

Nu Skin’s Dirty Little (umm...) Big Secret Exposed: Mainstream Chinese press exposes illegal operations

MLM debate is not a debate – it is a matter of fact.

It’s been a year since Citron explored the corporate actions of Nu Skin (NYSE:NUS), the Utah-based MLM Company most dependent on revenues and growth from Mainland China, while operating an illegal pyramid scheme.

In the intervening year, Bill Ackman focused attention on the legal jeopardies of the MLM model with regard to FTC regulation within the United States with his critique on Herbalife and introduced a debate on the legality of MLM. THIS REPORT DOES NOT CARE. As tweeted in the past, Citron was long HLF and most importantly readers must understand that not all MLM are created equal – Ackman just bet on the wrong horse.

A year ago, while on a CNBC debate, Deutsche Bank analyst Bill Schmitz defended Nu Skin, claiming that even if China might have some issues that made all of China disappear from Nu Skin’s financials, it accounted for only 10% of Nu Skin’s business.

WOW, HAVE THINGS CHANGED

Citron observes that Nu Skin has become **extraordinarily dependent on China for a disproportionate amount of its gross revenues, and all of its growth.** With its Mainland China sales now accounting for an extraordinary **28.9%** of its total revenues, investors face a tremendous amount of risk from Nu Skin’s business model. Can this revenue concentration and these growth rates be even remotely sustainable?

MLM Company	Percentage of Total Current Revenues from Mainland China
Herbalife	9.68%
Avon	7.90%
Nu Skin	28.94%

Specifically, Nu Skin has been on a tear in mainland China, with revenues soaring from 57.2 million in Q2 2012 to 197.6 million in Q2 2013 – an astounding increase of 244.9% year over year. **Without that Mainland China growth, Nu Skin’s revenue growth would have been negative on a year-over-year basis.**

Nu Skin	Worldwide Revenues	Mainland China Revenues	Worldwide, Net of Mainland China
Quarter ending 6/30/2013	682,927	197,609	485,318
Quarter ending 6/30/2012	593,235	57,299	535,936
Absolute Growth Year over Year	89,692	140,310	-50,618
Percentage Growth	15.07%	244.9%	-10.43%

By contrast, Herbalife generates less than 10% of its gross revenues in China, and shows proportionate growth in the preponderance of its primary reporting segments worldwide.

Herbalife	Worldwide Revenues	Mainland China Revenues	Worldwide, Net of Mainland China
Quarter ending 6/30/2013	1,219,200	118,000	1,101,200
Quarter ending 6/30/2012	1,031,900	77,100	954,800
Absolute Growth Year over Year	187,300	40,900	146,400
Percentage Growth	18.15%	53.1%	15.33%

How can this kind of outlier result be possible, and go unchallenged by Wall Street? Does Herbalife not know what they are doing?

This kind of sales growth doesn’t come about in a vacuum, and simply isn’t possible regardless of how good a product is.

Here is the answer:

As first uncovered by Citron last year and now emerging in the mainstream press in China -- Nu Skin is clearly operating an illegal and dangerous operation in China. Yes Fraud.

Mainstream Chinese Press exposes the illegal activities of Nu Skin

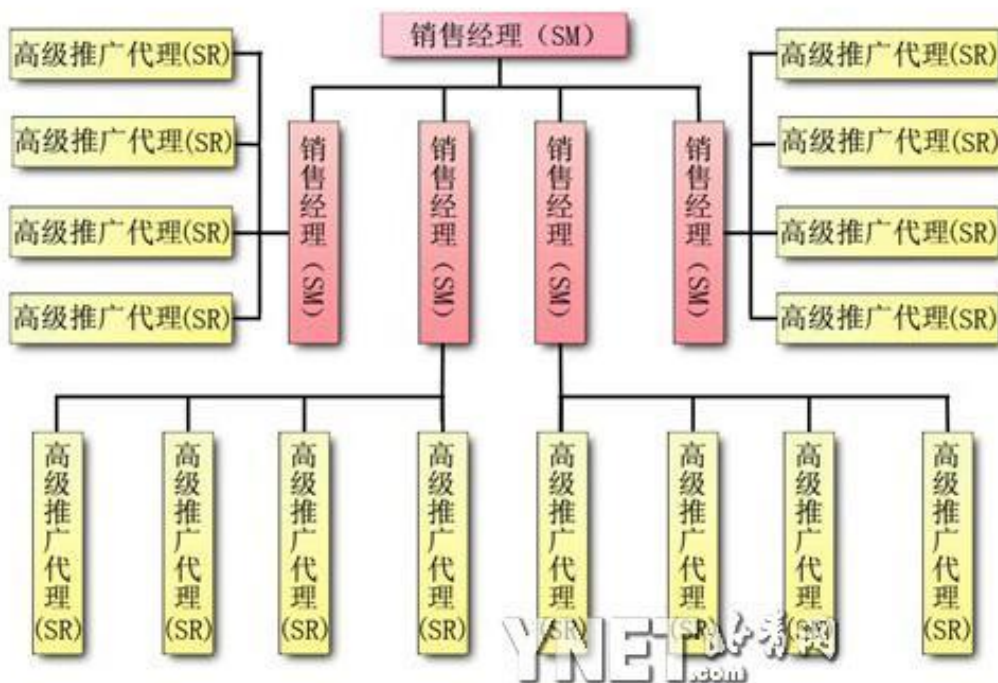
In a in-depth piece of research that has never been pointed out for investors, one of Beijing’s leading newspapers, China’s Beijing Youth Daily, published an expose on the ILLEGAL operations of Nu Skin in China.

<http://finance.chinaneews.com/cj/2013/06-07/4906781.shtml>

In it’s investigation, it concluded in fact that Nu Skin is running an illegal pyramid, and it is not just a few rogue salespeople, as management would like you to believe but rather a thoroughly planned and formulated operation on how to incentivize and deceive its customers. Most

importantly, the Beijing story shows internal documents and conversations with government officials that prove the illegal actions of Nu Skin.

Below is a chart published in the paper that clearly shows a payments structure that does not resemble that of a “direct seller”. Notice the Nu Skin logo on the page proves this is corporate.



How to keep people motivated? Nu Skin will show you. Just tell the unsuspecting Chinese citizens that if you sell enough products, you too can go to Dubai and live the life of a millionaire.



In order to keep the integrity of the story, we will not editorialize it any further but rather leave it to the reader to understand that the massive fraud that is being perpetrated by Nu Skin is no longer a dirty little secret.

And Just when you thought it could not get any could not get any worse, the same publication put up a follow-up report the following month that illustrates the danger of the Nu Skin MLM in China:

<http://www.azhixiao.com/a/toutiaohehuandeng/shouyeyoucenarong/2013/0710/68959.html>

For those of you can understand, you will be completely astonished at what you read and more importantly understand the dangers of multi-level marketing in the Chinese society and the reason for the law restricting its practice. The distributors make such outrageous claims as Nu Skin Pharmanex products can cure everything from cancer and Alzheimer's, to infertility. Here are some excerpts from the story.



Needless to say as stated in the article China Consumer Protection Law Research Association Deputy Secretary General Hao Qinfend has said that this type of advertising is clearly a violation of Chinese law and nothing more than false propaganda.

The more outrageous claims made by Nu Skin are no longer a secret, and the more publicity it gets...the closer it gets to an end.

So When Does China Clamp Down?

This is the key question that Citron does not have the answer for. In the Beijing Youth Investigation when referring to the Nu Skin operations we read:

The director of the Chinese anti-MLM Association said to the Beijing Youth News reporter:

“It’s not just Nu Skin, today the so called direct selling industry is a mess. Even if they get the direct selling license from the Ministry of Commerce, their business model is still done via assembling a team and developing downlines. They may hold up the flag of direct selling but in essence, they are conducting MLM.”

This shows that the government is aware of the Nu Skin issue and more importantly aware that it is a problem in Chinese society that will eventually be addressed. In the case of Nu Skin, this could easily be sooner rather than later, as it is a foreign company corrupting its citizens while its U.S. management has no direct accountability to the Chinese Government.

The curious case of Nu Skin took a lighter, yet more visible turn in China when a prominent Chinese actor had a Weibo set up under his name with testimonials for the Spa machine. He had to make a statement that he has never used the product and did not authorize his image and name being used in advertising. Turns out a lot of Chinese stars had their names used in this manner as well.

<http://www.azhixiao.com/a/toutiaohehuandeng/shouyeyoucenarong/2013/0516/68478.html>

The more publicity, the closer we get to regulation.

We took it a step further

This week Citron sent an individual to one of the Nu Skin stores in Nanjing (whose mayor is under investigation for corruption). What she found was a store ... but also a conduit to a nearby meeting room used as a place to train new distributors. The below link will detail the whole Nu Skin experience, as we found it just this week, along with supporting photos and company propaganda that further prove the illegal operation that is being perpetrated by Nu Skin. The below is the proof as of TODAY.

[**Link to Report on Nu Skin Site Visit in Nanjing**](#)

So what does all of this mean for the stock?

There is a reason the market has assigned risk to Herbalife. If in fact Herbalife were to ever get shut down by US authorities, then surely Nu Skin would fall under the same axe. Herbalife is growing outside one core region and is clearly not breaking the law in China (if so we are sure Ackman would have told you and their growth would be higher and inline with Nu Skin's)

On current forward P/E alone, Nu Skin would be trading at \$67 if compared to Herbalife. That would reflect the risk of regulatory intervention in the U.S.

	Forward P/E
Nu Skin	17.30
Herbalife	11.36

But what if Nu Skin's China operation became the focus of regulators? It didn't take long for the Chinese Government to bring worldwide pharma giant Glaxo to heel. What would Nu Skin face?

What would it be worth if instead of growth, it was facing a 25% haircut on revenues, and negative growth going forward? 50? 40? 30?

No doubt the greatest thing to happen to Nu Skin was the Herbalife battle between Ackman and Icahn. While the two titans were battling it out over the legality of Herbalife, Nu Skin was able to sneak in the side door, and grow its valuation while decreasing its short interest ... all while running a clearly illegal operation. It is time for the market to reflect those risks.



A Challenge to Nu Skin:

If I am lying – sue me. I will not hide behind a corporate veil or a mask of anonymity. You know who Citron is. We would gladly go to the court of law in the United States and prove that your business is running a MLM / pyramid sales operation in China. Citron states that knowing that you will sue in Utah. The evidence is so clear, that we would look forward to using discovery to uncover your illegal operation.

Regardless of what happens with next week's earnings, it does not take a genius stock analyst to understand that something is not right with Nu Skin. Their operations in China are running away from its competition and there is a reason behind it- **THEY ARE OPERATING ILLEGALLY**. I know, the Chinese Press knows it and sooner or later the market will react to it. This is not a debate, this is a matter of fact.