MANNATECH INC
Form 10-Q
August 06, 2018

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

FORM 10-Q
(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended: June 30, 2018
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.)
1410 Lakeside Parkway, Suite 200, Flower Mound, Texas	75028
(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 x No o

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 x No o

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

Large accelerated filer ¨	Accelerated filer ¨	Non-accelerated filer ¨	Smaller reporting company x	Emerging Growth Company ¨

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

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

As of July 31, 2018, the number of shares outstanding of the registrant's sole class of common stock, par value $0.0001 per share, was 2,402,612.

MANNATECH, INCORPORATED

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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, 2017, 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 or the regulations thereto;
- the ability to attract and retain independent associates and preferred customers;
- new regulatory changes that may affect operations, products or compensation plans or incentives;
- 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 of the countries in which we operate.

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,” “potential,” and “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," "us," "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".

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements
MANNATECH, INCORPORATED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share amounts)

ASSETS	June 30, 2018 (unaudited)	December 31, 2017
Cash and cash equivalents	$ 28,775	$ 37,682
Restricted cash	1,513	1,514
Accounts receivable, net of allowance of $636 and $582 in 2018 and 2017, respectively	237	273
Income tax receivable	—	907
Inventories, net	10,277	9,385
Prepaid expenses and other current assets	3,482	2,607
Deferred commissions	3,124	3,880
Total current assets	47,408	56,248
Property and equipment, net	5,656	3,537
Construction in progress	873	777
Long-term restricted cash	7,242	7,565
Other assets	3,827	3,876
Long-term deferred tax assets, net	5,634	4,239
Total assets	$ 70,640	$ 76,242
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current portion of capital leases	$ 98	$ 228
Accounts payable	6,414	6,008
Accrued expenses	6,331	5,771
Commissions and incentives payable	10,090	9,658
Taxes payable	3,296	2,404
Current notes payable	1,019	815
Deferred revenue	7,287	8,561
Total current liabilities	34,535	33,445
Capital leases, excluding current portion	108	144
Long-term deferred tax liabilities	1,098	1,147
Long-term notes payable	827	—
Other long-term liabilities	2,810	1,265
Total liabilities	39,378	36,001
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, 2,742,857 shares issued and 2,402,612 shares outstanding as of June 30, 2018 and 2,742,857 shares issued and 2,702,940 shares outstanding as of December 31, 2017	—	—
Additional paid-in capital	33,806	34,928
Retained earnings	2,862	4,190
Accumulated other comprehensive income	4,292	5,984
	(9,698)	(4,861)

Treasury stock, at average cost, 340,245 shares as of June 30, 2018 and 39,917 shares as of December 31, 2017, respectively		
Total shareholders’ equity	31,262	40,241
Total liabilities and shareholders’ equity	$ 70,640	$ 76,242

See accompanying notes to unaudited consolidated financial statements.

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MANNATECH, INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS – (UNAUDITED)
(in thousands, except per share information)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net sales	$45,137	$47,686	$86,520	$88,327
Cost of sales	8,141	8,786	16,390	17,548
Gross profit	36,996	38,900	70,130	70,779
Operating expenses:				
Commissions and incentives	19,322	18,994	36,307	36,075
Selling and administrative expenses	9,615	9,978	17,595	18,632
Depreciation and amortization expense	535	453	1,046	955
Other operating costs	7,873	6,656	16,419	14,332
Total operating expenses	37,345	36,081	71,367	69,994
Income (loss) from operations	(349)	2,819	(1,237)	785
Interest income	133	19	162	48
Other income (expense), net	476	(9)	764	32
Income (loss) before income taxes	260	2,829	(311)	865
Income tax provision	(644)	(1,034)	(337)	(317)
Net income (loss)	$(384)	$1,795	$(648)	$548
Earnings (loss) per common share:				
Basic	$(0.14)	$0.66	$(0.24)	$0.20
Diluted	$(0.14)	$0.65	$(0.24)	$0.19
Weighted-average common shares outstanding:				
Basic	2,674	2,711	2,696	2,706
Diluted	2,674	2,778	2,696	2,775

MANNATECH, INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) – (UNAUDITED)
(in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income (loss)	$(384)	$1,795	$(648)	$548
Foreign currency translations	(2,026)	(731)	(1,692)	1,648
Comprehensive income (loss)	$(2,410)	$1,064	$(2,340)	$2,196

See accompanying notes to unaudited consolidated financial statements.

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MANNATECH, INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
– (UNAUDITED)
(in thousands)

	Common stock Par value	Additional paid in capital	Retained earnings	Accumulated other comprehensive income	Treasury stock	Total shareholders' equity
Balance at December 31, 2017	$ —	$ 34,928	$ 4,190	$ 5,984	$ (4,861)	$ 40,241
Net loss	—	—	(648)	—	—	(648)
Payment of cash dividends	—	—	(680)	—	—	(680)
Charge related to stock-based compensation	—	626	—	—	—	626
Issuance of unrestricted shares	—	(1,748)	—	—	1,993	245
Repurchase of common stock	—	—	—	—	(6,830)	(6,830)
Foreign currency translations	—	—	—	(1,692)	—	(1,692)
Balance at June 30, 2018	$ —	$ 33,806	$ 2,862	$ 4,292	$ (9,698)	$ 31,262

See accompanying notes to unaudited consolidated financial statements.

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

	Six Months Ended June 30,	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$(648)	$548
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	1,046	955
Provision for inventory losses	339	202
Provision for doubtful accounts	216	73
Charge related to stock-based compensation	871	388
Deferred income taxes	(1,444)	(191)
Changes in operating assets and liabilities:		
Accounts receivable	(180)	(169)
Income tax receivable	907	1,590
Inventories	(1,231)	1,155
Prepaid expenses and other current assets	(188)	1,207
Deferred commissions	756	51
Other assets	50	561
Accounts payable	406	882
Accrued expenses and other liabilities	749	(701)
Taxes payable	891	493
Commissions and incentives payable	432	730
Deferred revenue	(1,274)	57
Net cash provided by operating activities	1,698	7,831
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of property and equipment	(1,074)	(680)
Proceeds from sale of assets	62	—
Net cash used in investing activities	(1,012)	(680)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from stock options exercised	—	83
Repurchase of common stock	(6,830)	(64)
Payment of cash dividends	(680)	(677)
Repayment of capital lease obligations	(747)	(778)
Net cash used in financing activities	(8,257)	(1,436)
Effect of currency exchange rate changes on cash and cash equivalents	(1,660)	1,510
Net (decrease) increase in cash, cash equivalents, and restricted cash	(9,231)	7,225
Cash, cash equivalents, and restricted cash at the beginning of the period	46,761	36,626
Cash, cash equivalents, and restricted cash at the end of the period	$37,530	$43,851
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Income taxes paid	$273	$479
Interest paid on capital leases and financing arrangements	$23	$37
Assets acquired through financing arrangements	$2,281	$130

See accompanying notes to unaudited consolidated financial statements.

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 Flower Mound, Texas, was incorporated in the state of Texas on November 4, 1993 and is listed on the NASDAQ Global Select Market under the symbol "MTEX". The Company develops, markets, and sells high-quality, proprietary nutritional supplements, topical and skin care and anti-aging products, and weight-management products. We currently sell our products into three regions: (i) the Americas (the United States, Canada, Colombia and Mexico); (ii) EMEA (Austria, the Czech Republic, Denmark, Estonia, Finland, Germany, the Republic of Ireland, Namibia, the Netherlands, Norway, South Africa, Spain, Sweden and the United Kingdom); and (iii) Asia/Pacific (Australia, Japan, New Zealand, the Republic of Korea, Singapore, Taiwan, Hong Kong, and China).

On July 1, 2017, the Company revised its 2017 Associate Compensation Plan, which was designed to stimulate business growth and development for our active business building associates ("independent associates" or "associates") and to maximize the buying experience for our preferred customers. In doing so, the Company hopes to better utilize commission dollars to stimulate Company growth. The 2017 Associate Compensation Plan provides revised income streams, new leadership levels and titles, and modified various volume requirements for our associates. In addition, the 2017 Associate Compensation Plan re-designated members as preferred customers and modified their pricing structure.

Associates and now preferred customers purchase the Company's products at published wholesale prices. The Company cannot distinguish products sold for personal use from other sales, when sold to associates, 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 Company operates a non-direct selling business in mainland China. Our subsidiary in China, Meitai Daily Necessity & Health Products Co., Ltd. ("Meitai"), is operating as a traditional retailer under a cross-border e-commerce model in China. Meitai cannot legally conduct a direct selling business in China unless it acquires a direct selling license in China.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") 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 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, 2017 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, 2017 and filed with the United States Securities and Exchange Commission (the "SEC") on March 26, 2018 (the "2017 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 2017 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.

Use of Estimates

The preparation of the Company’s consolidated financial statements in accordance with GAAP 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.

MANNATECH, INCORPORATED AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Cash, Cash Equivalents, and Restricted Cash

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. As of June 30, 2018 and December 31, 2017, credit card receivables were $2.1 million and $2.0 million, respectively. As of June 30, 2018 and December 31, 2017, cash and cash equivalents held in bank accounts in foreign countries totaled $18.3 million and $30.6 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.

A significant portion of our cash and cash equivalent balances were concentrated within the Republic of South Korea, with total net assets within this foreign location totaling $35.2 million and $32.7 million at June 30, 2018 and December 31, 2017, respectively. In addition, for the six months ended June 30, 2018, a concentrated portion of our operating cash flows were earned from operations within the Republic of South Korea. An adverse change in economic conditions within the Republic of South Korea could negatively affect the Company's results of operations.

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 June 30, 2018 and December 31, 2017, our total restricted cash was $8.8 million and $9.1 million, respectively.

The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported within the Company's consolidated balance sheets to the total amount presented in the consolidated statement of cash flows (in thousands):

	June 30, 2018	December 31, 2017
Cash and cash equivalents at beginning of period	$37,682	$ 28,687
Current restricted cash at beginning of period	1,514	1,510
Long-term restricted cash at beginning of period	7,565	6,429
Cash, cash equivalents, and restricted cash at beginning of period	$46,761	$ 36,626
Cash and cash equivalents at end of period	$28,775	$ 37,682
Current restricted cash at end of period	1,513	1,514
Long-term restricted cash at end of period	7,242	7,565
Cash, cash equivalents, and restricted cash at end of period	$37,530	$ 46,761

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 each of June 30, 2018 and December 31, 2017, receivables consisted primarily of amounts due from preferred customers and associates. As of June 30, 2018 and December 31, 2017, the Company's accounts receivable balance (net of allowance) was $0.2 million and $0.3 million, respectively. 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. As of each of June 30, 2018 and December 31, 2017, the Company held an allowance for doubtful accounts of $0.6 million.

Inventories

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

MANNATECH, INCORPORATED AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Other Assets

As of June 30, 2018 and December 31, 2017, other assets were $3.8 million and $3.9 million, respectively. These amounts primarily consisted of deposits for building leases in various locations of $1.9 million at each of June 30, 2018 and December 31, 2017. Additionally, included in the June 30, 2018 and December 31, 2017 balances was $1.7 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 each of the June 30, 2018 and December 31, 2017 balances was $0.2 million of indefinite lived intangible assets relating to the Manapol® powder trademark.

Notes Payable

Notes payable were $1.8 million and $0.8 million as of June 30, 2018 and December 31, 2017, respectively, as a result of funding from a capital financing agreement related to our investment in leasehold improvements, computer hardware and software and other financing arrangements. At June 30, 2018, the current portion was $1.0 million. At December 31, 2017, the current portion was $0.8 million.

Other Long-Term Liabilities

Other long-term liabilities were $2.8 million and $1.3 million as of June 30, 2018 and December 31, 2017, respectively. At each of June 30, 2018 and December 31, 2017, the Company recorded $0.2 million in other long-term liabilities related to uncertain income tax positions (see Note 7, Income Taxes, of the Company's annual report on Form 10-K for the year ended December 31, 2017, filed March 26, 2018). 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. At each of June 30, 2018 and December 31, 2017, accrued restoration costs related to these leases amounted to $0.4 million. At each of June 30, 2018 and December 31, 2017, the Company also recorded a long-term liability for estimated defined benefit obligation related to a non-U.S. defined benefit plan for its Japan operations of $0.4 million (see Note 9, Employee Benefit Plans, of the Company's 10-K, filed March 26, 2018). As of June 30, 2018, the Company recorded $1.4 million in other long-term liabilities for lease incentives related to the corporate headquarters operating lease.

Revenue Recognition

The Company's revenue is derived from sales of individual products and associate fees or, in certain geographic markets, starter and renewal packs. Substantially all of the Company's product sales are made at published wholesale prices to associates and preferred customers. 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 products when control of the product transfers to the customer, thus the performance obligation is satisfied. Corporate-sponsored event revenue is recognized when the event is held.

As a result of the 2017 Associate Compensation Plan, which was implemented on July 1, 2017, the Company also collects associate fees, which relate to providing associates with the right to earn commissions, benefits and incentives for an annual period. Revenue from software tools included in the first contractual year is recognized over three months and revenue from associate fees is recognized over 12 months (see Contracts with Multiple Performance Obligations for recognition guidelines). Almost all orders are paid via credit card. See Note 9, Segment Information, for disaggregation of revenues by geographic segment and type.

The Company collected associate fees within the United States, Canada, South Africa, Japan, Australia, New Zealand, Singapore, Hong Kong and Taiwan since the implementation of the 2017 Associate Compensation Plan. Prior to the

change, associates purchased packs that were bundles of products within these respective geographic markets.

Deferred Commissions

The Company defers commissions on (i) the sales of products shipped but not received by customers by the end of the respective period and (ii) the loyalty program. Deferred commissions are incremental costs and are amortized to expense consistent with how the related revenue is recognized. Deferred commissions were $3.9 million for the year ended December 31, 2017. Of this balance $1.8 million was amortized to commissions expense for the six months ended June 30, 2018. At June 30, 2018, deferred commissions were $3.1 million.

MANNATECH, INCORPORATED AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Deferred Revenue

The Company defers certain components of its revenue. Deferred revenue consisted of: (i) sales of products shipped but not received by customers by the end of the respective period; (ii) revenue from the loyalty program; (iii) prepaid registration fees from customers planning to attend a future corporate-sponsored event, and (iv) prepaid annual associate fees. At December 31, 2017, the Company’s deferred revenue was $8.6 million. Of this balance, $4.6 million was recognized as revenue for the six months ended June 30, 2018. At June 30, 2018, the Company’s deferred revenue was $7.3 million.

Mannatech’s customer loyalty program conveys a material right to the customer as it provides the promise to redeem loyalty points for the purchase of products, which is based on earning points through placing consecutive qualified automatic orders. The timing and recognition of loyalty points has not changed with the adoption of Accounting Standard Codification ("ASC") Topic 606, Revenue from Contracts with Customers ("ASC 606"). The Company factors in breakage rates, which is the percentage of the loyalty points that are expected to be forfeited or expire, for purposes of revenue recognition. Breakage rates are estimated based on historical data and can be reasonably and objectively determined. There have not been significant changes for the breakage estimate as a result of adopting ASC 606. The deferred revenue associated with the loyalty program at June 30, 2018 and December 31, 2017 was $5.0 million and $6.4 million, respectively.

Loyalty program	(in thousands)
Loyalty deferred revenue as of January 1, 2017	$ 7,033
Loyalty points forfeited	(5,895)
Loyalty points used	(14,316)
Loyalty points vested	17,836
Loyalty points unvested	1,748
Loyalty deferred revenue as of December 31, 2017	$ 6,406

Loyalty deferred revenue as of January 1, 2018	$6,406
Loyalty points forfeited	(2,131)
Loyalty points used	(6,754)
Loyalty points vested	6,345
Loyalty points unvested	1,091
Loyalty deferred revenue as of June 30, 2018	$4,957

Sales Refund and Allowances

The Company utilizes the expected value method, as set forth by ASC 606, to estimate the sales returns and allowance liability by taking the weighted average of the sales return rates over a rolling six-month period. The Company allocates the total amount recorded within the sales return and allowance liability as a reduction of the overall transaction price for the Company’s product sales. The Company deems the sales refund and allowance liability to be a variable consideration. The method for estimating the sales returns and allowance liability has remained consistent as a result of adopting ASC 606.

Historically, 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 six months ended June 30, 2018 our sales return reserve consisted of the following (in thousands):

Sales reserve as of January 1, 2018	$117
Provision related to sales made in current period	690

Adjustment related to sales made in prior periods	(11)
Actual returns or credits related to current period	(585)
Actual returns or credits related to prior periods	(106)
Sales reserve as of June 30, 2018	$105

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MANNATECH, INCORPORATED AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Contracts with Multiple Performance Obligations

Orders placed by associates or preferred customers constitute our contracts. Product sales placed in the form of an automatic order contain two performance obligations - a) the sale of the product and b) the loyalty program. For these contracts, the Company accounts for each of these obligations separately as they are each distinct. The transaction price is allocated between the product sale and the loyalty program on a relative standalone selling price basis. Sales placed through a one-time order contain only the first performance obligation noted above - the sale of the product.

The Company provides associates with access to a complimentary three-month package for the Success Tracker™ and Mannatech+ online business tools with the first payment of an associate fee. The first payment of an associate fee contains three performance obligations - a) the associate fee, whereby the Company provides an associate with the right to earn commissions, bonuses and incentives for a year, b) three months of complimentary access to utilize the Success Tracker™ online tool and c) three months of complimentary access to utilize the Mannatech+ online business tool. The transaction price is allocated between the three performance obligations on a relative standalone selling price basis. Associates do not have complimentary access to online business tools after the first contractual period.

With regards to both of the aforementioned contracts, the Company determines the standalone selling prices based on our overall pricing objectives, taking into consideration market conditions and other factors, including the value of the contracts.

Shipping and Handling Costs

The Company records inbound freight as a component of inventory and cost of sales. The Company records freight and shipping fees collected from its customers as fulfillment costs. In accordance with ASC 606-10-25-18a, freight and shipping fees are not deemed to be separate performance obligations as these activities occur before the customer receives the product.

Commissions and Incentives

Associates earn commissions and incentives based on their direct and indirect commissionable net sales over each month of the fiscal year. The Company accrues commissions and incentives when earned by associates and pays commissions on product and pack sales on a monthly basis.

Comprehensive Income and Accumulated Other Comprehensive Income

Comprehensive income 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 consists of the Company’s net income, foreign currency translation adjustments from its Japan, Republic of Korea, Taiwan, Denmark, Norway, Sweden, Colombia, Mexico and China operations, remeasurement of intercompany balances classified as equity in its Korea, Mexico and Cyprus operations, and changes in the pension obligation for its Japanese employees.

Recently Adopted Accounting Pronouncements

The Company adopted ASU 2014-09, Revenue from Contracts with Customers, as of January 1, 2018. In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU 2014-09, Revenue from Contracts with Customers.

This new standard requires companies to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which a company expects to be entitled in exchange for those goods or services. Under the new standard, revenue is recognized when a customer obtains control of a good or service. The standard allows for two transition methods - entities can either apply the new standard (i) retrospectively to each prior reporting period presented or (ii) retrospectively with the cumulative effect of initially applying the standard recognized at the date of initial adoption. In July 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers, which deferred the effective date by one year to December 15, 2017 for fiscal years, and interim periods within those fiscal years, beginning after that date. In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers, Principal versus Agent Considerations (Reporting Revenue versus Net), in April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers, identifying Performance Obligations and Licensing, and in May 2016, the FASB issued ASU 2016-12, Revenue from Contracts with Customers, Narrow-Scope Improvements and Practical Expedients, which provide additional clarification on certain topics addressed in ASU 2014-09. ASU 2016-08, ASU 2016-10, and ASU 2016-12 follow the same implementation guidelines as ASU 2014-09 and ASU 2015-14. All of these aforementioned ASUs have been codified under ASC 606. We adopted this standard on January 1, 2018 utilizing the modified retrospective approach applied to open contracts at the date of initial application. As the cumulative effect of applying the modified retrospective approach was immaterial, no adjustment was recorded to the opening balance of retained earnings. The timing of revenue recognition for our

various revenue streams was not materially impacted by the adoption of this standard. The Company believes its business processes, systems, and controls are appropriate to support recognition and disclosure under ASC 606. In addition, the adoption has led to increased footnote disclosures. The overall financial impact of adopting this standard did not have a material impact on our consolidated financial statements, financial condition, changes in financial condition or results of operations.

The Company adopted ASU 2016-18, Statement of Cash Flows, Restricted Cash (Topic 230), during the first quarter of 2018. In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows, Restricted Cash (Topic 230), which addresses the diversity in the classification and presentation of changes in restricted cash on the statement of cash flows. The amendment requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and restricted cash. Restricted cash amounts are to be included with cash and cash equivalents when reconciling the beginning and ending amounts of cash on the statement of cash flows. The guidance is effective for annual periods beginning after December 15, 2017. Early adoption is permitted. The adoption of this ASU did not have a material impact on our financial statements, financial condition, changes in financial condition or results of operations.

The Company adopted ASU 2017-09, Compensation, Stock Compensation (Topic 718), during the first quarter of 2018. In May 2017, the FASB issued ASU 2017-09, Compensation, Stock Compensation (Topic 718), to clarify which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. The new standard is required to be applied prospectively. The guidance was effective January 1, 2018, and the adoption of this ASU did not have a material impact on our financial statements, financial condition, changes in financial condition or results of operations.

Accounting Pronouncements Issued But Not Yet Effective

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). Under ASU 2016-02, an entity will be required to recognize right-of-use assets and lease liabilities on its balance sheet and disclose key information about leasing arrangements. ASU 2016-02 offers specific accounting guidance for a lessee, a lessor and sale and leaseback transactions. Lessees and lessors are required to disclose qualitative and quantitative information about leasing arrangements to enable a user of the financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. For public companies, ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period, and requires a modified retrospective adoption, with early adoption permitted. Management is currently in the initial stages of evaluating the future impact of ASU 2016-02 on its consolidated financial position, results of operations and cash flows. The overall financial impact of adopting this standard is unknown at this time.

In February 2018, the FASB issued ASU 2018-02, Income Statement - Reporting Comprehensive Income, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (Topic 220), which amended its standard on comprehensive income to provide an option for an entity to reclassify the stranded tax effects of the Tax Cuts and Jobs Act (the "TCJA") that was passed in December of 2017 from accumulated other comprehensive income (AOCI) directly to retained earnings. The stranded tax effects result from the remeasurement of deferred tax assets and liabilities which were originally recorded in comprehensive income but whose remeasurement is reflected in the income statement. This is a one-time amendment applicable only to the changes resulting from the TCJA. The standard will be effective for the Company on January 1, 2019, and may be reflected retroactively to any period in which the impacts of the TCJA are recognized. The standard permits early adoption for any financial statements that have not been released as of the date of the revised standard. The overall financial impact of adopting this standard is unknown at this time.

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

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NOTE 2: INVENTORIES

Inventories consist of raw materials, finished goods, and promotional materials. The Company provides an allowance for any slow-moving or obsolete inventories. Inventories as of June 30, 2018 and December 31, 2017, consisted of the following (in thousands):

	June 30, 2018	December 31, 2017
Raw materials	$485	$ 879
Finished goods	10,354	9,072
Inventory reserves for obsolescence	(562)	(566)
Total	$10,277	$ 9,385

NOTE 3: INCOME TAXES

For the three and six months ended June 30, 2018, the Company’s effective tax rate was (359.8)% and (44.6)%, respectively. For the three and six months ended June 30, 2017, the Company’s effective tax rate was 36.5% and 36.6%, respectively. For the three and six months ended June 30, 2018 and 2017, the Company’s effective tax rate was determined based on the estimated annual effective income tax rate.

The effective tax rates for the three and six months ended June 30, 2018, were different from the federal statutory rate due to the mix of earnings across jurisdictions, add-backs from foreign loss positions in certain jurisdictions and the impact of global intangible low-tax income (“GILTI”) as a result of the TCJA.

The effective tax rate for the three and six months ended June 30, 2017, was slightly higher than would have been expected if the federal statutory rate were applied to income before tax. Items increasing the effective income tax rate include the valuation allowances associated with certain deferred tax assets, “subpart F income” resulting from controlled foreign corporation operations and foreign permanent components. Items decreasing the effective income tax rate include the favorable rate differences from foreign jurisdictions, unrealized foreign exchange gains and deductions on non-qualified stock options.

On December 22, 2017, the SEC staff issued Staff Accounting Bulletin 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act (“SAB 118”), which provides guidance on accounting for the impact of the TCJA, in effect allowing an entity to use a methodology similar to the measurement period in a business combination. Pursuant to the disclosure provisions of SAB 118, as of June 30, 2018, the Company has not completed its accounting for the tax effects of the TCJA. The Company recorded a reasonable estimate of the impact from the TCJA, but is still analyzing the TCJA and refining our calculations. Additionally, future guidance from the Internal Revenue Service, SEC, or the FASB could result in changes to our accounting for the tax effects of the TCJA.

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 Mannatech, Incorporated 2017 Stock Incentive Plan.

In determining the potential dilution effect of outstanding stock options during the three and six months ended June 30, 2018, the Company used the quarterly and six-month ended average common stock close price of $19.46 and $17.12 per share, respectively. For the three and six months ended June 30, 2018, approximately 0.1 million and 0.3

million shares of the Company's common stock subject to options were excluded from the diluted EPS calculation, respectively, as the effect would have been antidilutive. The Company reported a net loss for both of the three and six months ended June 30, 2018.

In determining the potential dilution effect of outstanding stock options during the three and six months ended June 30, 2017, the Company used the quarterly and six-month ended average common stock close price of $15.04 and $16.71 per share, respectively. For the three and six months ended June 30, 2017, approximately 0.1 million and 0.3 million shares of the Company's common stock subject to options were excluded from the diluted EPS calculation, respectively, as the effect would have been antidilutive.

MANNATECH, INCORPORATED AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5: STOCK-BASED COMPENSATION

The Company currently has one active stock-based compensation plan, the Mannatech, Incorporated 2017 Stock Incentive Plan (the "2017 Plan"), which was adopted by the Company's Board of Directors on April 17, 2017 and was approved by its shareholders on June 8, 2017. The 2017 Plan supersedes the Mannatech, Incorporated 2008 Stock Incentive Plan, as amended, which was set to expire on February 20, 2018. The Board has reserved a maximum of 250,000 shares of our common stock that may be issued under the 2017 Plan, consisting of 181,674 newly reserved shares and 68,326 shares that remained available for issuance under the 2008 Plan (subject to adjustments for stock splits, stock dividends or other changes in corporate capitalization). As of June 30, 2018, the Company had a total of 39,572 shares available for grant under the 2017 Plan, which expires on April 16, 2027.

The 2008 Plan provided, and the 2017 Plan provides, for grants of incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, restricted stock units, performance stock and performance stock units to our employees, board members, and consultants. However, only employees of the Company and its corporate subsidiaries are eligible to receive incentive stock options. The exercise price per share for all stock options will be no less than the market value of a share of common stock on the date of grant. Any incentive stock option granted to an employee owning more than 10% of our common stock will have an exercise price of no less than 110% of our common stock's market value on the grant date.

The majority of stock options vest over two or three years, and generally are granted with a term of ten years, or five years in the case of an incentive option granted to an employee who owns more than 10% of our common stock.

The Company records stock-based compensation expense related to granting stock options in selling and administrative expenses. During the six months ended June 30, 2018 and 2017, the company granted 184,667 and 10,000 stock options, respectively. The fair value of stock options granted during the six months ended June 30, 2018 and 2017 was approximately $7.29 and $5.87 per share, respectively. The Company recognized compensation expense as follows for the three and six months ended June 30 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Total gross compensation expense	$589	$ 67	$626	$143
Total tax benefit associated with compensation expense	29	15	36	28
Total net compensation expense	$560	$ 52	$590	$115

As of June 30, 2018, the Company expects to record compensation expense in the future as follows (in thousands):

	Six months ending December 31, 2018	Year ending December 31,		
		2019	2020	2021
Total gross unrecognized compensation expense	$ 261	$481	$138	$ —
Tax benefit associated with unrecognized compensation expense	14	19	7	—

Total net unrecognized compensation expense	$ 247	$462	$131	$ —

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NOTE 6: SHAREHOLDERS’ EQUITY

Common Stock

On May 18, 2018, the Company commenced a modified Dutch auction cash tender offer to purchase up to $16.0 million of its outstanding common stock, par value $0.0001 per share, at a per share price not greater than $21.00 nor less than $18.50, to each seller in cash, less any applicable withholding taxes and without interest (the "tender offer"). The tender offer expired on June 15, 2018. As a result of the tender offer, the Company accepted for purchase a total of 316,659 shares of its common stock which were properly tendered and not properly withdrawn at the price of $21.00 per share, for an aggregate purchase price of $6.8 million, which was funded from cash on hand. These common shares represented approximately 11.6% of the Company's total outstanding shares as of April 30, 2018.

As of June 30, 2018, the Company had 2,402,612 shares of common stock outstanding.

Accumulated Other Comprehensive Income

Accumulated other comprehensive income, displayed in the Consolidated Statement of Shareholders’ Equity, represents net income plus the results of certain shareholders’ equity changes not reflected in the Consolidated Statements of Operations, such as foreign currency translation and certain pension and post-retirement benefit obligations. The after-tax components of accumulated other comprehensive income, are as follows (in thousands):

	Foreign Currency Translation	Pension Postretirement Benefit Obligation	Accumulated Other Comprehensive Income, Net
Balance as of December 31, 2017	$ 5,703	$ 281	$ 5,984
Current-period change [(1)]	(1,692)	—	(1,692)
Balance as of June 30, 2018	$ 4,011	$ 281	$ 4,292

[(1)]No material amounts reclassified from accumulated other comprehensive income.

Dividends

On March 12, 2018, the Board of Directors declared a dividend of $0.125 per share that was paid on March 28, 2018 to shareholders of record on March 21, 2018, for an aggregate amount of $340 thousand.

On May 10, 2018, the Board of Directors declared a dividend of $0.125 per share that was paid on May 30, 2018 to shareholders of record on May 23, 2018, for an aggregate amount of $340 thousand.

NOTE 7: LITIGATION

Insured Litigation - Personal Injury

Ralph Pinkston v. Cornerstone Technologies, LLC d/b/a Cornerstone Show Foundation, Mannatech Inc., and Anatole Partners III, LLC, Case No. DC-17-13494 (192nd Dist. Ct., Dallas, Co., Tex)

On October 13, 2017, the Company’s registered agent received service of process of the above-captioned matter. Ralph Pinkston (the “Plaintiff”) is a truck driver who is alleging that he suffered injuries to his foot while unloading audio-visual equipment owned by Defendant Cornerstone from his truck on to the dock at Defendant Anatole’s hotel

(the “Hotel”) on the morning of April 5, 2016. The Company held its 2016 MannaFest event at the Hotel from April 6, 2016 to April 10, 2016. Defendant Cornerstone provided production services to the Company for the event. The Plaintiff alleges that his injuries were due to the negligence of the Company and the other defendants. The Plaintiff is seeking damages in excess of $200,000. The Company submitted this matter to its insurance carrier and retained approved outside counsel. The Plaintiff deposed two Company employees on May 31, 2018. The parties reached a settlement agreement on June 12, 2018 with the Company paying Plaintiff $16,000 in exchange for his full release of all claims against the Company. On June 21, 2018, the Court issued an Order Granting Plaintiff’s Notice of Nonsuit with Prejudice of Defendant Mannatech, Inc. The Company considers this matter closed.

MANNATECH, INCORPORATED AND SUBSIDIARIES
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Administrative Proceeding

Mannatech Korea, Ltd. v. Busan Custom Office, Busan District Court, Korea

On or before April 12, 2015, Mannatech Korea, Ltd. filed a suit against the Busan Custom Office ("BCO") to challenge BCO's method of calculation regarding its assessment notice issued on July 11, 2013. The assessment notice included an audit of the Company's imported goods covering fiscal years 2008 through 2012 and required the Company to pay $1.0 million for this assessment, all of which was paid in January 2014. Both parties submitted a response to the Court's inquiry on January 15, 2016. The final hearing for the case was held on May 26, 2016 where each party presented their respective arguments. The Court set the decision hearing on October 27, 2016, and the Court decided the case in the Company's favor. However, on November 18, 2016, BCO filed an appeal to the Busan High Court. The first hearing occurred on March 31, 2017, and the second hearing occurred on April 21, 2017. The final hearing was held on June 2, 2017. The Court issued its decision on June 30, 2017 in favor of the BCO. The Company appealed this decision on August 24, 2017. The Company anticipates a final decision on the appeal by the first quarter of 2019. This matter remains open.

Patent Litigation

Mannatech, Incorporated v. Wellness Quest, LLC and Harley Reginald McDaniel, Case No. 3:14-cv-2497, U.S. District Court, for the Northern District of Texas, Dallas Division

On July 11, 2014 the Company filed a patent infringement lawsuit against Wellness Quest, LLC and Dr. H. Reginald McDaniel ("Defendants") alleging the Defendants infringe United States Patent Nos. 7,157,431 and 7,202,220, both entitled "Compositions of Plant Carbohydrates as Dietary Supplements," (the "Patents") and seeking to stop their manufacture, offer, and sale of infringing glyconutritional dietary supplement products. Mediation on this matter was held on April 24, 2015 and a settlement was not reached.

On November 5, 2015, the Court issued an Order accepting Defendant's stipulation of infringement under the Court's claim interpretation and granted the Company's partial motion for summary judgment and issued a permanent injunction against Defendants' infringement of the Patents. The Court stayed the permanent injunction until the conclusion of Defendants' appeal to the U.S. Court of Appeals for the Federal Circuit (the "Court of Appeals"). On August 5, 2016, the Court of Appeals issued a per curium opinion affirming the trial court's judgment in favor of the Company. On August 10, 2016, the Company filed a motion to lift the stay of permanent injunction previously issued by the trial court. On August 24, 2016, the Company received confirmation from its counsel that Defendants changed the formulation of the infringing product to a formulation proposed by the Company. On October 18, 2016, the Court entered an order lifting the stay and putting the permanent injunction back into full effect. On March 31, 2017, the Court entered the Agreed Scheduling Order for trial on damages and determination of willfulness.

On June 22, 2017, bankruptcy counsel for Defendant Dr. McDaniel filed a Suggestion of Bankruptcy with the Court notifying the Court and the Company that on June 20, 2017, Defendant Dr. McDaniel filed a Chapter 7 Bankruptcy in the United States Bankruptcy Court for the Northern District of Texas in Cause No. 17-42560. This case was automatically stayed, which under the Bankruptcy Code, prevents any type of collection to continue including litigation against the debtor. Defendant Dr. McDaniel asserted that the stay included Defendant Wellness Quest as it is wholly owned by Defendant Dr. McDaniel. On May 11, 2018, the Court entered an order granting a discharge to Defendant Dr. McDaniel in the bankruptcy proceeding. Concerned that the cost of prosecuting its remaining claim for damages against Defendant Wellness Quest would far exceed Defendant Wellness Quest's ability to pay, the Company submitted an Agreed Order to Dismiss the matter on June 8, 2018. The Court entered an order dismissing the case on

June 18, 2018. The Company considers this matter closed.

In Re: Harley Reginald McDaniel, Case No. 17-42560 (U.S. Bankruptcy Court for the Northern District of Texas)

On June 22, 2017, the Company received notice that on June 20, 2017, Dr. H. Reginald McDaniel (the "Debtor") filed a Chapter 7 Bankruptcy in the United States Bankruptcy Court for the Northern District of Texas. The Company is the largest creditor based on the Company's judgment against the Debtor in the patent litigation styled, Mannatech, Incorporated v. Wellness Quest, LLC and Harley Reginald McDaniel. The Debtor asserts that the value of the debt is $700,000. The Company engaged bankruptcy counsel. The first meeting of creditors was held on August 8, 2017. On August 24, 2017, the Chapter 7 Trustee and the Company each filed objections to certain exemptions asserted by the Debtor. On August 25, 2017, the U.S. Trustee filed a motion seeking dismissal of the case. On September 14, 2017, the Company filed its response opposing the U.S. Trustee's motion on the grounds that dismissal would be contrary to the best interests of the creditors. A hearing on the motion to dismiss was held on September 20, 2017. On October 12, 2017, the U.S. Trustee stipulated to dismiss its dismissal motion. On November 7, 2017, the Company filed a proof of claim in the amount of $700,000. On November 27, 2017, the Company commenced an adversary proceeding in the case styled Mannatech, Inc. v. Harley Reginald McDaniel, Sr., Adversary Number 17-04153 against the Debtor seeking a declaration that the indebtedness to Mannatech is non-dischargeable. On December 27, 2017, the Chapter 7 Trustee, the Debtor,

and the Company negotiated a Settlement and Compromise Agreement and on January 2, 2018, the Chapter 7 Trustee filed a motion seeking the Court’s approval of that agreement. On January 31, 2018, the Court entered an Order granting the Trustee’s motion. On March 9, 2018, the Company dismissed the adversarial case against the Debtor. On March 15, 2018, the Company received notice that the Chapter 7 Trustee submitted the Final Report to the U.S. Trustee’s office for approval. The U.S. Trustee filed the Notice of the Trustee’s Final Report and Application for Compensation with the Court on April 24, 2018. Under the Final Report, the Company is scheduled to receive $62,976.69 for its allowed, general unsecured claim. Objections to the Final Report or the Application for Compensation must be filed with Court and served on the U.S. Trustee within 30 days of the date of the notice. If no objection to the Final Report is filed and served, the U.S. Trustee may pay proceeds contemplated by the Final Report without further order of the Court. No objections to the Final Report were filed. On May 11, 2018, the Court entered an order granting a discharge to the Debtor. On June 4, 2018 the Company received a check for $62,976.69 as its portion of the proceeds from the bankruptcy estate. The Company considers this matter closed.

Trademark Opposition - U.S. Patent and Trademark Office

United States Trademark Opposition No. 91221493, Shaklee Corporation v. Mannatech, Incorporated re: UTH

On April 15, 2015, the Company received notice that Shaklee Corporation (“Shaklee”) filed a Notice of Opposition to the Company’s trademark application for UTH (stylized as Ûth) with the USPTO. On May 19, 2015, the Company filed an answer to the opposition and also filed a counterclaim seeking to cancel Shaklee’s registration of its YOUTH mark.

On March 28, 2017, the Trademark Trial and Appeal Board (the "TTAB") ruled on the 56(d) Motion, granting the Company’s motion in part to oblige Shaklee to answer the Company’s request for discovery related to Shaklee’s use or non-use of the YOUTH mark. The Company took the deposition of Shaklee’s designated witness on May 31, 2017. On June 29, 2017, the Company filed Applicant’s Opposition to Opposer’s Motion for Summary Judgment on Applicant’s Counterclaim for Abandonment and Applicant’s Cross Motion for Summary Judgment on its Counterclaim for Abandonment. Shaklee’s reply in support of their Motion for Summary Judgement and Response to the Company’s Counterclaim was filed on August 3, 2017. Each party’s respective motions for summary judgment were denied by the TTAB. The Company filed its expert disclosures on and the parties completed discovery on May 21, 2018. The Company’s pretrial disclosures are due on September 3, 2018.

It is not possible at this time to predict the outcome of this office action or 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. This matter remains open.

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 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 the contingencies arising from current legal matters where an outcome was deemed to be probable, and the loss amount could be reasonably estimated.

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NOTE 8: 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 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 June 30, 2018. The table below presents the recorded amount of financial assets measured at fair value (in thousands) on a recurring basis as of June 30, 2018 and December 31, 2017.

June 30, 2018	Level 1	Level 2	Level 3	Total
Assets				
Money Market Funds – JPMorgan Chase, US	$8,000	$ —	$ —	$8,000
Interest bearing deposits – various banks	9,277	—	—	9,277
Total assets	$17,277	$ —	$ —	$17,277
Amounts included in:				
Cash and cash equivalents	$10,504	$ —	$ —	$10,504
Restricted cash	740	—	—	740
Long-term restricted cash	6,033	—	—	6,033
Total	$17,277	$ —	$ —	$17,277

December 31, 2017	Level 1	Level 2	Level 3	Total
Assets				
Money Market Funds – Fidelity, US	$—	$ —	$ —	$—
Interest bearing deposits – various banks	23,695	—	—	23,695
Total assets	$23,695	$ —	$ —	$23,695
Amounts included in:				
Cash and cash equivalents	$16,651	$ —	$ —	$16,651
Restricted cash	741	—	—	741
Long-term restricted cash	6,303	—	—	6,303
Total	$23,695	$ —	$ —	$23,695

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NOTE 9: SEGMENT INFORMATION

The Company's sole reporting segment is one where we sell proprietary nutritional supplements, skin care and anti-aging products, and weight-management and fitness products through network marketing distribution channels operating in twenty-five countries. Each of the business units sells similar packs (with the exception of the United States, Canada, South Africa, Japan, Australia, New Zealand, Singapore, Hong Kong, and Taiwan where packs have been replaced with associate fees, see Note 1, Organization and Summary of Significant Accounting Policies) 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 pack sales and associate fees and product sales. The Company sells its products through its independent associates who occupy positions in our network and distribute products through similar distribution channels in each country. No single independent associate has ever accounted for more than 10% of the Company's consolidated net sales. The Company also operates a non-direct selling business in mainland China. Our subsidiary in China, Meitai, is operating as a traditional retailer under a cross-border e-commerce model. Meitai cannot legally conduct a direct selling business in China unless it acquires a direct selling license in China.

The Company operates facilities in fourteen countries and sells product in twenty-six 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, Hong Kong, Singapore, Colombia and China. Each facility services different geographic areas. We currently sell our products in three regions: (i) the Americas (the United States, Canada, Colombia and Mexico); (ii) EMEA (Austria, the Czech Republic, Denmark, Estonia, Finland, Germany, the Republic of Ireland, Namibia, the Netherlands, Norway, South Africa, Spain, Sweden and the United Kingdom); and (iii) Asia/Pacific (Australia, Japan, New Zealand, the Republic of Korea, Singapore, Taiwan, Hong Kong and China).

Consolidated net sales shipped to customers in these regions, along with pack or associate fee and product information for the three and six months ended June 30, were as follows (in millions, except percentages):

	Three Months Ended June 30,				Six Months Ended June 30,			
Region	2018		2017		2018		2017	
Americas	$17.3	38.4 %	$19.5	40.9 %	$31.0	35.8 %	$35.0	39.6 %
Asia/Pacific	24.5	54.3 %	24.7	51.8 %	48.7	56.3 %	46.6	52.8 %
EMEA	3.3	7.3 %	3.5	7.3 %	6.8	7.9 %	6.7	7.6 %
Totals	$45.1	100.0%	$47.7	100.0%	$86.5	100.0%	$88.3	100.0%

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Consolidated product sales	$44.5	$41.5	$85.5	$76.6
Consolidated pack sales and associate fees[(a)]	0.6	6.0	1.1	11.7
Consolidated other	—	0.2	(0.1)	—
Consolidated total net sales	$45.1	$47.7	$86.5	$88.3

[(a)]Coincident with the introduction of the 2017 Associate Compensation Plan, which was implemented on July 1, 2017, the Company collects associate fees, which each independent associate pays to the Company annually in order

to be entitled to earn commissions, benefits and incentives for that year. The Company collected associate fees within the United States, Canada, South Africa, Japan, Australia, New Zealand, Singapore, Hong Kong, and Taiwan since the implementation of 2017 Associate Compensation Plan. Prior to the change, independent associates purchased packs that were bundles of products within these respective geographic markets. Since implementing the 2017 Associate Compensation Plan, total associate fees represented an immaterial amount of total sales.

MANNATECH, INCORPORATED AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Long-lived assets, which include property and equipment and construction in process for the Company and its subsidiaries, as of June 30, 2018 and December 31, 2017, reside in the following regions, as follows (in millions):

Region	June 30, 2018	December 31, 2017
Americas	$ 5.2	$ 2.9
Asia/Pacific	1.2	1.3
EMEA	0.1	0.1
Total	$ 6.5	$ 4.3

Inventory balances, which consist of raw materials, work in process, finished goods, and promotional materials, as offset by the allowance for slow moving or obsolete inventories, reside in the following regions (in millions):

Region	June 30, 2018	December 31, 2017
Americas	$4.3	$ 3.5
Asia/Pacific	4.4	4.5
EMEA	1.6	1.4
Total	$10.3	$ 9.4

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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 six months ended June 30, 2018 as compared to the same periods in 2017, and should be read in conjunction with Item 1 "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. To supplement our financial results presented in accordance with GAAP, we disclose certain adjusted financial measures which we refer to as Constant dollar ("Constant dollar") measures, which are non-GAAP financial measures. Refer to the Non-GAAP Financial Measures section herein for a description of how such Constant dollar measures are determined.

COMPANY OVERVIEW

Mannatech is a global wellness solution provider, which was incorporated and began operations in November 1993. We develop and sell innovative, high quality, proprietary nutritional supplements, topical and skin care and anti-aging products, and weight-management products that target optimal health and wellness. We currently sell our products in three regions: (i) the Americas (the United States, Canada, Colombia 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, Spain, Sweden and the United Kingdom); and (iii) Asia/Pacific (Australia, Japan, New Zealand, the Republic of Korea, Singapore, Taiwan, Hong Kong, and China).

On July 1, 2017, we revised our 2017 Associate Compensation Plan, which was designed to stimulate business growth and development for our active business building associates and to maximize the buying experience for our preferred customers. In doing so, the Company hopes to better utilize commission dollars to stimulate Company growth. The 2017 Associate Compensation Plan provides revised income streams, new leadership levels and titles, and modified various volume requirements for our associates. In addition, the 2017 Associate Compensation Plan re-designated members as preferred customers and modified their pricing structure.

We conduct our business as a single operating segment and primarily sell our products through a network of approximately 202,000 active associates and preferred customer positions held by individuals that had purchased our products and/or packs or paid associate fees during the last 12 months, who we refer to as current associates and preferred customers. New pack sales and the receipt of new associate fees in connection with new positions in our network are leading indicators for the long-term success of our business. New associate or preferred customer positions are created in our network when our associate fees are paid or packs and products are purchased for the first time under a new account. We operate as a seller of nutritional supplements, topical and skin care and anti-aging products, and weight-management products through our network marketing distribution channels operating in 25 countries and direct e-commerce retail in China. 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 current associates and preferred customers that occupy sales or purchasing positions in our network; entry into new markets and growth of existing markets; niche market development; new product introduction; and investment in our infrastructure. Our subsidiary in China, Meitai, is currently operating as a traditional retailer under a cross-border e-commerce model. Meitai cannot legally conduct a direct selling business in China until it acquires a direct selling license in China.

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Current Economic Conditions and Recent Developments

Overall net sales decreased $2.6 million, or 5.3%, to $45.1 million, during the three months ended June 30, 2018, as compared to the same period in 2017. Net sales for the six months ended June 30, 2018 decreased by $1.8 million, or 2.0%, to $86.5 million, as compared to the same period in 2017. For the three and six months ended June 30, 2018, our net sales declined 7.3% and 5.1%, respectively, on a Constant dollar basis (see Non-GAAP Measures, below); favorable foreign exchange during the three and six months ended June 30, 2018, caused a $0.9 million and $2.7 million increase, respectively, in GAAP net sales as compared to the same period in 2017. For the three and six months ended June 30, 2018, our operations outside of the Americas accounted for approximately 61.6% and 64.2%, respectively, of our consolidated net sales.

The net sales comparisons for the three and six months ended June 30, 2018 and June 30, 2017 were primarily affected by the average value of product orders and the transition to associate fees from pack sales in conjunction with the changes made to our 2017 Associate Compensation Plan.

- For the three months ended June 30, 2018, the average product order value increased 15.2%, to $205, as compared to $178 for the same period in 2017. This was partially offset by a 8.9% decrease in the number of product orders, to 222,775 for the three months ended June 30, 2018, as compared to 244,438 during the same period in 2017. For the six months ended June 30, 2018, the average product order value increased 18.2%, to $201, as compared to $170 for the same period in 2017. This was partially offset by a 6.5% decrease in the number of product orders, to 443,711for the six months ended June 30, 2018, as compared to 474,461 during the same period in 2017.
- The number of packs sold to, and associate fees paid by, new and continuing independent associates and preferred customers decreased 22.6% during the second quarter of 2018 to 23,779, as compared to 30,734 during the same period in 2017. In addition, the average value of packs and associate fees decreased by $170, to $25 for the second quarter of 2018, as compared to $195 for the same period in 2017. The number of packs sold to, and associate fees paid by, new and continuing independent associates and preferred customers decreased 24.9% to 44,517, for the six months ended June 30, 2018, as compared to 59,250 for the same period in 2017. Additionally, the average value of packs and associate fees decreased by $172, to $25, for the six months ended June 30, 2018, as compared to $197 for the same period in 2017.

The changes in our 2017 Associate Compensation Plan were strategically designed to reduce the importance of pack sales and maximize the buying experience for our preferred customers, thus affecting the mix between product and pack sales. Additional information regarding the changes to our 2017 Associate Compensation Plan can be found in the Current Economic Conditions and Recent Developments section of Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations of the Company's annual report on Form 10-K for the year ended December 31, 2017, filed March 26, 2018.

Excluding the effects due to the translation of foreign currencies into U.S. dollars, net sales would have decreased $3.5 million and $4.5 million, respectively, for the three and six months ended June 30, 2018. These adjusted net sales expressed in Constant dollars are a non-GAAP financial measure discussed in further detail below.

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RESULTS OF OPERATIONS

Three Months Ended June 30, 2018 Compared to Three Months Ended June 30, 2017

The table below summarizes our consolidated operating results in dollars and as a percentage of net sales for the three months ended June 30, 2018 and 2017 (in thousands, except percentages):

	2018		2017		Change from 2018 to 2017	
	Total dollars	% of net sales	Total dollars	% of net sales	Dollar	Percentage
Net sales	$45,137	100.0 %	$47,686	100.0 %	$(2,549)	(5.3)%
Cost of sales	8,141	18.0 %	8,786	18.4 %	(645)	(7.3)%
Gross profit	36,996	82.0 %	38,900	81.6 %	(1,904)	(4.9)%
Operating expenses:						
Commissions and incentives	19,322	42.8 %	18,994	39.8 %	328	1.7 %
Selling and administrative expenses	9,615	21.3 %	9,978	20.9 %	(363)	(3.6)%
Depreciation and amortization expense	535	1.2 %	453	0.9 %	82	18.1 %
Other operating costs	7,873	17.4 %	6,656	14.0 %	1,217	18.3 %
Total operating expenses	37,345	82.7 %	36,081	75.7 %	1,264	3.5 %
Income (loss) from operations	(349)	(0.8)%	2,819	5.9 %	(3,168)	(112.4)%
Interest income	133	0.3 %	19	— %	114	600.0 %
Other income (expense), net	476	1.1 %	(9)	— %	485	(5,388.9)%
Income (loss) before income taxes	260	0.6 %	2,829	5.9 %	(2,569)	(90.8)%
Provision for income taxes	(644)	(1.4)%	(1,034)	(2.2)%	390	(37.7)%
Net income (loss)	$(384)	(0.9)%	$1,795	3.8 %	$(2,179)	(121.4)%

Six Months Ended June 30, 2018 Compared to Six Months Ended June 30, 2017

The table below summarizes our consolidated operating results in dollars and as a percentage of net sales for the six months ended June 30, 2018 and 2017 (in thousands, except percentages):

	2018		2017		Change from 2018 to 2017	
	Total dollars	% of net sales	Total dollars	% of net sales	Dollar	Percentage
Net sales	$86,520	100.0 %	$88,327	100.0 %	$(1,807)	(2.0)%
Cost of sales	16,390	18.9 %	17,548	19.9 %	(1,158)	(6.6)%
Gross profit	70,130	81.1 %	70,779	80.1 %	(649)	(0.9)%
Operating expenses:						
Commissions and incentives	36,307	42.0 %	36,075	40.8 %	232	0.6 %
Selling and administrative expenses	17,595	20.3 %	18,632	21.1 %	(1,037)	(5.6)%
Depreciation and amortization expense	1,046	1.2 %	955	1.1 %	91	9.5 %
Other operating costs	16,419	19.0 %	14,332	16.2 %	2,087	14.6 %
Total operating expenses	71,367	82.5 %	69,994	79.2 %	1,373	2.0 %
Income (loss) from operations	(1,237)	(1.4)%	785	0.9 %	(2,022)	(257.6)%

Interest income	162		0.2	%	48		0.1	%	114		237.5	%
Other income, net	764		0.9	%	32		—	%	732		2,287.5	%
Income (loss) before income taxes	(311	)	(0.4	)%	865		1.0	%	(1,176	)	(136.0	)%
Provision for income taxes	(337	)	(0.4	)%	(317	)	(0.4	)%	(20	)	6.3	%
Net income (loss)	$(648	)	(0.7	)%	$548		0.6	%	$(1,196	)	(218.2	)%

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Non-GAAP Financial Measures

To supplement our financial results presented in accordance with GAAP, we disclose operating results that have been adjusted to exclude the impact of changes due to the translation of foreign currencies into U.S. dollars, including changes in: Net Sales, Gross Profit, and Income from Operations. We refer to these adjusted financial measures as Constant dollar items, which are non-GAAP financial measures. We believe these measures provide investors an additional perspective on trends. To exclude the impact of changes due to the translation of foreign currencies into U.S. dollars, we calculate current year results and prior year results at a constant exchange rate, which is the prior year's rate. Currency impact is determined as the difference between actual growth rates and constant currency growth rates.

Three-month period ended (in millions, except percentages)	June 30, 2018		June 30, 2017	Constant $ Change	
	GAAP Measure: Total $	Non-GAAP Measure: Constant $	GAAP Measure: Total $	Dollar	Percent
Net sales	$45.1	$ 44.2	$ 47.7	$(3.5)	(7.3)%
Product	44.5	43.6	41.5	2.1	5.1 %
Pack sales and associate fees[(a)]	0.6	0.6			