequent increases in fair value of the fixed asset are not recorded. In addition, if we determine the estimated remaining useful life of the asset should be reduced from our original estimate; the periodic depreciation expense is adjusted prospectively, based on the new remaining useful life of the fixed asset.

30

---

Table of Contents

The impairment calculation requires us to apply judgment and estimates concerning future cash flows, strategic plans, useful lives, and discount rates. If actual results are not consistent with our estimates and assumptions, we may be exposed to an additional impairment charge, which could be material to our results of operations. In addition, if accounting standards change, or if fixed assets become obsolete, we may be required to write off any unamortized costs of fixed assets, or if estimated useful lives change, we would be required to accelerate depreciation or amortization periods and recognize additional depreciation expense in our consolidated statement of operations.

Historically, our estimates and assumptions related to the carrying value and the estimated useful lives of our fixed assets have not materially deviated from actual results. As of September 30, 2013, the estimated useful lives and net carrying values of fixed assets were as follows:

	Estimated useful life	Net carrying value at September 30, 2013
Computer hardware and software	3 to 5 years	\$0.9 million
Leasehold improvements	2 to 10 years <sup>(1)</sup>	1.8 million
Office furniture and equipment	5 to 7 years	0.8 million
Automobiles	3 to 5 years	0.1 million
Total net carrying value at September 30, 2013		\$3.6 million

<sup>(1)</sup> We amortize leasehold improvements over the shorter of the useful estimated life of the leased asset or the lease term.

The net carrying costs of fixed assets and construction in progress are exposed to impairment losses if our assumptions and estimates of their carrying values change, there is a change in estimated future cash flow, or there is a change in the estimated useful life of the fixed asset. Based on management's analysis, no impairment indicators existed for the nine months ended September 30, 2013.

#### Uncertain Income Tax Positions and Tax Valuation Allowances

As of September 30, 2013, we recorded no taxes payable and \$0.2 million in other long-term liabilities on our consolidated balance sheet related to uncertain income tax positions. As required by FASB ASC Topic 740, Income Taxes, we use judgments and make estimates and assumptions related to evaluating the probability of uncertain income tax positions. We base our estimates and assumptions on the potential liability related to an assessment of whether the income tax position will "more likely than not" be sustained in an income tax audit. We are also subject to periodic audits from multiple domestic and foreign tax authorities related to income tax and other forms of taxation. These audits examine our tax positions, timing of income and deductions, and allocation procedures across multiple jurisdictions. As part of our evaluation of these tax issues, we establish reserves in our consolidated financial statements based on our estimate of current probable tax exposures. Depending on the nature of the tax issue, we could be subject to audit over several years. Therefore, our estimated reserve balances and liability related to uncertain income tax positions may exist for multiple years before the applicable statute of limitations expires or before an issue is resolved by the taxing authority. Additionally, we may be requested to extend the statute of limitations for tax years under audit, which may cause the classification between current and long-term to change. We believe our tax liabilities related to uncertain tax positions are based upon reasonable judgment and estimates; however, if actual results materially differ, our effective income tax rate and cash flows could be affected in the period of discovery or resolution.

The examination of our 2005-2009 tax years by the IRS for U.S. federal tax purposes was settled during the second quarter of 2013. In connection with the audit, the IRS and the Company agreed to a net tax deficiency of \$0.8 million and the payment of interest accrued through June 30, 2013 of \$0.2 million, without any penalties. The tax and interest payments were made during the third quarter of 2013. In connection with the settlement of the audit, we reclassified

amounts owed to the IRS and previously recorded as uncertain tax positions as taxes payable, resulting in a \$1.0 million tax benefit through September 30, 2013. There are other ongoing income tax audits in various international jurisdictions that are not material to our financial statements.

We also review the estimates and assumptions used in evaluating the probability of realizing the future benefits of our deferred tax assets and record a valuation allowance when we believe that a portion or all of the deferred tax assets may not be realized. If we are unable to realize the expected future benefits of our deferred tax assets, we are required to provide a valuation allowance. We use our past history and experience, overall profitability, future management plans, and current economic information to evaluate the amount of valuation allowance to record. As of September 30, 2013, we maintained a valuation allowance for deferred tax assets arising from our operations of \$8.7 million because they did not meet the “more likely than not” criteria as defined by the recognition and measurement provisions of FASB ASC Topic 740, Income Taxes. In addition, as of September 30, 2013, we had deferred tax assets, after valuation allowance, totaling \$3.3 million, which may not be realized if our assumptions and estimates change, which would affect our effective income tax rate and cash flows in the period of discovery or resolution.

31

---

Table of Contents

Revenue Recognition and Deferred Commissions

We recognize revenue from shipped packs and products upon receipt by the customer. Corporate-sponsored event revenue is recognized when the event is held. We defer certain components of our revenue. At each of September 30, 2013 and December 31, 2012, our deferred revenue was \$5.3 million and \$1.5 million, respectively. During the third quarter, we started a loyalty program where customers earn loyalty points from qualified automatic orders, which can be applied for future purchases. We defer the dollar equivalent in revenue of these points until the points are applied or forfeited. The deferred revenue associated with the loyalty program at September 30, 2013 was \$2.5 million. Deferred revenue consisted primarily of: (i) the sales of packs and products shipped but not received by the customers by the end of the respective period; (ii) the revenue from the loyalty program and (iii) prepaid registration fees from customers planning to attend a future corporate-sponsored event. In total current assets, we defer commissions on (i) the sales of packs and products shipped but not received by the customers by the end of the respective period and (ii) the loyalty program. Deferred commissions were \$2.2 million and \$0.6 million at September 30, 2013 and December 30, 2012.

Product Return Policy

We stand behind our packs and products and believe we offer a reasonable and industry-standard product return policy to all of our customers. We do not resell returned products. Refunds are not processed until proper approval is obtained. All refunds must be processed and returned in the same form of payment that was originally used in the sale. Each country in which we operate has specific product return guidelines. However, we allow our associates and members to exchange products as long as the products are unopened and in good condition. Our return policies for our retail customers and our associates and members are as follows:

**Retail Customer Product Return Policy.** This policy allows a retail customer to return any of our products to the original associate who sold the product and receive a full cash refund from the associate for the first 180 days following the product's purchase if located in the United States and Canada, and for the first 90 days following the product's purchase in the remaining countries. The associate may then return or exchange the product based on the associate product return policy.

**Associate and Member Product Return Policy.** This policy allows the associate or member to return an order within one year of the purchase date upon terminating his/her account. If an associate or member returns a product unopened and in good condition, he/she may receive a full refund minus a 10% restocking fee. We may also allow the associate or member to receive a full satisfaction guarantee refund if they have tried the product and are not satisfied for any reason, excluding promotional materials. This satisfaction guarantee refund applies in the United States and Canada, only for the first 180 days following the product's purchase, and applies in the remaining countries for the first 90 days following the product's purchase; however, any commissions earned by an associate will be deducted from the refund. If we discover abuse of the refund policy, we may terminate the associate's or member's account.

Historically, sales returns estimates have not materially deviated from actual sales returns, as the majority of our customers who return merchandise do so within the first 90 days after the original sale. Based upon our return policies and historical experience, we estimate a sales return reserve for expected sales refunds over a rolling six month period. If actual results differ from our estimated sales returns reserves due to various factors, the amount of revenue recorded each period could be materially affected. Historically, our sales returns have not materially changed through the years and have averaged 1.5% or less of our gross sales.

Table of Contents

## Accounting for Stock-Based Compensation

We grant stock options to our employees, board members, and consultants. At the date of grant, we determine the fair value of a stock option award and recognize compensation expense over the requisite service period, or the vesting period of such stock option award, which is two to four years. The fair value of the stock option award is calculated using the Black-Scholes option-pricing model (“calculated fair value”). The Black-Scholes option-pricing model requires us to apply judgment and use highly subjective assumptions, including expected stock option life, expected volatility, expected average risk-free interest rates, and expected forfeiture rates. For the nine months ended September 30, 2013, our assumptions and estimates used for the calculated fair value of stock options granted in 2013 were as follows:

	February 2013 Grant	March 2013 Grant	June 2013 Grant	August 2013 Grant
Estimated fair value per share of options granted:	\$ 3.57	\$ 3.53	\$ 6.07	\$ 11.71
Assumptions:				
Annualized dividend yield	0.00 %	0.00 %	0.00 %	0.00 %
Risk-free rate of return	0.75 %	0.66 %	0.89 %	1.36 %
Common stock price volatility	82.3 %	82.0 %	80.3 %	81.2 %
Expected average life of stock options (in years)	4.5	4.5	4.5	4.5

The assumptions we use are based on our best estimates and involve inherent uncertainties related to market conditions that are outside of our control. If actual results are not consistent with the assumptions we use, the stock-based compensation expense reported in our consolidated financial statements may not be representative of the actual economic cost of stock-based compensation. For example, if actual employee forfeitures significantly differ from our estimated forfeitures, we may be required to make an adjustment to our consolidated financial statements in future periods. As of September 30, 2013, using our current assumptions and estimates, we anticipate recognizing \$0.2 million in gross compensation expense through 2016 related to unvested stock options outstanding.

If we grant additional stock options in the future, we would be required to recognize additional compensation expense over the vesting period of such stock options in our consolidated statement of operations. Gross compensation expense would equal the calculated fair value of such stock options, which is dependent on the assumptions used to calculate such fair value, but has historically ranged between 34% to 69% of the exercise price multiplied by the number of stock options awarded. As of September 30, 2013, we had 72,371 shares available for grant in the future.

Contingencies and Litigation

Each quarter, we evaluate the need to establish a reserve for any legal claims or assessments. We base our evaluation on our best estimates of the potential liability in such matters. The legal reserve includes an estimated amount for any damages and the probability of losing any threatened legal claims or assessments. We consult with our general and outside counsel to determine the legal reserve, which is based upon a combination of litigation and settlement strategies. Although we believe that our legal reserve and accruals are based on reasonable judgments and estimates, actual results could differ, which may expose us to material gains or losses in future periods. If actual results differ, if circumstances change, or if we experience an unanticipated adverse outcome of any legal action, including any claim or assessment, we would be required to recognize the estimated amount which could reduce net income, earnings per share, and cash flows.

RECENT ACCOUNTING PRONOUNCEMENTS



See “Recent Accounting Pronouncements” in Note 8 of the Notes to our Consolidated Financial Statements, which is incorporated herein by reference.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

We do not engage in trading market risk sensitive instruments and do not purchase investments as hedges or for purposes “other than trading” that are likely to expose us to certain types of market risk, including interest rate, commodity price, or equity price risk. Although we have investments, we believe there has been no material change in our exposure to interest rate risk. We have not issued any debt instruments, entered into any forward or futures contracts, purchased any options, or entered into any swap agreements.

We are exposed, however, to other market risks, including changes in currency exchange rates as measured against the United States dollar. Because the change in value of the United States dollar measured against foreign currency may affect our consolidated financial results, changes in foreign currency exchange rates could positively or negatively affect our results as expressed in United States dollars. For example, when the United States dollar strengthens against foreign currencies in which our products are sold or weakens against foreign currencies in which we may incur costs, our consolidated net sales or related costs and expenses could be adversely affected.

33

---

Table of Contents

We believe inflation has not had a material impact on our consolidated operations or profitability. We expanded into Canada in 1996, into Australia in 1998, into the United Kingdom in 1999, into Japan in 2000, into New Zealand in 2002, into the Republic of Korea in 2004, into Taiwan and Denmark in 2005, into Germany in 2006, into South Africa and Singapore in 2008, into Austria, the Netherlands, Norway, and Sweden in September 2009, into Mexico in January 2011, into the Czech Republic, Estonia, Finland, and the Republic of Ireland in June 2011 and into the Republic of Namibia in August 2011. During 2013, we have expanded into Hong Kong and Ukraine. We translate our revenues and expenses in foreign markets using an average rate.

We maintain policies, procedures, and internal processes in an effort to help monitor any significant market risks and we do not use any financial instruments to manage our exposure to such risks. We assess the anticipated foreign currency working capital requirements of our foreign operations and maintain a portion of our cash and cash equivalents denominated in foreign currencies sufficient to satisfy most of these anticipated requirements.

We caution that we cannot predict with any certainty our future exposure to such currency exchange rate fluctuations or the impact, if any, such fluctuations may have on our future business, product pricing, operating expenses, and on our consolidated financial position, results of operations, or cash flows. However, to combat such market risk, we closely monitor our exposure to currency fluctuations. The foreign currencies in which we currently have exposure to foreign currency exchange rate risk include the currencies of Canada, Australia, the United Kingdom, Japan, New Zealand, the Republic of Korea, Taiwan, Denmark, Germany, South Africa, Singapore, Austria, the Netherlands, Norway, Sweden, Mexico, the Czech Republic, Estonia, Finland, the Republic of Ireland, Hong Kong, and Ukraine.

The current (spot) rate, average currency exchange rates, and the low and high of such currency exchange rates as compared to the United States dollar, for each of these countries as of and for the nine months ended September 30, 2013 were as follows:

Country (foreign currency name)	Low	High	Average	Spot
Australia (Dollar)	0.89000	1.05690	0.98182	0.93220
Austria, Germany, the Netherlands, Estonia, Finland, the Republic of Ireland (Euro)	1.27990	1.36420	1.31717	1.35250
Canada (Dollar)	0.94580	1.01680	0.97744	0.97100
Czech Republic (Koruna)	0.04930	0.05336	0.05123	0.05262
Denmark (Krone)	0.17170	0.18290	0.17663	0.18130
Hong Kong (Dollar)	0.12880	0.12900	0.12890	0.12900
Japan (Yen)	0.00969	0.01161	0.01036	0.01018
Mexico (Peso)	0.07478	0.08352	0.07900	0.07613
New Zealand (Dollar)	0.77140	0.86220	0.81790	0.82970
Norway (Krone)	0.16010	0.18340	0.17213	0.16710
Republic of Korea (Won)	0.00086	0.00098	0.00091	0.00094
Singapore (Dollar)	0.77960	0.81930	0.79938	0.79640
South Africa (Rand)	0.09632	0.11810	0.10598	0.09938
Sweden (Krona)	0.14680	0.15900	0.15355	0.15550
Switzerland (Franc)	1.02770	1.10450	1.07013	1.10450
Taiwan (Dollar)	0.03310	0.03477	0.03371	0.03388
Ukraine (Hryvnia)	0.12210	0.12670	0.12450	0.12380
United Kingdom (British Pound)	1.48940	1.62890	1.54660	1.61430

## Item 4. Controls and Procedures

## Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer (principal executive officer) and our Chief Financial Officer (principal financial officer), have concluded, based on their evaluation as of the end of the period covered by this report, that our disclosure controls and procedures (as defined in Rule 13a-15(e) or Rule 15d – 15(e) under the Exchange Act) are effective to ensure that information required to be disclosed by us in reports filed or submitted under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms and include controls and procedures designed to ensure that information required to be disclosed by us in such reports is accumulated and communicated to our management, including our principal executive and financial officers, as appropriate, to allow timely decisions regarding required disclosure.

34

---

Table of Contents

Changes in Internal Control over Financial Reporting

During the quarter ended September 30, 2013, there were no changes in our internal control over our financial reporting that we believe materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

35

---

Table of Contents

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

See “Litigation” in Note 7 of the Notes to our Unaudited Consolidated Financial Statement, which is incorporated herein by reference.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2012, which could materially affect our business or our consolidated financial position, results of operations, and cash flows. The risks described in our Annual Report on Form 10-K are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be insignificant also may become materially adverse or may affect our business in the future or our consolidated financial position, results of operations, or cash flows.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not Applicable.

Item 5. Other Information

None.

Item 6. Exhibits

See Index to Exhibits following the signature page of this Quarterly Report on Form 10-Q.

36

---

Table of Contents

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.

MANNATECH, INCORPORATED

Dated: November 13, 2013 By: /s/ Robert A. Sinnott

Robert A. Sinnott

Chief Executive Officer and Chief Science Officer

(principal executive officer)

Dated: November 13, 2013 By: /s/ S. Mark Nicholls

S. Mark Nicholls

Chief Financial Officer

(principal financial officer)

Table of ContentsINDEX TO EXHIBITS

Exhibit Number	Exhibit Description	Incorporated by Reference		
		Form	File No.	Filing Date
3.1	Amended and Restated Articles of Incorporation of Mannatech, dated May 19, 1998.	S-1	333-631333.1	October 28, 1998
3.2	Certificate of Amendment to the Amended and Restated Articles of Incorporation of Mannatech, dated January 13, 2012.	8-K	000-246573.1	January 17, 2012
3.3	Fourth Amended and Restated Bylaws of Mannatech, dated August 8, 2001 (Corrected).	10-K	000-246573.2	March 16, 2007
3.4	First Amendment to the Fourth Amended and Restated Bylaws of Mannatech, effective November 30, 2007.	8-K	000-246573.1	December 6, 2007
4.1	Specimen Certificate representing Mannatech's common stock, par value \$0.0001 per share.	S-1	333-631334.1	October 28, 1998
<u>31.1</u> *	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, of the Chief Executive Officer of Mannatech.	*	*	*
<u>31.2</u> *	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, of the Chief Financial Officer of Mannatech.	*	*	*
<u>32.1</u> *	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of the Chief Executive Officer of Mannatech.	*	*	*
<u>32.2</u> *	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of the Chief Financial Officer of Mannatech.	*	*	*
101.INS**	XBRL Instance Document	**	**	**
101.SCH**	XBRL Taxonomy Extension Schema Document	**	**	**
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase Document	**	**	**
101.LAB**	XBRL Taxonomy Extension Label Linkbase Document	**	**	**
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document	**	**	**
101.DEF**	XBRL Taxonomy Extension Definition Linkbase Document	**	**	**

\* Filed herewith.

\*\* Furnished herewith. In accordance with Rule 406T of Regulation S-T, the information in these exhibits shall not be deemed to be "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to liability under that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, except as expressly set forth by specific reference in such filing.