FLOTEK INDUSTRIES INC/CN/
Form 10QSB
November 08, 2005

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

FORM 10 - QSB

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2005

[_] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE EXCHANGE ACT

Commission File Number 1-13270

FLOTEK INDUSTRIES, INC.
(Exact name of small business issuer as specified in its charter)

Delaware	**90-0023731**
(State or other jurisdiction of incorporation)	(I.R.S. Employer Identification Number)

7030 Empire Central Drive, Houston TX 77040
(Address of Principal Executive Offices)

(713) 849-9911
(Issuer's telephone number)

Check whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 ¨**

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.) **YES ¨ NO x**

There were 8,241,035 shares of the issuer's common stock, $.0001 par value, outstanding as of November 4, 2005.

Transitional small business disclosure format: **YES ¨ NO x**

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Forward-Looking Statements

Except for the historical information contained herein, the discussion in this Form 10-QSB includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. The words "anticipate", "believe", "expect", "plan", "intend", "project", "forecast", "could" and similar expressions are intended to identify forward-looking statements. All statements other than statements of historical facts included in this Form 10-QSB regarding the Company's financial position, business strategy, budgets and plans, and objectives of management for future operations are forward-looking statements. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from those in the forward-looking statements for various reasons, including, but not limited to, the effect of competition, the level of petroleum industry exploration and production expenditures, world economic and political conditions, prices of and the demand for crude oil and natural gas, weather, the legislative environment in the United States of America and other countries, adverse changes in the capital and equity markets, and other risk factors including those identified herein.

PART I - FINANCIAL INFORMATION

Item 1. ***Financial Statements***

FLOTEK INDUSTRIES, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS

	September 30, 2005 (Unaudited)	December 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 8,832,769	$ 284,801
Restricted cash	¾	37,038
Accounts receivable, net	7,565,413	3,372,236
Inventories, net	10,775,042	2,447,390
Other current assets	99,254	39,721
Total current assets	27,272,478	6,181,186
Property, plant and equipment, net	7,761,752	2,116,796
Goodwill	11,748,889	7,465,725
Intangible and other assets, net	1,701,154	193,380
	$ 48,484,273	$ 15,957,087
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 2,158,188	$ 2,641,577
Accrued liabilities	2,040,177	1,617,762
Current portion of long-term debt	2,182,109	1,136,467
Amounts due to related parties	¾	466,401
Deferred tax liability	1,602,765	¾
Total current liabilities	7,983,239	5,862,207
Long-term debt, less current portion	7,788,784	5,271,987
Total liabilities	15,772,023	11,134,194
Stockholders' equity:		
Common stock, $.0001 par value; 20,000,000 shares authorized; shares issued and outstanding: September 30, 2005 - 8,241,035 and December 31, 2004 - 6,670,004	824	667
Additional paid-in capital	39,745,013	17,082,141
Accumulated deficit	(7,033,587)	(12,259,915)
Total stockholders' equity	32,712,250	4,822,893
	$ 48,484,273	$ 15,957,087

The accompanying notes are an integral part of these consolidated condensed financial statements.

FLOTEK INDUSTRIES, INC.
CONSOLIDATED CONDENSED INCOME STATEMENTS
(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	**2004**	**2005**	**2004**
Revenues	$ 13,303,670	$ 5,671,044	$ 36,805,438	$ 15,278,420
Cost of revenues	7,576,120	3,174,442	21,746,026	8,662,846
Gross profit	5,727,550	2,496,602	15,059,412	6,615,574
Expenses:				
Selling, general and administrative	2,415,259	1,314,024	6,461,727	3,915,949
Depreciation and amortization	421,810	173,686	999,805	537,960
Research and development	163,005	75,111	440,863	211,401
Total expenses	3,000,074	1,562,821	7,902,395	4,665,310
Income from operations	2,727,476	933,781	7,157,017	1,950,264
Other income (expense):				
Interest expense	(214,956)	(178,900)	(653,004)	(522,961)
Other, net	(1,133)	48,223	39,539	51,678
Total other income (expense)	(216,089)	(130,677)	(613,465)	(471,283)
Income before income taxes	2,511,387	803,104	6,543,552	1,478,981
Provision for income taxes	(741,620)	(100,000)	(1,317,224)	(100,000)
Net income	$ 1,769,767	$ 703,104	$ 5,226,328	$ 1,378,981
Basic and diluted earnings per common share:				
Basic earnings per common share	$ 0.24	$ 0.11	$ 0.75	$ 0.21
Diluted earnings per common share	$ 0.21	$ 0.10	$ 0.67	$ 0.19
Weighted average common shares used in computing basic earnings per common share	7,387,467	6,666,330	6,976,915	6,656,496
Incremental common shares from stock options and warrants	955,062	643,039	865,177	646,645
Weighted average common shares used in computing diluted earnings per common share	8,342,529	7,309,369	7,842,092	7,303,141

The accompanying notes are an integral part of these consolidated condensed financial statements.

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FLOTEK INDUSTRIES, INC.
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine Months Ended September 30, 2005	2004
Cash flows from operating activities:		
Net income	$ 5,226,328	$ 1,378,981
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	999,805	537,960
Change in assets and liabilities:		
Restricted cash	37,038	¾
Accounts receivable	(1,316,939)	(983,577)
Inventories	(885,852)	(488,757)
Deposits and other	(101,205)	48,318
Accounts payable	(1,967,762)	(436,035)
Accrued liabilities	406,595	633,022
Deferred tax liability	(186,501)	¾
Net cash provided by operating activities	2,211,507	689,912
Cash flows from investing activities:		
Acquisition earn-out payment	(153,830)	(229,633)
Acquisitions, net of cash acquired	(7,452,084)	¾
Other assets	(267,890)	¾
Capital expenditures	(1,425,370)	(107,393)
Net cash used in investing activities	(9,299,174)	(337,026)
Cash flows from financing activities:		
Issuance of stock	19,914,598	107,800
Proceeds from borrowings	9,602,862	302,019
Repayments of indebtedness	(13,415,424)	(700,045)
Payments to related parties	(466,401)	(62,660)
Net cash used in financing activities	15,635,635	(352,886)
Net increase in cash and cash equivalents	8,547,968	¾
Cash and cash equivalents at beginning of period	284,801	¾
Cash and cash equivalents at end of period	$ 8,832,769	$ ¾
Supplementary schedule of non-cash investing and financing activities (See Note 3):		
Fair value of net assets acquired	$ 17,410,757	$ ¾
Less cash acquired	(133,674)	¾
Less debt issued	(7,375,000)	¾
Less equity issued	(2,449,999)	¾
Acquisition, net of cash acquired	$ 7,452,084	$ ¾
Supplemental disclosure of cash flow information:		
Interest paid	$ 689,373	$ 531,000
Income taxes paid	$ 1,413,524	$ ¾

The accompanying notes are an integral part of these consolidated condensed financial statements.

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Note 1 - Business and Basis of Presentation

Flotek Industries, Inc. and subsidiaries was incorporated under the laws of the Province of British Columbia on May 17, 1985. On October 23, 2001, we changed our corporate domicile to Delaware. We are engaged in the manufacturing and marketing of innovative specialty chemicals and downhole drilling and production equipment, and in the management of automated bulk material handling, loading and blending facilities. Flotek serves major and independent companies in the domestic and international oilfield service industry. Company headquarters are located in Houston, Texas, and we have operations in Texas, Oklahoma, Louisiana, Utah and Wyoming. We market our products domestically and internationally in over 20 countries.

The consolidated condensed financial statements consist of Flotek Industries, Inc. and its wholly-owned subsidiaries, collectively referred to herein as the "Company" or "Flotek". All significant intercompany transactions and balances have been eliminated in consolidation.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and certain assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. While management believes current estimates are reasonable and appropriate, actual results could differ from these estimates.

In the opinion of management, the unaudited consolidated condensed financial statements of the Company include all adjustments (consisting solely of normal recurring adjustments) necessary for a fair presentation of its financial position as of September 30, 2005 and its results of operations and cash flows for the three and nine month periods ended September 30, 2005 and 2004. The consolidated condensed statement of financial position as of December 31, 2004 is derived from the December 31, 2004 audited consolidated financial statements. Although management believes the disclosures in these financial statements are adequate to make the information presented not misleading, certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. The results of operations and cash flow for the three and nine month periods ended September 30, 2005 are not necessarily indicative of the results to be expected for the full year.

Certain amounts for fiscal 2004 have been reclassified in the accompanying consolidated condensed financial statements to conform to the current year presentation.

Note 2 - Summary of Significant Accounting Policies

Cash and Cash Equivalents

Cash equivalents consist of highly liquid investments with an original maturity of three months or less.

Restricted Cash

Restricted cash serves as collateral for a standby letter of credit that provides financial assurance that the Company will fulfill its obligations related to an international contract to design and project manage the construction of a bulk handling facility in Mexico.

Inventories

Inventories consist of raw materials, work-in-process, finished goods and parts and materials used in manufacturing and construction operations. Finished goods inventories include raw materials, direct labor and production overhead. Valuation of acquired work-in-process inventory is determined based on the guidance in FAS 141 “Business Combinations” (“FAS 141”). The Company determines the value of acquired work-in-process inventories by estimating the selling prices of finished goods less the sum of (a) cost to complete, (b) costs of disposal, and (c) a reasonable profit allowance for the completing and selling effort of the Company based on profit for similar finished goods. Inventories are carried at the lower of cost or market using the weighted average cost method. The Company maintains a reserve for slow-moving and obsolete inventories, which is reviewed for adequacy on a periodic basis.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Valuation of acquired property, plant and equipment is determined based on the guidance in FAS 141. The Company determines value of acquired property, plant and equipment on the lower of (a) replacement cost or (b) appraised value. The cost of ordinary maintenance and repairs is charged to operations, while replacements and major improvements are capitalized. Depreciation is provided at rates considered sufficient to depreciate the cost of the assets using the straight-line method over estimated useful lives.

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment recognized is measured by the amount by which the carrying amount of the assets exceeds either the fair value or the estimated discounted cash flows of the assets, whichever is more readily measurable. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

Goodwill and Intangible Assets

Goodwill represents the excess of the aggregate price paid by us in acquisitions over the fair market value of the tangible and identifiable intangible net assets acquired. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 142, “Goodwill and Other Intangible Assets”, separable intangible assets that are not deemed to have indefinite lives will be amortized over their useful lives. The Company’s other intangibles consists of patents, non-compete agreements and deferred financing costs.

Financial Instruments

The Company considers the fair value of all financial instruments (primarily accounts receivable and long-term debt) not to be materially different from their carrying values at the end of each fiscal year based on management's estimate of the collectibility of net accounts receivable and due to our ability to borrow funds under terms and conditions similar to those of our existing debt and because the majority of our debt carries a floating rate.

The Company has no off-balance sheet debt or other off-balance sheet financing arrangements. The Company has not entered into derivatives or other financial instruments.

Revenue Recognition

Revenue for product sales is recognized when all of the following criteria have been met: (i) evidence of an agreement exists, (ii) products are shipped or services rendered to the customer and all significant risks and rewards of ownership have passed to the customer, (iii) the price to the customer is fixed and determinable and (iv) collectibility is reasonably assured. Accounts receivable are recorded at that time, net of any discounts. Earnings are charged with a provision for doubtful accounts based on a current review of collectibility of the accounts receivable. Accounts receivable deemed ultimately uncollectible are applied against the allowance for doubtful accounts. Deposits and other funds received in advance of delivery are deferred until the transfer of ownership is complete.

The Materials Translogistics business unit ("MTI") recognizes revenues of its design and construction oversight contracts under the percentage-of-completion method of accounting, measured by the percentage of costs incurred to date to the total estimated costs of completion. This percentage is applied to the total estimated revenue at completion to calculate revenues earned to date. Contract costs include all direct labor and material costs and those indirect costs related to manufacturing and construction operations. General and administrative costs are charged to expense as incurred. Changes in job performance and estimated profitability, including those arising from contract bonus or penalty provisions and final contract settlements, may result in revisions to costs and income and are recognized in the

period in which such revisions appear probable. All known or anticipated losses on contracts are recognized in full when such amounts become apparent. MTI bulk material transload revenue is recognized as services are performed for the customer.

Foreign Currency

The Company has sales that are denominated in currencies other than the United States dollar. In accordance with SFAS No. 52, “Foreign Currency Translation”, any foreign currency transaction gains or losses are included in the Company’s results of operations. The Company has not entered into any forward foreign exchange contracts to hedge the potential impact of currency fluctuations on our foreign currency denominated sales.

Research and Development Costs

Expenditures for research activities relating to product development and improvement are charged to expense as incurred.

Income Taxes

Income taxes are computed under the liability method. The Company provides deferred income tax assets and liabilities for the expected future tax consequences attributable to differences between the financial statement carrying amounts and the respective tax basis of assets and liabilities. These deferred assets and liabilities are based on enacted tax rates and laws that will be in effect when the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred income tax assets to amounts which are more likely than not to be realized.

Earnings Per Share

Earnings per common share is calculated by dividing net income or loss attributable to common stockholders by the weighted average number of common shares outstanding. Dilutive income or loss per share is calculated by dividing net income or loss attributable to common stockholders by the weighted average number of common shares outstanding and dilutive effect of stock options and warrants.

Stock-Based Compensation

The Company recognizes compensation expense associated with stock-based awards under the recognition and measurement principles of Accounting Principles Board Opinion ("APB") No. 25, “Accounting for Stock Issued to Employees”, and related interpretations. The difference between the quoted market price as of the date of the grant and the contractual purchase price of shares is charged to operations over the vesting period. No compensation expense has been recognized for stock options with fixed exercise prices equal to the market price of the stock on the dates of grant. The Company provides supplemental disclosure of the effect on net income (loss) and earnings (loss) per share as if the provisions of SFAS No. 123, “Accounting for Stock-Based Compensation, as amended by SFAS No. 148, “Accounting for Stock-Based Compensation - Transition and Disclosure” had been applied in measuring compensation expense.

Recent Accounting Pronouncements

In May 2005, the Financial Accounting Standards Board (“FASB”), issued SFAS No. 154, “Accounting Changes and Error Corrections”. The Company’s effective date for the pronouncement begins December 15, 2005. SFAS No. 154 requires that all voluntary changes in accounting principles, including corrections of errors, are retrospectively applied to prior financial statements as if that principle had always been used, unless it is impracticable to do so. When it is impracticable to calculate the effects on all prior periods, SFAS No. 154 requires that the new principle be applied to the earliest period practicable. The Company will adopt SFAS No. 154 as of December 15, 2005.

In March of 2005, the SEC staff issued Staff Accounting Bulletin No. 107 (“SAB 107”) to assist preparers by simplifying some of the implementation challenges of SFAS 123(R) while enhancing the information that investors

receive. SAB 107 creates a framework that is premised on two overarching themes: (a) considerable judgment will be required by preparers to successfully implement SFAS 123(R), specifically when valuing employee stock options; and (b) reasonable individuals, acting in good faith, may conclude differently on the fair value of employee stock options. Key topics covered by SAB 107 include: (a) valuation models—SAB 107 reinforces the flexibility allowed by SFAS 123(R) to choose an option-pricing model that meets the standard's fair value measurement objective; (b) expected volatility—SAB 107 provides guidance on when it would be appropriate to rely exclusively

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on either historical or implied volatility in estimating expected volatility; and (c) expected term—the new guidance includes examples and some simplified approaches to determining the expected term under certain circumstances. The Company will apply the principles of SAB 107 in conjunction with its adoption of SFAS 123(R).

In December 2004, the FASB issued SFAS No. 123(R) “Share-Based Payment”. This is a revision of SFAS No. 123, “Accounting for Stock-Based Compensation”, and supersedes APB No. 25. As noted in our stock-based compensation accounting policy described above, the Company does not record compensation expense for stock-based compensation. Under SFAS 123R, the Company will be required to measure the cost of employee services received in exchange for stock based on the grant date at fair value (with limited exceptions). That cost will be recognized over the period during which an employee is required to provide services in exchange for the award (usually the vesting period). The fair value will be estimated using an option-pricing model. Excess tax benefits, as defined in SFAS 123R, will be recognized as an addition to additional paid-in capital. The standard is effective as of the beginning of the first interim or annual reporting period that begins after December 15, 2005. The Company is currently in the process of evaluating the impact of SFAS 123(R) on its financial statements, including different option-pricing models.

In December 2004, the FASB published the following two final FASB Staff Positions, effective immediately. SFAS No. 109-1, "Application of FASB Statement No.109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004", gives guidance on applying FASB Statement No. 109, "Accounting for Income Taxes”. SFAS No. 109-2, "Accounting and Disclosure Guidance for that Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004" provides guidance on the Act's repatriation provision. The Company is in the process of reviewing the SFAS No. 109-1 and SFAS No. 109-2; however, at this time, the Company does not believe that the adoption of these standards will have a material impact on its consolidated financial position, results of operations or cash flows.

In November 2004, the FASB Emerging Issues Task Force, or EITF, reached a consensus in applying the conditions in Paragraph 42 of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets, in Determining Whether to Report Discontinued Operations". Evaluation of whether operations and cash flows have been eliminated depends on whether (i) continuing operations and cash flows are expected to be generated, and (ii) the cash flows, based on their nature and significance, are considered direct or indirect. This consensus should be applied to a component that is either disposed of or classified as held-for-sale in fiscal periods beginning after December 15, 2004. The Company does not believe that the adoption of EITF03-13 will have a material impact on its consolidated financial position, results of operations or cash flows.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs—An Amendment of ARB No. 43, Chapter 4" (SFAS No. 151). SFAS No. 151 amends the guidance in ARB No. 43, Chapter 4, "Inventory Pricing," to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Among other provisions, the new rule requires that items such as idle facility expense, excessive spoilage, double freight, and re-handling costs be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal" as stated in ARB No. 43. SFAS No. 151 is effective for fiscal years beginning after June 15, 2005. The Company is required to adopt SFAS No. 151 beginning on January 1, 2006. The Company is currently evaluating the effect that the adoption of SFAS No. 151 will have on its consolidated financial position, results of operations and cash flows, but does not expect SFAS No. 151 to have a material impact.

Note 3 - Acquisitions

On February 14, 2005, the Company completed the purchase of Spidle Sales and Services, Inc. (“Spidle”). The consolidated condensed income statements include the results of operations of Spidle commencing January 1, 2005. A written agreement transferred effective control of Spidle to the Company as of January 1, 2005 without restrictions except those required to protect the shareholders of Spidle. Spidle is accounted for as a wholly-owned subsidiary of

the Company.

The purchase price of the Spidle acquisition has been allocated to the assets acquired and liabilities assumed based on estimated fair values, following the completion of an independent appraisal and other evaluations. In accordance with SFAS No. 141, “Accounting for Business Combinations,” the excess of the net fair value of the assets acquired over the purchase price was allocated proportionately to reduce the values assigned to non-current assets in determining their fair values. In applying Statement No. 141 to the transaction, the net value of property, plant and equipment was reduced by $16.0 million. A deferred tax liability of $1.8 million was recorded as a result of the fair

value of the assets for book purposes being higher than the tax basis which is carried at original cost. The total purchase price consisted of $6.1 million in cash, a $1.3 million seller note payable over three years, and 129,271 shares of the Company's common stock.

	Appraised Investment	Application of FAS 14	Recorded Investment
Cash	$ 133,673	$ ¾	$ 133,673
Receivables	2,495,877	¾	2,495,877
Inventories	6,873,854	¾	6,873,854
Deferred tax asset	74,000	¾	74,000
Property, plant and equipment	17,484,818	(16,001,480)	1,483,338
Accounts payable	(927,436)	¾	(927,436)
Accrued liabilities	(112,828)	¾	(112,828)
Federal income taxes payable	(156,212)	¾	(156,212)
Deferred tax liability	¾	(1,789,266)	(1,789,266)
Less: Total purchase price	8,075,000	¾	8,075,000
Excess of investment over purchase price	$ 17,790,746	$ (17,790,746)	$ ¾

In August 19, 2005, the Company purchased the assets of privately held Harmon's Machine Works, Inc. ("Harmon") a down-hole oilfield and mining tool company located in Midland, Texas, for approximately $4.9 million. The assets acquired included approximately $2.2 million of property, plant and equipment, $0.4 million in accounts receivable, $0.4 million in inventory and approximately $1.9 million in goodwill and other intangible assets. Consideration paid consisted of approximately $3.9 million in cash, $0.6 million in the Company's common stock and the assumption of $0.4 million of net liabilities. The Company financed the acquisition utilizing an equipment term loan of $1.3 million, an acquisition loan of $1.0 million, a real estate term loan of $0.2 million and $1.3 million of a revolving credit facility (See Note 7). The assets purchased have become part of the Company's Drilling Products segment.

Additionally, on September 1, 2005, the Company purchased the assets of privately held Precision-LOR, Ltd. ("LOR"), a drilling tool rental and inspection service provider located in South Texas, for approximately $4.9 million. The assets acquired included approximately $1.4 million of equipment and approximately $3.5 million in goodwill and other intangible assets. Consideration paid consisted of approximately $3.7 million in cash and $1.2 million in the Company's common stock. Cash proceeds from the Company's equity issuance (See Note 8) were utilized for the purchase. The assets purchased have become part of the Company's Drilling Products segment.

Note 4 - Inventories

The components of inventories for the period ended September 30, 2005 and December 31, 2004 were as follows:

	For the Period Ended	
	September 30, 2005	December 31, 2004
Raw materials	$ 1,751,100	$ 797,430
Finished goods	9,525,941	2,107,217
Gross inventories	11,277,041	2,904,647
Less: Slow-moving and obsolescence reserve	(501,999)	(457,257)
Inventories, net	$ 10,775,042	$ 2,447,390

Additional inventory of approximately $6.9 million associated with the Spidle acquisition was recorded January 1, 2005 (see Note 3). Additional inventory of approximately $0.4 million associated with the Harmon acquisition was recorded August 19, 2005.

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Note 5 - Property, Plant and Equipment

For the period ended September 30, 2005 and December 31, 2004, property, plant and equipment was comprised of the following:

	For the Period Ended	
	September 30, 2005	December 31, 2004
Land	$ 268,594	$ 68,000
Buildings and leasehold improvements	3,092,477	1,990,436
Machinery and equipment	6,497,681	953,224
Equipment in progress	207,523	¾
Furniture and fixtures	278,585	108,481
Transportation equipment	1,484,776	514,652
Computer equipment	427,090	424,837
Gross property, plant and equipment	12,256,726	4,059,630
Less: Accumulated depreciation and amortization	(4,494,974)	(1,942,834)
Net property and equipment	$ 7,761,752	$ 2,116,796

Property, plant and equipment of approximately $1.5 million associated with the Spidle acquisition was recorded January 1, 2005 (see Note 3). Property, plant and equipment of approximately $2.2 million associated with the Harmon acquisition was recorded August 19, 2005. Additional property, plant and equipment of approximately $1.8 million associated with the LOR acquisition was recorded September 1, 2005.

Note 6 - Goodwill and Intangible Assets

In February 2002, we acquired IBS 2000, Inc., a Denver-based company engaged in the development and manufacture of environmentally neutral chemicals for the oil industry. The terms of the acquisition called for an "Earn-Out Payment" based on 25% of the division's earnings before interest and taxes for the three one-year periods ending on March 31, 2003, 2004 and 2005. During 2004, the Company recorded additional goodwill of $320,012 associated with an earn-out for the period March 31, 2003 through December 31, 2004 to reflect additional acquisition consideration related to this agreement. In the first quarter of 2005 the Company recorded additional goodwill of $153,830 to reflect the final amount of additional acquisition consideration related to this agreement. As of July 31, 2005, $175,411 had been paid. On August 2, 2005, the remaining balance of $298,431 was settled in 34,080 shares of common stock (See Note 8).

Note 7 - Long-Term Debt

Long-term debt for the period ended September 30, 2005 and December 31, 2004 consisted of the following:

	For the Period Ended	
	September 30, 2005	December 31, 2004
Senior Credit Facility		
Equipment term loan (A)	$ 5,950,000	$ ¾
Real estate term loan (A)	812,665	¾
Amendments to Senior Credit Facility		
Equipment term loan (B)	1,309,667	¾
Real estate term loan (B)	223,908	¾
Promissory notes to stockholders of acquired businesses, maturing December 2007 and 2008	350,000	750,000
Promissory notes to stockholders of acquired businesses, maturing February 2008	1,104,861	¾
Note payable to Facilities	¾	465,495
Note payable to bank maturing March 2008	¾	1,365,766
Note payable to bank maturing October 2008	¾	629,539
Term loan payable to bank maturing December 2007	¾	536,281
Revolving line of credit, maturing September 2005	¾	2,439,483
Mortgage note payable maturing December 2012	¾	96,872
Other	219,792	125,018
Total	9,970,893	6,408,454
Less current maturities	(2,182,109)	(1,136,467)
Long-term debt	$ 7,788,784	$ 5,271,987

Senior Credit Facility

On February 14, 2005, the Company entered into a new senior credit facility (as amended, the "Senior Credit Facility") with Wells Fargo. The Senior Credit Facility was originally made up of a revolving line of credit, an equipment term loan and a real estate term loan.

Equipment term loan (A). The equipment term loan provides for borrowings of $7,000,000 bearing interest at prime rate plus 50 basis points payable over 60 months. This loan was utilized in the purchase of Spidle in February 2005 (See Note 3).

Real estate term loan (A). The real estate term loan provides for borrowings of $855,437 bearing interest at prime rate. The loan is payable over 60 months, and amortized over 180 months. This loan was utilized in the purchase of Spidle in February 2005 (See Note 3).

On August 19, 2005, the Company amended its Senior Credit Facility. The revolving credit line was amended and three additional loans were added (descriptions below).

Equipment term loan (B). The additional equipment term loan provides for borrowings of $1,320,000 bearing interest at prime rate plus 50 basis points payable over 60 months. This loan was specifically utilized for the purchase of Harmon in August 2005 (See Note 3).

Real estate term loan (B). The additional real estate term loan provides for borrowings of $225,000 bearing interest at prime rate. The loan is payable over 60 months, and amortized over 180 months. This loan was specifically utilized for the purchase of Harmon in August 2005 (See Note 3).

Revolving line of credit. The amended revolving line of credit provides for borrowing through February 14, 2007, bearing interest at prime rate plus 50 basis points. The prime rate was 6.75% on September 30, 2005. The maximum amount that may be outstanding under the amended line of credit is the lesser of (a) $6,000,000 (a $1,000,000 increase from the original revolving line of credit), or (b) the sum of 80% of eligible domestic trade receivables and 50% of eligible inventory, as defined. The terms are interest-only, maturing February 2007. The Company utilized the additional borrowing capacity in the purchase of Harmon in August 2005 (See Note 3). Proceeds from the Company stock offering were used to pay down this loan within the same month (See Note 8).

Acquisition loan. The acquisition loan provides for borrowings of $1,000,000 bearing interest at prime rate plus 1% payable over 17 months. This loan was specifically utilized for the purchase of Harmon in August 2005 (See Note 3). Proceeds from the Company stock offering were used to retire this loan in September 2005 (See Note 8).

Promissory notes to stockholders of acquired businesses, maturing February 2008

In conjunction with the acquisition of Spidle in February 2005, the Company issued $1,275,000 of notes payable to the seller. The notes are payable over 36 months and bear interest at 6%.

Promissory note, maturing April 2008

On January 30, 2003, the Company entered into an agreement with Stimulation Chemicals, LLC (“SCL”) to procure raw materials as ordered by CESI, granting CESI 120 day payment terms for a 15% markup. Dr. Penny owned 37.06% and Mr. Beall owned 62.94% of SCL. At that time, both owners of SCL were directors as well as principal stockholders of the Company. Dr. Penny was and is an employee and director of the Company, and Mr. Beall is a former director of the Company. On August 27, 2003, a new agreement was executed for repayment of the outstanding balance of $359,993 beginning September 15, 2003 with monthly principal and interest payments in the amount of $38,600, plus interest of 1% per month on the unpaid balance until paid in full. As of December 31, 2004, the outstanding balance owed to SCL was $347,333. On February 14, 2005, SCL was required to fully subordinate its debt position and defer principal payments for six months in connection with the new senior credit facility. To compensate for the subordination the interest rate on the note was raised to 21%. On April 1, 2005, 62.94% of the outstanding principal and interest was paid to Mr. Beall to retire his portion of the loan. The remaining principal was converted into a new loan with Dr. Penny, bearing a fixed interest rate of 12.5%, payable over 36 months, maturing April 2008. Proceeds from the Company stock offering were used to pay down this loan in August 2005 (See Note 8).

Additionally, in August 2005, proceeds from the Company stock offering in August 2005 were utilized to pay down the notes payable to Oklahoma Facilities, LLC (“Facilities”), and a portion of the promissory notes to stockholders of CESI maturing December 2007 and 2008.

All bank borrowings are collateralized by substantially all of our assets. Bank borrowings are subject to certain financial covenants and a material adverse change subjective acceleration clause. As of September 30, 2005, the Company was in compliance with all covenants.

The Company believes the fair value of its long-term debt approximates the recorded value as of September 30, 2005, as the majority of the long-term debt carries a floating interest rate based on the prime rate.

Note 8 - Common Stock

On August 29, 2005, we completed a private offering of 1,300,000 shares of common stock at a price of $16.30 per share to 18 accredited investors. Gross proceeds from the private offering were $21,190,000; estimated costs associated with the offering were $1,381,400. Proceeds from the sale were used for general corporate purposes, strategic acquisitions, and repayment of existing indebtedness. In connection with the sale, we covenanted with the private placement investors to file a registration statement with the SEC within 60 days of the completion of the

private offering, covering resale of the shares by those investors. We submitted our Form SB-2 registration statement with the SEC on October 28, 2005, within 60 days of the completion of the private offering (See Note 13).

The amount of common shares issued and outstanding is summarized as follows:

Issued and outstanding as of December 31, 2004	6,670,004
Shares issued for Spidle acquisition (See Note 3)	129,271
Shares issued for IBS 2000 “earn-out payment” (See Note 6)	34,080
Shares issued for Harmon acquisition (See Note 3)	35,108
Shares issued in private offering (See above)	1,300,000
Shares issued for LOR acquisition (See Note 3)	68,001
Stock options exercised through September 30, 2005	4,571
Issued and outstanding as of September 30, 2005	8,241,035

Note 9 - Earnings Per Share

Net income per share is calculated by dividing net income attributable to common stockholders by the weighted average number of common shares outstanding. Diluted income per share is calculated by dividing net income attributable to common stockholders by the weighted average number of common shares outstanding and potentially dilutive common shares. For the nine months ended September 30, 2005, 56,029 stock warrants were excluded from the computation of diluted earnings per share because the warrant exercise price of $13.13 per share was greater than the average market price of the Company’s common stock.

A reconciliation of the number of shares used for the basic and diluted earnings per share calculation is as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2005	**2004**	**2005**	**2004**
Net income	$ 1,769,767	$ 703,104	$ 5,226,328	$ 1,378,981
Weighted-average common shares outstanding	7,387,467	6,666,330	6,976,915	6,656,496
Basic earnings per common share	$ 0.24	$ 0.11	$ 0.75	$ 0.21
Diluted earnings per common share	$ 0.21	$ 0.10	$ 0.67	$ 0.19
Weighted-average common shares outstanding	7,387,467	6,666,330	6,976,915	6,656,496
Effect of dilutive securities	955,062	643,039	865,177	646,645
Weighted-average common equivalent shares outstanding	8,342,529	7,309,369	7,842,092	7,303,141

A reconciliation of the number of shares used for the basic earnings per share calculation on a pro forma basis for 2004 had the acquisition of Spidle occurred January 1, 2004 is as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2005	**2004**	**2005**	**2004**
Pro forma revenues	$ 32,303,670	$ 10,858,641	$ 36,805,438	$ 27,321,366
Pro forma income from operations	2,752,312	1,637,886	7,181,853	2,990,607
Pro forma net income	1,794,603	1,563,016	5,251,164	2,961,214
Pro forma weighted-average common shares outstanding	7,387,467	6,795,601	6,976,915	6,785,767
Basic earnings per common share	$ 0.24	$ 0.23	$ 0.75	$ 0.44

Note 10 - Stock Based Compensation Expense

The Company has elected to follow APB Opinion No. 25 in accounting for our employee stock options. Accordingly, no compensation expense is recognized in the financial statements because the exercise price of the

employee stock options equals the market price of the common stock on the date of grant. If determined under SFAS No. 123, the Company's compensation costs based on the fair value at the grant date for its stock options, net income and earnings per share would have been reduced to the following pro forma amounts:

	For the Three Months Ended September 30,				For the Nine Months Ended September 30,			
	2005		2004		2005		2004	
Net income:								
As reported	$	1,769,767	$	703,104	$	5,226,328	$	1,378,981
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects		¾		(12,808)		(43,922)		(47,075)
Pro forma	$	1,769,767	$	690,296	$	5,182,406	$	1,331,906
Basic earnings per share:								
As reported	$	0.24	$	0.11	$	0.75	$	0.21
Pro forma	$	0.24	$	0.10	$	0.74	$	0.20
Diluted earnings per share:								
As reported	$	0.21	$	0.10	$	0.67	$	0.19
Pro forma	$	0.21	$	0.09	$	0.66	$	0.18

For the three months ended September 30, 2005, the Company had two stock option grants totaling 18,140, no stock option exercises and 250 stock option forfeitures. For the nine months ended September 30, 2005, the Company had four stock option grants totaling 73,140, stock option exercises totaling 4,571 and stock option forfeitures of 23,530.

Note 11 - Income Taxes

Our effective income tax rate in 2005 and 2004 differs from the federal statutory rate primarily due to state income taxes and changes in the valuation allowances due to the utilization of net operating loss carryforwards.

A valuation allowance was provided in full against our net deferred tax assets due to our uncertainty surrounding the realization of our deferred tax assets in future years. Certain Internal Revenue Code provisions may limit the use of our net operating loss carryforwards. We are currently assessing limitations on our net operating loss carryforwards, if any, on future periods. As of December 31, 2004, we had estimated net operating loss carryforwards of approximately $8.8 million, expiring in various amounts in 2017 through 2023.

Our current corporate organization structure requires us to file two separate consolidated U.S. Federal income tax returns. As a result, taxable income of one group cannot be offset by tax attributes, including net operating losses, of the other group. Accordingly, the effective tax rate in future periods may differ significantly from the expected statutory rates depending on the level of taxable income or loss for each group.

Note 12 - Related Party Transactions

On January 30, 2003, the Company entered into an agreement with Stimulation Chemicals, LLC ("SCL") to procure raw materials as ordered by CESI, granting CESI 120 day payment terms for a 15% markup. Dr. Penny owned 37.06% and Mr. Beall owned 62.94% of SCL. At that time, both owners of SCL were directors as well as principal

stockholders of the Company. Dr. Penny was and is an employee of the Company, and Mr. Beall is a former director of the Company. On August 27, 2003, a new agreement was executed for repayment of the outstanding balance of $359,993 beginning September 15, 2003 with monthly principal and interest payments in the amount of $38,600, plus interest of 1% per month on the unpaid balance until paid in full. As of December 31, 2004, the outstanding balance owed to SCL was $347,333. On February 14, 2005, SCL was required to fully subordinate its debt position and defer principal payments for six months in connection with the new senior credit facility. To compensate for the subordination, the interest rate on the note was raised to 21%. On April 1, 2005, 62.94% of the outstanding

principal and interest was paid to Mr. Beall to retire his portion of the loan. The remaining principal was converted into a new loan with Dr. Penny, bearing a fixed interest rate of 12.5%, payable over 36 months, maturing April 2008. In September 2005 the loan with Dr. Penny was paid down with proceeds from the Company's private offering (See Note 8).

On July 25, 2002, we borrowed $500,000 under a promissory note from Facilities. One of the Company's officers, who is also a director and principal stockholder, has a minority investment interest in and is an officer of Facilities. The majority of the note is secured by specific Petrovalve inventory. The note was amended on October 1, 2004, bearing interest at the prime rate plus 7.25%, payable in 36 monthly installments beginning January 1, 2005. On February 14, 2005, Facilities was required to fully subordinate its outstanding debt position in connection with the new senior credit facility**.**

Total operating expenses

58.6

57.8

59.5

Earnings from operations

16.6

18.1

16.6

Other income, net

0.1

0.2

0.4

Earnings before income taxes

16.7

18.3

17.0

Income taxes

5.3

6.2

6.0

Net earnings

11.4

%

12.1

%

11.0

%

Summary of 2006 Financial Results and Developments

Consolidated net sales continued to improve throughout 2006, increasing 15.8% to $374.2 million from $323.1 million in 2005. Excluding the positive impact of foreign currency fluctuations, net sales increased 14.8%. Overall, sales growth can be attributed to an increase in the number of active Associates resulting in increased product sold in most countries within the Direct Selling segment.

Net earnings for the year increased 5.8% to $41.3 million. As a percentage of net sales, net earnings decreased from 12.1% in 2005, to 11.0% in 2006. Two items that significantly influenced these changes in net earnings for the year were: 1) increased net sales, and 2) the recognition of equity-based compensation expense as a result of the adoption of Statement of Financial Accounting Standards No. 123(R), Share-Based Payment (equity-based compensation expense was not recognized in prior years Consolidated Statements of Earnings), which is discussed further below.

The first significant event of the year was our inaugural Asia Pacific Convention held in Singapore in March. In September we held our annual International Convention in Salt Lake City, Utah. Nearly 7,000 Associates from 12 different countries attended the September Convention. At our International

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Convention, we introduced a new Optimizer supplement, TenX Antioxidant Blast, a unique dietary supplement fruit bar that provides the equivalent of two fruit servings and is fortified with important antioxidants, including quercetin and our patented Olivol® olive-fruit extract. We also announced that we would be featured in the November issue of *Success from Home* magazine, a commercial publication on home-based business opportunities. We purchased large quantities of the November issue of this magazine and priced them for sale to our Associates at cost. In an effort to further subsidize the cost to Associates of distributing the magazine as a prospecting and marketing tool, we also offer free shipping on packs of 56 magazines when placed the monthly product subscription program known as Autoship. In addition, and for a limited time, Associates who purchased a 56-pack of the *Success from Home* magazine were eligible to participate in a matching commission check promotion.

In September we also received our business license in Malaysia and announced that we expected to begin operations there in the first quarter of 2007. We officially commenced operations in Malaysia on January 8, 2007. Throughout 2007 we will continue to focus on growing our business in existing markets, as well as developing our business in Malaysia.

Implementation of SFAS No. 123(R)

Effective January 1, 2006, we adopted the provisions of SFAS No. 123(R), which requires equity-based compensation expense to be recognized in financial statements. The modified prospective application was used to adopt these provisions. Under this method, compensation expense includes the estimated fair value of equity awards earned during the reported period. Our Consolidated Statements of Earnings for 2006 interim periods reflect equity-based compensation expense, which has not been reflected in either interim or annual Consolidated Statements of Earnings for fiscal years prior to 2006. Equity-based compensation expense recognized in the Consolidated Statements of Earnings for the year ended December 30, 2006 was as follows:

	Year Ended December 30, 2006 (in thousands)
Cost of sales	$ 558
Selling, general and administrative	3,710
Research and development	521
	4,789
Related tax benefit	1,544
Net equity-based compensation expense	$ 3,245

Earnings per basic and diluted share were reduced $0.17 from what earnings would have been exclusive of equity-based compensation. The following table shows remaining unrecognized compensation expense on a pre-tax basis related to all types of equity awards outstanding as of December 30, 2006. This table does not include an estimate for future grants that may be issued.

	(in thousands)
2007	$ 5,481
2008	4,792
2009	2,878
2010	2,268
Thereafter	484
	$ 15,903

The cost above is expected to be recognized over a weighted-average period of 2.2 years.

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More information on our equity-based compensation plans and the accounting for equity-based compensation expense can be found in Note K Equity-Based Compensation, to the Consolidated Financial Statements.

Fiscal Year 2006 compared to Fiscal Year 2005

Net Sales. Net sales increased 15.8% to $374.2 million in 2006, an increase of $51.1 million, from $323.1 million in 2005. The change consisted of a $50.0 million increase in the Direct Selling segment and a $1.1 million increase in the Contract Manufacturing segment.

The following table summarizes the changes in net sales by segment and geographic region for the fiscal years ended December 31, 2005 and December 30, 2006:

Net Sales By Segment and Region
(in thousands)

Segment / Region	Year Ended 2005		2006		Change from Prior Year	Percent Change
Direct Selling						
North America						
United States	$ 134,227	41.5 %	$ 159,377	42.6 %	$ 25,150	18.7 %
Canada	61,252	19.0 %	69,053	18.5 %	7,801	12.7 %
Mexico	13,966	4.3 %	18,059	4.8 %	4,093	29.3 %
North America Total	209,445	64.8 %	246,489	65.9 %	37,044	17.7 %
Asia Pacific						
Australia-New Zealand	44,711	13.8 %	48,316	12.9 %	3,605	8.1 %
Hong Kong	12,217	3.8 %	16,049	4.3 %	3,832	31.4 %
Japan	10,173	3.1 %	9,154	2.4 %	(1,019)	(10.0)%
Taiwan	20,068	6.3 %	21,168	5.7 %	1,100	5.5 %
South Korea	4,750	1.5 %	6,941	1.8 %	2,191	46.1 %
Singapore	13,589	4.2 %	16,788	4.5 %	3,199	23.5 %
Asia Pacific Total	105,508	32.7 %	118,416	31.6 %	12,908	12.2 %
Segment Total	314,953	97.5 %	364,905	97.5 %	49,952	15.9 %
Contract Manufacturing	8,136	2.5 %	9,285	2.5 %	1,149	14.1 %
Consolidated	$ 323,089	100.0 %	$ 374,190	100.0 %	$ 51,101	15.8 %

Net sales from the Direct Selling segment in North America increased 17.7% over the prior year. Excluding the positive impact of foreign currency fluctuations, sales in this region improved 15.6%. The overall sales growth in this region during 2006 was driven by a 14.6% increase in the number of active Associates and, to a lesser extent, an 11.1% increase in the number of active Preferred Customers.

Net sales in the Asia Pacific region of the Direct Selling segment improved 12.2% over prior year results. Excluding the negative impact of foreign currency in this region, sales increased 13.3%. This sales growth was driven by a 15.7% increase in the number of active Associates.

We believe that in addition to our quality products and rewarding Compensation Plan, the growth in the number of Active Associates can be attributed to the following:

- Unique incentive programs, including contests and promotions designed to increase selling activity;
- Ongoing communication with Associate leaders in the field;
- Growing Associate leadership base;
- Company-sponsored events directed at Associate recognition, motivation, and training; and

- The introduction of new products and sales tools.

Net sales in the Contract Manufacturing segment increased 14.1% to $9.3 million, from $8.1 million in 2005. The increase can be attributed primarily to the fulfillment of backlogged orders throughout the first half of the year and, to a lesser extent, a modest increase in sales to existing third-party customers.

The Company follows the practice of providing guidance concerning anticipated consolidated net sales. Management currently anticipates net sales for 2007 to grow between 15% and 17%, compared with 2006. The anticipated increase in net sales is expected to come from our Direct Selling segment.

The following tables summarize the changes in our active customer base for the Direct Selling segment by geographic region as of the dates indicated:

Active Associates By Region
(rounded to the nearest thousand)

Region	As of December 31, 2005			As of December 30, 2006			Change from Prior Year	Percent Change	
North America									
United States	51,000	38.3	%	59,000	38.5	%	8,000	15.7	%
Canada	23,000	17.3	%	24,000	15.7	%	1,000	4.3	%
Mexico	8,000	6.0	%	11,000	7.2	%	3,000	37.5	%
North America Total	82,000	61.6	%	94,000	61.4	%	12,000	14.6	%
Asia Pacific									
Australia-New Zealand	17,000	12.8	%	19,000	12.4	%	2,000	11.8	%
Hong Kong	4,000	3.0	%	9,000	5.9	%	5,000	125.0	%
Japan	5,000	3.8	%	4,000	2.6	%	(1,000)	(20.0	)%
Taiwan	13,000	9.8	%	14,000	9.2	%	1,000	7.7	%
South Korea	2,000	1.5	%	2,000	1.3	%		0.0	%
Singapore	10,000	7.5	%	11,000	7.2	%	1,000	10.0	%
Asia Pacific Total	51,000	38.4	%	59,000	38.6	%	8,000	15.7	%
Total	133,000	100.0	%	153,000	100.0	%	20,000	15.0	%

Active Preferred Customers By Region
(rounded to the nearest thousand)

Region	As of December 31, 2005			As of December 30, 2006			Change from Prior Year	Percent Change	
North America									
United States	44,000	62.9	%	50,000	64.1	%	6,000	13.6	%
Canada	18,000	25.7	%	18,000	23.1	%		0.0	%
Mexico	1,000	1.4	%	2,000	2.5	%	1,000	100.0	%
North America Total	63,000	90.0	%	70,000	89.7	%	7,000	11.1	%
Asia Pacific									
Australia-New Zealand	6,000	8.6	%	7,000	9.0	%	1,000	16.7	%
Hong Kong	**	0.0	%	**	0.0	%		N/A	
Japan	1,000	1.4	%	1,000	1.3	%		0.0	%
Taiwan	**	0.0	%	**	0.0	%		N/A	
South Korea	**	0.0	%	**	0.0	%		N/A	
Singapore	**	0.0	%	**	0.0	%		N/A	
Asia Pacific Total	7,000	10.0	%	8,000	10.3	%	1,000	14.3	%
Total	70,000	100.0	%	78,000	100.0	%	8,000	11.4	%

** Active Preferred Customer count is less than 500.

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Total Active Customers By Region
(rounded to the nearest thousand)

Region	As of December 31, 2005			As of December 30, 2006			Change from Prior Year	Percent Change	
North America									
United States	95,000	46.8	%	109,000	47.2	%	14,000	14.7	%
Canada	41,000	20.2	%	42,000	18.2	%	1,000	2.4	%
Mexico	9,000	4.4	%	13,000	5.6	%	4,000	44.4	%
North America Total	145,000	71.4	%	164,000	71.0	%	19,000	13.1	%
Asia Pacific									
Australia-New Zealand	23,000	11.3	%	26,000	11.2	%	3,000	13.0	%
Hong Kong	4,000	2.0	%	9,000	3.9	%	5,000	125.0	%
Japan	6,000	3.0	%	5,000	2.1	%	(1,000)	(16.7	)%
Taiwan	13,000	6.4	%	14,000	6.1	%	1,000	7.7	%
South Korea	2,000	1.0	%	2,000	0.9	%		0.0	%
Singapore	10,000	4.9	%	11,000	4.8	%	1,000	10.0	%
Asia Pacific Total	58,000	28.6	%	67,000	29.0	%	9,000	15.5	%
Total	203,000	100.0	%	231,000	100.0	%	28,000	13.8	%

Gross Profit. Consolidated gross profit improved to 76.1% of net sales in 2006, from 75.9% in 2005. This increase was driven by modest improvements in both of our operating segments that are explained below.

Gross profit in the Direct Selling segment improved to 78.1% of net segment sales in 2006, from 78.0% in 2005. This improvement in gross profit margins for the Direct Selling segment can be attributed primarily to lower costs on certain key raw materials, such as Coenzyme Q10. This improvement was partially offset by the following:

- Higher freight costs on shipments to Associates and Preferred Customers;
- The required inclusion of equity-based compensation expense; and
- Additional costs relating to our promotions on the *Success from Home* magazine.

Although gross profit margin in the Contract Manufacturing segment improved modestly, this segment continued to generate minimal gross profit margins from its third-party customers in both 2006 and 2005. As a reminder, we acquired the Contract Manufacturing business primarily as a means to produce the Company s Sensé product line. We are not actively pursuing growth of the third-party business in this segment.

We anticipate improvement to gross profit margins in the Direct Selling segment during 2007, which is primarily due to the lower costs negotiated on raw materials. Additionally, we replaced one of our freight carriers, which we believe will provide some relief to the higher shipping costs that we experienced during 2006.

Associate Incentives. Expenses related to Associate incentives are only incurred by the Direct Selling segment and represent the most significant cost as a percentage of net sales for this segment. Associate incentives increased to 40.1% of net segment sales in 2006, compared to 39.4% in 2005. The increase in Associate incentives relative to net segment sales can be primarily attributed to an increase in amounts paid on incentive promotions, including higher paying contests and promotions.

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We expect Associate incentives to approximate current levels for the foreseeable future. However, as we look for ways to continue to increase sales, our Associate incentives may fluctuate modestly quarter to quarter.

Selling, General, and Administrative. Selling, general, and administrative expenses increased to 19.5% of net sales in 2006 from 18.7% in 2005. This increase, as a percentage of net sales, can be attributed largely to the recognition of equity-based compensation expense, the selling, general and administrative portion of which totaled 1.0% of net sales in 2006. This increased cost as a percentage of sales was partially offset by modest operating leverage generated on our growing sales base.

In absolute terms, our selling, general and administrative expenses increased by $12.5 million from 2005 to 2006. This absolute increase in selling, general and administrative expenses can, in great part, be attributed to the following:

- Increased spending in many of our markets to support growing sales and an increasing number of Associates;
- Expensing of equity-based compensation of $3.7 million;
- Increased spending related to our international expansion efforts, mostly in Malaysia; and
- Increased costs associated with Company-sponsored events such as our annual International Convention held in September 2006, and the inaugural Asia Pacific Convention held in March 2006.

We believe that selling, general, and administrative expenses in 2007, as a percentage of net sales, will be in line with what we experienced in 2006. Although we have experienced leverage on this line item in the last several years, we will be focusing on a few key initiatives in 2007 that we believe will have a beneficial impact to the long-term financial health of USANA.

Other Income. Other income increased to $1.4 million in 2006, from $487 thousand in 2005. The improvement in other income can be attributed to foreign currency gains realized in 2006.

Income Taxes. Income taxes totaled 35.3% of earnings before income taxes in 2006, compared with 33.7% in 2005. This increase reduced diluted earnings per share in 2006 by approximately $0.06. This increase can be attributed to a 40% phase out of the Extraterritorial Income Exclusion in 2006, tax expense associated with non-deductible value added taxes, and taxes associated with equity-based compensation under SFAS No. 123(R). The 2006 effective tax rate increase was partially offset by an increase in the 2006 Federal Incremental Research Credit.

We expect that our effective tax rate for the full year of 2007 will be approximately 36.5%. This expected increase is due to the complete phase out of the Extraterritorial Income Exclusion, partially offset by the increased deduction for Qualified Production Activities as well as an extension of the Federal Incremental Research Credit. The anticipated tax rate for 2007 may be affected by the type and amount of stock options exercised during the year and other items.

Net Earnings. Net earnings increased 5.8% to $41.3 million in 2006, an increase of $2.3 million, from $39.0 million in 2005. Net earnings growth slowed during 2006 due to the following:

- The inclusion of equity-based compensation expense that impacted net earnings by $3.2 million;
- Higher relative incentives paid to our Associates;
- Increased expenses associated with international expansion efforts; and
- A higher effective tax rate.

Diluted earnings per share improved to $2.20 in 2006, an increase of $0.22, from $1.98 in 2005. Diluted earnings per share in 2006 included equity-based compensation expense that reduced earnings per

share by $0.17; whereas the diluted earnings per share of $1.98 in 2005 did not include equity-based compensation expense.

We expect to grow earnings per share in 2007 between 17% and 20%. This estimate assumes a 2007 tax rate of 36.5%, which is meaningfully higher than the 35.3% tax rate we experienced in 2006. We believe that growth in earnings per share will exceed that of growth in net sales as a result of improved gross margins, a lower proportion of our net sales coming from the Contract Manufacturing segment, and execution of the remaining amounts available under the share buy back program.

Fiscal Year 2005 compared to Fiscal Year 2004

Net Sales. Net sales increased 20.0% to $323.1 million in 2005, an increase of $53.7 million, from $269.4 million in 2004. During 2005, net sales in the Direct Selling segment increased by $55.9 million, while net sales in the Contract Manufacturing segment declined $2.2 million from 2004.

The following table summarizes the change in net sales by segment and geographic region for the fiscal years ended January 1, 2005 and December 31, 2005:

Net Sales By Segment and Region
(in thousands)

Segment / Region	Year Ended 2004		2005		Change from Prior Year	Percent Change
Direct Selling						
North America						
United States	$ 112,151	41.6 %	$ 134,227	41.5 %	$ 22,076	19.7 %
Canada	51,800	19.2 %	61,252	19.0 %	9,452	18.2 %
Mexico	8,258	3.1 %	13,966	4.3 %	5,708	69.1 %
North America Total	172,209	63.9 %	209,445	64.8 %	37,236	21.6 %
Asia Pacific						
Australia-New Zealand	35,187	13.1 %	44,711	13.8 %	9,524	27.1 %
Hong Kong	10,819	4.0 %	12,217	3.8 %	1,398	12.9 %
Japan	9,120	3.4 %	10,173	3.1 %	1,053	11.5 %
Taiwan	15,861	5.9 %	20,068	6.3 %	4,207	26.5 %
South Korea	5,676	2.1 %	4,750	1.5 %	(926)	(16.3)%
Singapore	10,168	3.8 %	13,589	4.2 %	3,421	33.6 %
Asia Pacific Total	86,831	32.3 %	105,508	32.7 %	18,677	21.5 %
Segment Total	259,040	96.2 %	314,953	97.5 %	55,913	21.6 %
Contract Manufacturing	10,311	3.8 %	8,136	2.5 %	(2,175)	(21.1)%
Consolidated	$ 269,351	100.0 %	$ 323,089	100.0 %	$ 53,738	20.0 %

The increase in net sales contributed by the Direct Selling segment can be primarily attributed to the following factors:

- A 16.7% increase in the active Associate base and an 11.1% increase in the active Preferred Customer base for the year ended 2005;
- A $5.7 million increase in Mexico due to a full year of operations; and
- Stronger foreign currencies relative to the U.S. dollar, which positively affected the translation of sales in foreign currencies by $7.7 million.

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The decrease in net sales of our Contract Manufacturing segment can be attributed to an increased focus on the manufacture of our Sensé line and a decreased emphasis on our third-party business.

The following tables summarize the growth in active customers for the Direct Selling segment by geographic region as of the dates indicated:

Active Associates By Region
(rounded to the nearest thousand)

Region	As of January 1, 2005			As of December 31, 2005			Change from Prior Year	Percent Change	
North America									
United States	43,000	37.7	%	51,000	38.3	%	8,000	18.6	%
Canada	22,000	19.3	%	23,000	17.3	%	1,000	4.5	%
Mexico	7,000	6.1	%	8,000	6.0	%	1,000	14.3	%
North America Total	72,000	63.1	%	82,000	61.6	%	10,000	13.9	%
Asia Pacific									
Australia-New Zealand	14,000	12.3	%	17,000	12.8	%	3,000	21.4	%
Hong Kong	5,000	4.4	%	4,000	3.0	%	(1,000)	(20.0	)%
Japan	4,000	3.5	%	5,000	3.8	%	1,000	25.0	%
Taiwan	9,000	7.9	%	13,000	9.8	%	4,000	44.4	%
South Korea	2,000	1.8	%	2,000	1.5	%		0.0	%
Singapore	8,000	7.0	%	10,000	7.5	%	2,000	25.0	%
Asia Pacific Total	42,000	36.9	%	51,000	38.4	%	9,000	21.4	%
Total	114,000	100.0	%	133,000	100.0	%	19,000	16.7	%

We believe that various factors contributed to the increase in the number of active Associates during 2005, including enthusiasm surrounding the new self-preserving Sensé product line, ongoing communication with Associate leaders in the field, and company-sponsored events and promotions to motivate Associates.

Active Preferred Customers By Region
(rounded to the nearest thousand)

Region	As of January 1, 2005			As of December 31, 2005			Change from Prior Year	Percent Change	
North America									
United States	38,000	60.3	%	44,000	62.9	%	6,000	15.8	%
Canada	17,000	27.0	%	18,000	25.7	%	1,000	5.9	%
Mexico	1,000	1.6	%	1,000	1.4	%		0.0	%
North America Total	56,000	88.9	%	63,000	90.0	%	7,000	12.5	%
Asia Pacific									
Australia-New Zealand	5,000	7.9	%	6,000	8.6	%	1,000	20.0	%
Hong Kong	1,000	1.6	%	**	0.0	%	(1,000)	(100.0	)%
Japan	1,000	1.6	%	1,000	1.4	%		0.0	%
Taiwan	**	0.0	%	**	0.0	%		N/A	
South Korea	**	0.0	%	**	0.0	%		N/A	
Singapore	**	0.0	%	**	0.0	%		N/A	
Asia Pacific Total	7,000	11.1	%	7,000	10.0	%		0.0	%
Total	63,000	100.0	%	70,000	100.0	%	7,000	11.1	%

** Active Preferred Customer count is less than 500.

Total Active Customers By Region
(rounded to the nearest thousand)

Region	As of January 1, 2005			As of December 31, 2005			Change from Prior Year		Percent Change	
North America										
United States	81,000	45.8	%	95,000	46.8	%	14,000		17.3	%
Canada	39,000	22.0	%	41,000	20.2	%	2,000		5.1	%
Mexico	8,000	4.5	%	9,000	4.4	%	1,000		12.5	%
North America Total	128,000	72.3	%	145,000	71.4	%	17,000		13.3	%
Asia Pacific										
Australia-New Zealand	19,000	10.8	%	23,000	11.3	%	4,000		21.1	%
Hong Kong	6,000	3.4	%	4,000	2.0	%	(2,000	)	(33.3	)%
Japan	5,000	2.8	%	6,000	3.0	%	1,000		20.0	%
Taiwan	9,000	5.1	%	13,000	6.4	%	4,000		44.4	%
South Korea	2,000	1.1	%	2,000	1.0	%			0.0	%
Singapore	8,000	4.5	%	10,000	4.9	%	2,000		25.0	%
Asia Pacific Total	49,000	27.7	%	58,000	28.6	%	9,000		18.4	%
Total	177,000	100.0	%	203,000	100.0	%	26,000		14.7	%

Gross Profit. Consolidated gross profit increased to 75.9% of net sales in 2005 from 75.2% in 2004. This improvement in consolidated gross profit can primarily be attributed to a decrease in the impact that the Contract Manufacturing segment had on the total, and to a lesser extent, modest leverage benefits gained on a rising sales base.

Gross profit in the Direct Selling segment increased modestly in 2005 to 78.0% of net segment sales, compared to 77.7% in 2004. This modest improvement can primarily be attributed to leverage benefits on semi-variable costs realized on a rising sales base.

The Contract Manufacturing segment generated minimal profit from its third-party customers for the year 2005, compared to gross profit of 12.5% in 2004. The decline in gross profit margin from third-party customers can primarily be attributed to production inefficiencies in the segment s third-party business. The Contract Manufacturing business was acquired primarily as a means to produce the Company s Sensé product line, not for the third-party business.

Associate Incentives. Expenses related to Associate incentives are only incurred by the Direct Selling segment and represent the most significant cost as a percentage of net sales for this segment. Associate incentives increased to 39.4% of net segment sales in 2005, compared to 39.0% in 2004. The increase in Associate incentives relative to net segment sales can be attributed to a higher payout rate of base commissions generated. We also began an initiative to increase rewards to our top-performing Associates in the third quarter of 2005 through contests, promotions, and other incentives designed to support sales growth and assist our Associates in growing their respective businesses.

Selling, General, and Administrative. Selling, general, and administrative expenses decreased to 18.7% of net sales in 2005 from 20.3% in 2004. The decrease, as a percentage of net sales, can be attributed to leverage gained on the increase in sales during 2005.

In absolute terms, our selling, general and administrative expenses increased $5.6 million from 2004 to 2005, which was attributable to an increase in spending in many of our markets to support growing sales and an increasing number of Associates.

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Income Taxes. Income taxes totaled 33.7% of earnings before income taxes in 2005, compared with 31.7% in 2004. The increase in the effective tax rate for 2005 can be attributed to the first 20% phase out of the Extraterritorial Income Exclusion, which was only partially offset by a new 3% deduction for Qualified Production Activities. Additionally, in 2004 we received a favorable settlement from a foreign tax audit.

Net Earnings. Net earnings increased 26.7% to $39.0 million in 2005, an increase of $8.2 million, from $30.8 million in 2004. The increase in net earnings can be primarily attributed to increased net sales and improved operating margins.

Diluted earnings per share improved to $1.98 in 2005, an increase of $0.47, from $1.51 in 2004.

Quarterly Financial Information

The following tables set forth unaudited quarterly operating results for each of the last eight fiscal quarters, as well as percentages of net sales for certain data for the periods indicated. This information has been prepared on a basis consistent with the Consolidated Financial Statements and includes all adjustments, consisting only of normal recurring adjustments that management considers necessary for a fair presentation of the data. Quarterly results are not necessarily indicative of future results of operations. This information should be read in conjunction with the audited Consolidated Financial Statements and notes thereto that are included elsewhere in this report.

	Quarter Ended							
	April 2, 2005	July 2, 2005	Oct. 1, 2005	Dec. 31, 2005	April 1, 2006	July 1, 2006	Sept. 30, 2006	Dec. 30, 2006
	(in thousands, except per share data)							
Consolidated Statements of Earnings Data:								
Net sales	$ 75,527	$ 80,878	$ 81,038	$ 85,646	$ 88,229	$ 92,482	$ 93,698	$ 99,781
Cost of sales	18,010	19,499	19,760	20,747	21,338	22,276	22,188	23,743
Gross profit	57,517	61,379	61,278	64,899	66,891	70,206	71,510	76,038
Operating expenses:								
Associate incentives	28,499	30,774	31,358	33,414	34,006	36,025	36,994	39,226
Selling, general, and administrative	14,849	15,168	14,756	15,553	17,626	17,991	17,898	19,339
Research and development	599	689	551	500	732	830	881	754
Total operating expenses	43,947	46,631	46,665	49,467	52,364	54,846	55,773	59,319
Earnings from operations	13,570	14,748	14,613	15,432	14,527	15,360	15,737	16,719
Other income (expense), net	165	(67)	172	217	295	336	68	712
Earnings before income taxes	13,735	14,681	14,785	15,649	14,822	15,696	15,805	17,431
Income taxes	4,807	5,138	4,743	5,168	5,262	5,352	5,582	6,292
Net earnings	$ 8,928	$ 9,543	$ 10,042	$ 10,481	$ 9,560	$ 10,344	$ 10,223	$ 11,139
Earnings per share*:								
Basic	$ 0.47	$ 0.50	$ 0.53	$ 0.56	$ 0.52	$ 0.57	$ 0.57	$ 0.62
Diluted	$ 0.45	$ 0.48	$ 0.51	$ 0.54	$ 0.50	$ 0.55	$ 0.55	$ 0.61
Weighted average shares outstanding:								
Basic	19,068	18,948	18,867	18,609	18,460	18,149	17,780	17,824
Diluted	19,971	19,821	19,755	19,336	19,228	18,777	18,486	18,405

* Earnings per share is computed independently for each of the quarters presented. Therefore, the sum of the quarterly earnings per share amounts does not necessarily equal the total for the year.

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	Quarter Ended April 2, 2005	July 2, 2005	Oct. 1, 2005	Dec. 31, 2005	April 1, 2006	July 1, 2006	Sept. 30, 2006	Dec. 30, 2006
Consolidated Statements of Earnings as a percentage of Net Sales:								
Net Sales	100.0 %	100.0 %	100.0 %	100.0 %	100.0 %	100.0 %	100.0 %	100.0 %
Cost of Sales	23.8	24.1	24.4	24.2	24.2	24.1	23.7	23.8
Gross profit	76.2	75.9	75.6	75.8	75.8	75.9	76.3	76.2
Operating Expenses:								
Associate Incentives	37.7	38.0	38.7	39.0	38.5	39.0	39.5	39.3
Selling, general and administrative	19.7	18.8	18.2	18.2	20.0	19.5	19.1	19.4
Research and development	0.8	0.9	0.7	0.6	0.8	0.9	0.9	0.8
Total operating expenses	58.2	57.7	57.6	57.8	59.3	59.4	59.5	59.5
Earnings from operations	18.0	18.2	18.0	18.0	16.5	16.5	16.8	16.7
Other income (expense), net	0.2	(0.1)	0.2	0.3	0.3	0.4	0.1	0.7
Earnings before income taxes	18.2	18.1	18.2	18.3	16.8	16.9	16.9	17.4
Income taxes	6.4	6.4	5.9	6.0	6.0	5.8	6.0	6.3
Net earnings	11.8 %	11.7 %	12.3 %	12.3 %	10.8 %	11.1 %	10.9 %	11.1 %

We may experience variations in the results of operations from quarter to quarter as a result of factors that include the following:

- The recruiting and retention of Associates;
- The opening of new markets;
- The timing of company-sponsored Associate events;
- Fluctuations in currency exchange rates;
- New product introductions;
- The timing of holidays, which may reduce the amount of time Associates spend selling products or recruiting new Associates;
- The negative impact of changes in or interpretations of regulations that may limit or restrict the sale of certain products in some countries;
- The adverse effect of a failure by us or an Associate, or allegations of a failure, to comply with applicable governmental regulations;
- The integration and operation of new information technology systems;
- The inability to introduce new products or the introduction of new products by competitors;
- Entry into one or more of our markets by competitors;
- Availability of raw materials;

- General conditions in the nutritional supplement, personal care, and weight management industries or the network marketing industry; and

- Consumer perceptions of our products and operations.

Because our products are ingested by consumers or applied to their bodies, we are highly dependent upon consumers perception of the safety, quality, and efficacy of our products. As a result, substantial

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negative publicity, whether founded or unfounded, concerning one or more products or other products similar to our products could adversely affect our business, financial condition, and results of operations.

As a result of these and other factors, quarterly revenues, expenses, and results of operations could vary significantly in the future, and period-to-period comparisons should not be relied upon as indications of future performance. There can be no assurance that we will be able to increase revenues in future periods or be able to sustain the level of revenue or rate of revenue growth on a quarterly or annual basis that we have sustained in the past. Due to the foregoing factors, future results of operations could be below the expectations of public market analysts and investors. If that occurred, the market price of our common stock would likely be materially adversely affected.

Liquidity and Capital Resources

We continue to finance our growth with cash flows from operations. In 2006, net cash flows from operating activities totaled $60.5 million, compared to $48.0 million in 2005. Cash and cash equivalents increased to $27.0 million at December 30, 2006, from $10.6 million at December 31, 2005. Net working capital increased to $20.8 million at December 30, 2006, compared with net working capital of $15.3 million at December 31, 2005. The increase in cash and cash equivalents and net working capital during 2006 can be attributed to strong cash flow from operating activities, which was offset in great part by the purchase of shares under our Share Repurchase Plan totaling $41.0 million.

We have continued to grow significantly over the last several years and require additional administrative and warehouse space, as well as additional parking for our employees. To address this need, we are expanding our corporate headquarters and anticipate that the facility expansion will require a total investment of approximately $16 million, which is meaningfully higher than the original estimate we provided of $9 million in our 2005 Form 10-K. This increase is due to an increase in the scope of this expansion, as well as an increase in the cost of materials. As of December 30, 2006, progress billings on this expansion totaled $7.1 million, of which $6.2 million was paid and $0.9 million was accrued for work performed through December 30, 2006. We expect the remaining amounts to be paid in full during 2007.

During the fourth quarter of 2006, we entered into an agreement to purchase a facility in Australia, which will replace the facility we currently lease there. We expect to move operations to this new facility in late 2007 or early 2008, and we will terminate our existing lease at that time. We placed a deposit on this facility of $968 thousand during the fourth quarter of 2006, and paid the remaining amount of $5.0 million in January 2007 when we assumed possession of this facility. We expect to spend an additional $3.6 million on the remodel and fit-out of this facility during 2007.

We believe that the future investments in our corporate headquarters, as well as the new facility in Australia, will be paid for with cash flows generated from operations. Total investments in property, plant, and equipment in 2007 are expected to be between $20 and $25 million, including the aforementioned facilities.

During the fiscal year ended December 30, 2006, directors, officers, and employees exercised stock options, resulting in cash proceeds to the Company of $3.5 million.

During the second quarter of 2006, our $10 million credit facility was amended, increasing our line of credit to $25 million. The amendment also modified certain restrictive covenants in the agreement to be based on EBITDA and a debt coverage ratio. As of December 30, 2006, we were in compliance with these covenants.

We believe that current cash balances, cash provided by operations, and amounts available under the line of credit are sufficient to cover our capital needs in the ordinary course of business for the foreseeable future. If we experience an adverse operating environment or unusual capital expenditure requirements, additional financing may be required. However, no assurance can be given that additional financing, if

required, would be available on favorable terms. We might also require or seek additional financing for the purpose of expanding new markets, growing our existing markets, and for other reasons. Such financing may include the sale of additional equity securities. Any financing which involves the sale of equity securities or instruments convertible into equity securities could result in immediate and possibly significant dilution to existing shareholders.

Contractual Obligations and Commercial Contingencies

The following table summarizes our expected contractual obligations and commitments subsequent to December 30, 2006:

Payments Due By Period
(in thousands)

Contractual Obligations	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Operating Leases	$ 18,663	$ 3,668	$ 10,505	$ 4,490	$
Capital Commitments	14,745	14,745			
Other Commitments	6,104	2,700	2,583	821	
Total Contractual Obligations	$ 39,512	$ 21,113	$ 13,088	$ 5,311	$

Obligations for Operating Leases in the above table contain the assumption that, in the normal course of business, any facility leases that expire within the time frame represented will be renewed or replaced by leases on other properties, assuming operations continue and will extend, at a maximum, through 2011.

Included in Capital Commitments in the above table is the remaining $8.9 million for the expansion to our corporate headquarters building. We expect this construction to be complete by the end of 2007, at an estimated total cost of approximately $16 million. Also included in Capital Commitments is the remaining $5.0 million due upon possession of the Australian facility.

Inflation

We do not believe that inflation has had a material impact on our historical operations or profitability.

Critical Accounting Estimates

Our Consolidated Financial Statements included in this report have been prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP). Our significant accounting policies are described in Note A to the Consolidated Financial Statements. The preparation of financial statements in accordance with US GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying footnotes. Those estimates and assumptions are derived and continually evaluated based on historical experiences, current facts and circumstances, and changes in the business environment. However, actual results may sometimes differ materially from estimates under different conditions. Critical accounting estimates are defined as both those that are material to the portrayal of our financial condition and results of operations, and those that require management s most subjective judgments. We believe our most critical accounting estimates are as described in this section.

Revenue Recognition.

- In accordance with Staff Accounting Bulletin 104, Revenue Recognition, revenue is recognized at the point of shipment of the merchandise, at which point the risks and rewards of ownership have passed to the customer. SAB 104 specifies that revenue is realizable when the

following four criteria are met: persuasive evidence of a sale arrangement exists, delivery of the product has occurred, the price is fixed or determinable, and payment is reasonably assured. For our Direct Selling segment, we require cash or credit card payment prior to shipping and do not extend credit to customers.

- Payments received for unshipped products are recorded as deferred revenue and are included in other current liabilities.

- A provision for product returns and allowances is provided for and is founded on historical experience.

- In addition, Emerging Issues Task Force No 00-10, Accounting of Shipping and Handling Fees and Costs, states amounts billed to customers for shipping and handling are classified as revenue.

- In accordance with the guidelines of Emerging Issues Task Force No 01-09, Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor s Products), commissions paid to a purchasing Associate on his or her own orders will be captured and reported as a reduction to net sales in the form of sales discounts. Management estimates, based on the structure of USANA s compensation plan, that an Associate who places an order with sales volume points in a personal sales position will eventually be paid commission on that purchase. Reduction of revenue for personal sales positions for Associates outside of the United States is converted to U.S. Dollars at the average exchange rate for the period. Application of EITF 01-09 for commission paid on an Associate s own orders resulted in reductions to previously reported net sales by 1.3% and 1.4% during 2004 and 2005, respectively. In addition, 2006 reported net sales were 1.6% lower than what would have been otherwise reported had this change not been implemented.

- Also, we collect an annual renewal fee from our Associates that is deferred when collected and recognized as income on a straight-line basis over a subsequent twelve-month period.

Allowance for Inventory Valuation. Inventories are stated at the lower of cost or market, using the first-in, first-out method. The components of inventory cost include raw materials, labor, and overhead. An allowance for inventory valuation is maintained and is based on the difference between the cost of the inventory and its estimated market value. To estimate the allowance, various assumptions are made in regard to excess or slow moving inventories, non-conforming inventories, expiration dates, current and future product demand, production planning, and market conditions. A change in any of these variables could result in additional reserves.

Valuation of Goodwill and Impairment Analysis. Goodwill represents the excess of purchase price paid over the fair market value of identifiable net assets of companies acquired. In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, goodwill is not amortized; however, it is tested at least annually for impairment or more frequently if events or changes in circumstances indicate impairment. We engage an independent third-party to conduct the annual impairment test of goodwill. We determine the fair market value of reporting units acquired using widely accepted valuation methods, including both a market approach and an income approach. The market approach involves judgment when considering the appropriateness of comparable entities and use of related multiples to determine fair market value, in terms of operating activities, size, and scope. The income approach requires the use of estimates and assumptions in projecting future operating results and related cash flows. Based on the valuation conducted as part of the impairment test, if a significant downward revision were made in estimates and assumptions that resulted in a fair market value for the reporting unit that was less than its carrying value, an impairment loss for goodwill would be necessary to reduce the carrying amount of goodwill related to

the entity. There were no changes in the carrying amount of goodwill for each of the acquired subsidiaries for the year ended December 30, 2006.

Accounting for Income Taxes. We calculate income taxes in each of the jurisdictions in which we operate in accordance with SFAS No. 109, Accounting for Income Taxes. This process involves estimating our current tax exposure, together with assessing temporary differences for items treated differently for tax and financial reporting. Judgment is required in assessing the future tax consequences of events that have been recognized in our financial statements or tax returns. Variations in the actual outcome of these future tax consequences could materially impact our financial position, results of operations, or cash flows. Accruals for tax contingencies are provided for in accordance with the requirements of SFAS No. 5, Accounting for Contingencies.

On an interim basis, we estimate what our effective tax rate will be for the full fiscal year and record a quarterly income tax provision in accordance with the anticipated annual rate. As the fiscal year progresses, we continually refine our estimate based upon actual events and earnings by jurisdiction during the year. This estimation process periodically results in changes to our expected effective tax rate for the fiscal year. When this occurs, we adjust the income tax provision during the quarter in which the change in estimate occurs so that the year-to-date provision equals the expected annual rate.

In June 2006, the FASB issued FIN No. 48, Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109, which clarifies the accounting for uncertainty in income tax positions. FIN 48 defines the threshold for recognizing tax return positions in the financial statements as more likely than not that the position is sustainable, based on technical merits of the provision. FIN 48 also provides guidance on the measurement, classification and disclosure of tax return positions in the financial statements. FIN 48 is effective for the first reporting period beginning after December 15, 2006, with the cumulative effect of the change in accounting principle recorded as an adjustment to the beginning balance of retained earnings in the period of adoption. The Company s accounting for income tax contingency reserves is not based on the provisions of FIN 48 because its financial statements for the year-ended December 30, 2006 have been issued without the early adoption of the provisions of this interpretation. The Company is currently evaluating the impact of adopting FIN 48 on its consolidated financial statements.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

We conduct business in several countries and intend to continue to expand our foreign operations. Net sales, earnings from operations, and net earnings are affected by fluctuations in currency exchange rates, interest rates, and other uncertainties inherent in doing business and selling product in more than one currency. In addition, our operations are exposed to risks associated with changes in social, political, and economic conditions inherent in foreign operations, including changes in the laws and policies that govern foreign investment in countries where we have operations, as well as, to a lesser extent, changes in United States laws and regulations relating to foreign trade and investment.

Foreign Currency Risks. Consolidated net sales outside the United States represented 54.5%, 55.9%, and 54.9% of net sales in 2004, 2005, and 2006, respectively. Inventory purchases are transacted primarily in U.S. dollars from vendors located in the United States. The local currency of each international subsidiary is considered the functional currency, with all revenue and expenses being translated at weighted-average exchange rates for reported periods. In general, our reported sales and earnings are affected positively by a weakening U.S. dollar and negatively by a strengthening of the U.S. dollar. Changes in currency exchange rates affect the relative prices at which we sell our products. Given the uncertainty of exchange rate fluctuations, we cannot estimate the effect of these fluctuations on our future business, product pricing, results of operations, or financial condition.

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We seek to reduce exposure to fluctuations in foreign exchange rates by creating offsetting positions through the use of foreign currency exchange contracts. We do not use derivative financial instruments for trading or speculative purposes. Our strategy in this regard includes entering into foreign currency exchange contracts to manage currency fluctuations in our expected net cash flow from certain of our international markets, which are primarily represented by intercompany cash transfers. As of December 30, 2006, we had contracts in place to offset exposure to the Canadian Dollar, Australian Dollar, New Zealand Dollar, New Taiwan Dollar, and Mexican Peso. For additional disclosure regarding outstanding foreign currency forwards and options, see Note J of the Consolidated Financial Statements included in this report. There can be no assurance that our practices will be successful in eliminating all or substantially all of the risks encountered in connection with our foreign currency transactions.

Following are the average exchange rates of foreign currency units to one U.S. dollar for each of our foreign markets for fiscal years 2004, 2005, and 2006:

	Year ended		
	2004	**2005**	**2006**
Canadian Dollar	1.30	1.21	1.13
Australian Dollar	1.36	1.31	1.33
New Zealand Dollar	1.51	1.42	1.54
Hong Kong Dollar	7.80	7.78	7.77
Japanese Yen	108.10	109.95	116.27
New Taiwan Dollar	33.34	32.13	32.52
Korean Won	1,144.07	1,023.94	954.46
Singapore Dollar	1.69	1.66	1.59
Mexican Peso(1)	11.35	10.89	10.90
Chinese Yuan(2)	*	8.08	7.97

(1) The 2004 Mexican Peso exchange rate represents the average for the first ten months of Mexican operations that commenced in March 2004.

(2) The 2005 Chinese Yuan exchange rate represents the average for the first three months of operations of our Chinese manufacturing facility acquired in October 2005.

* Market was not in operation during year indicated.

Interest Rate Risks. As of December 30, 2006, we had no outstanding debt, and, therefore, we currently have no direct exposure to interest rate risk.

Item 8. Financial Statements and Supplementary Data

The Financial Statements and Supplementary Data required by this Item are set forth at the pages indicated at Item 15.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized, and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the

disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures.

As of the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a- 15(e) under the Securities Exchange Act of 1934, as amended). Based on the foregoing, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures were effective.

Management s Report on Internal Control Over Financial Reporting

The management of USANA Health Sciences, Inc. (the Company) is responsible for establishing and maintaining adequate internal control over financial reporting, (as defined in Rule 13a- 15(f) under the Securities Exchange Act of 1934, as amended). The Company s internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company s financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company,

- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company, and

- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

The Company s management assessed the effectiveness of the Company s internal control over financial reporting as of December 30, 2006. In making this assessment, the Company s management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control Integrated Framework*. Based on its assessment, management believes that, as of December 30, 2006, the Company s internal control over financial reporting is effective based on those criteria.

Management s assessment of the effectiveness of internal control over financial reporting as of December 30, 2006, has been audited by Grant Thornton, LLP, the independent registered public accounting firm who also audited the Company s Consolidated Financial Statements. Grant Thornton s attestation report on management s assessment of the Company s internal control over financial reporting appears elsewhere in this report under the heading Report of Independent Certified Public Accountants .

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the quarter ended December 30, 2006 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Board of Directors and Stockholders
USANA Health Sciences, Inc. and Subsidiaries

We have audited management s assessment, included in the accompanying Management s Report on Internal Control Over Financial Reporting, that USANA Health Sciences, Inc. and Subsidiaries (the Company) maintained effective internal control over financial reporting as of December 30, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management s assessment that USANA Health Sciences, Inc. and Subsidiaries maintained effective internal control over financial reporting as of December 30, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, USANA Health Sciences, Inc and Subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 30, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of USANA Health Sciences, Inc. and Subsidiaries as of December 31, 2005 and December 30, 2006, and the related consolidated statements of earnings, stockholders equity and comprehensive income, and cash flows for each of the three years in the period ended December 30, 2006 and our report dated February 19, 2007 expressed an unqualified opinion on those financial statements.

/s/ GRANT THORNTON LLP

Salt Lake City, Utah
February 19, 2007

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information for this Item is incorporated by reference to the definitive proxy statement to be filed pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended.

Item 11. Executive Compensation

The information for this Item is incorporated by reference to the definitive proxy statement to be filed pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information for this Item is incorporated by reference to the definitive proxy statement to be filed pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information for this Item is incorporated by reference to the definitive proxy statement to be filed pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended.

Item 14. Principal Accounting Fees and Services

The information for this Item is incorporated by reference to the definitive proxy statement to be filed pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended.

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) The following documents are filed as part of this Form:

1. *Financial Statements*

Report of Independent Registered Public Accounting Firm	F-1
Consolidated Balance Sheets	F-2
Consolidated Statements of Earnings	F-3
Consolidated Statements of Stockholders Equity and Comprehensive Income	F-4
Consolidated Statements of Cash Flows	F-5
Notes to the Consolidated Financial Statements	F-6

Quarterly Financial Data (unaudited) (included in Note N of the Notes to the Consolidated Financial Statements)

2. *Financial Statement Schedules.* [Those that are required are included in the Consolidated Financial Statements or Notes thereto.]

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3. *Exhibits.*

Exhibit Number	Description
3.1	Amended and Restated Articles of Incorporation (Incorporated by reference to Current Report on Form 8-K, filed April 25, 2006)
3.2	Bylaws (Incorporated by reference to Current Report on Form 8-K, filed April 25, 2006)
4.1	Specimen Stock Certificate for Common Stock, no par value (Incorporated by reference to Registration Statement on Form 10, File No. 0-21116, effective April 16, 1993)
10.1	2002 USANA Health Sciences, Inc. Stock Option Plan (Incorporated by reference to Registration Statement on Form S-8, filed July 18, 2002)*
10.2	Credit Agreement by and between Bank of America, N.A. and USANA Health Sciences, Inc. (Incorporated by reference to Report on Form 10-Q for the period ended July 3, 2004)
10.3	Amendment dated May 17, 2006 to Credit Agreement dated June 16, 2004 (Incorporated by reference to Report on Form 8-K filed April 25, 2006)
10.4	USANA Health Sciences, Inc. 2006 Equity Incentive Award Plan (Incorporated by reference to Report on Form 8-K, filed April 25, 2006)*
10.5	Form of Stock Option Agreement for award of non-statutory stock options to employees under the USANA Health Sciences, Inc. 2006 Equity Incentive Award Plan (Incorporated by reference to Report on Form 8-K, filed April 26, 2006)*
10.6	Form of Stock Option Agreement for award of non-statutory stock options to directors who are not employees under the USANA Health Sciences, Inc. 2006 Equity Incentive Award Plan (Incorporated by reference to Report on Form 8-K, filed April 26, 2006)
10.7	Form of Incentive Stock Option Agreement under the USANA Health Sciences, Inc. 2006 Equity Incentive Award Plan (Incorporated by reference to Report on Form 8-K, filed April 26, 2006)*
10.8	Form of Stock-Settled Stock Appreciation Rights Award Agreement for employees under the USANA Health Sciences, Inc. 2006 Equity Incentive Award Plan (Incorporated by reference to Report on Form 8-K, filed April 26, 2006)*
10.9	Form of Stock-Settled Stock Appreciation Rights Award Agreement for directors who are not employees under the USANA Health Sciences, Inc. 2006 Equity Incentive Award Plan (Incorporated by reference to Report on Form 8-K, filed April 26, 2006)
10.10	Form of Deferred Stock Unit Award Agreement for grants of deferred stock units to directors who are not employees under the USANA Health Sciences, Inc. 2006 Equity Incentive Award Plan (Incorporated by reference to Report on Form 8-K, filed April 26, 2006)
10.11	Form of employee or director non-statutory stock option agreement under the 2002 Stock Option Plan (Incorporated by reference to Report on Form 10-K, filed March 6, 2006)*
10.12	Form of employee incentive stock option agreement under the 2002 Stock Option Plan (Incorporated by reference to Report on Form 10-K, filed March 6, 2006)*
11.1	Computation of Net Income per Share (included in Notes to Consolidated Financial Statements)
14	Code of Ethics of USANA Health Sciences, Inc. (Posted on the Company s internet web site at www.usanahealthsciences.com)

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21	Subsidiaries of the Registrant, as of February 28, 2007 (Filed herewith)
23	Consent of Independent Registered Public Accounting Firm (Filed herewith)
31.1	Certification of Chief Executive Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002 (Filed herewith)
31.2	Certification of Chief Financial Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002 (Filed herewith)
32.1	Certification of Chief Executive Officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350 (Filed herewith)
32.2	Certification of Chief Financial Officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350 (Filed herewith)

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* Denotes a management contract or compensatory plan or arrangement.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

	USANA HEALTH SCIENCES, INC.	
	By:	/s/ MYRON W. WENTZ
		Myron W. Wentz, PhD,
		Chairman and Chief Executive Officer

Date: March 8, 2007

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ MYRON W. WENTZ Myron W. Wentz, PhD	Chairman and Chief Executive Officer (Principal Executive Officer)	March 8, 2007
/s/ DAVID A. WENTZ David A. Wentz	President	March 8, 2007
/s/ RONALD S. POELMAN Ronald S. Poelman	Director	March 8, 2007
/s/ ROBERT ANCIAUX Robert Anciaux	Director	March 8, 2007
/s/ DENIS E. WAITLEY Denis E. Waitley, PhD	Director	March 8, 2007
/s/ JERRY G. MCCLAIN Jerry G. McClain	Director	March 8, 2007
/s/ GILBERT A. FULLER Gilbert A. Fuller	Executive Vice President and Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	March 8, 2007

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REPORT OF INDEPENDENT
REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
USANA Health Sciences, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of USANA Health Sciences, Inc. and Subsidiaries (the Company) as of December 31, 2005 and December 30, 2006, and the related consolidated statements of earnings, stockholders equity and comprehensive income, and cash flows for each of the three years in the period ended December 30, 2006. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of USANA Health Sciences, Inc. and Subsidiaries as of December 31, 2005 and December 30, 2006, and the consolidated results of their operations and their consolidated cash flows for each of the three years in the period ended December 30, 2006 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note A to the consolidated financial statements, the Company adopted Statement 123R, Share-Based Payment, on a modified prospective basis as of January 1, 2006.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of USNA Health Sciences, Inc. and Subsidiaries internal control over financial reporting as of December 30, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 19, 2007 expressed an unqualified opinion.

/s/ GRANT THORNTON LLP

Salt Lake City, Utah
February 19, 2007

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands)

	December 31, 2005	December 30, 2006
ASSETS		
Current assets		
Cash and cash equivalents	$ 10,579	$ 27,029
Inventories	22,223	22,483
Prepaid expenses and other current assets	6,024	8,908
Deferred income taxes	3,004	2,195
Total current assets	41,830	60,615
Property and equipment, net	23,302	30,323
Goodwill	5,690	5,690
Other assets	2,886	3,374
	$ 73,708	$ 100,002
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 4,955	$ 10,241
Other current liabilities	21,601	29,564
Total current liabilities	26,556	39,805
Long-term liabilities	1,414	
Stockholders equity		
Common stock, $0.001 par value; authorized 50,000 shares, issued and outstanding 18,343 as of December 31, 2005 and 17,859 as of December 30, 2006	18	18
Additional paid-in capital	9,161	15,573
Retained earnings	35,720	44,251
Accumulated other comprehensive income	839	355
Total stockholders equity	45,738	60,197
	$ 73,708	$ 100,002

The accompanying notes are an integral part of these statements.

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USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS
(in thousands, except per share data)

	Year ended 2004	2005	2006
Net sales	$ 269,351	$ 323,089	$ 374,190
Cost of sales	66,822	78,016	89,545
Gross profit	202,529	245,073	284,645
Operating expenses:			
Associate incentives	100,960	124,045	146,251
Selling, general, and administrative	54,692	60,326	72,854
Research and development	2,031	2,339	3,197
Total operating expenses	157,683	186,710	222,302
Earnings from operations	44,846	58,363	62,343
Other income (expense):			
Interest income	572	561	654
Interest expense		(12)	(110)
Other, net	(339)	(62)	867
Other income	233	487	1,411
Earnings before income taxes	45,079	58,850	63,754
Income taxes	14,302	19,856	22,488
Net earnings	$ 30,777	$ 38,994	$ 41,266
Earnings per common share			
Basic	$ 1.61	$ 2.07	$ 2.29
Diluted	$ 1.51	$ 1.98	$ 2.20
Weighted average common shares outstanding			
Basic	19,163	18,873	18,053
Diluted	20,415	19,721	18,724

The accompanying notes are an integral part of these statements.

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME
Years ended January 1, 2005; December 31, 2005; and December 30, 2006
(in thousands)

	Common Stock Shares	Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance at January 3, 2004	19,470	$ 19	$ 14,187	$ 28,935	$ 1,230	$ 44,371
Comprehensive income						
Net earnings for the year				30,777		30,777
Foreign currency translation adjustment, net					245	245
Comprehensive income						31,022
Common stock retired	(1,204)	(1)	(9,724)	(25,216)		(34,941)
Common stock issued under stock option plan, including tax benefit of $5,973	687	1	7,390			7,391
Balance at January 1, 2005	18,953	19	11,853	34,496	1,475	47,843
Comprehensive income						
Net earnings for the year				38,994		38,994
Foreign currency translation adjustment, net					(636)	(636)
Comprehensive income						38,358
Common stock retired	(1,160)	(1)	(11,428)	(37,770)		(49,199)
Common stock issued under stock option plan, including tax benefit of $5,775	550		8,736			8,736
Balance at December 31, 2005	18,343	18	9,161	35,720	839	45,738
Comprehensive income						
Net earnings for the year				41,266		41,266
Foreign currency translation adjustment, net					(484)	(484)
Comprehensive income						40,782
Common stock retired	(1,045)	(1)	(8,222)	(32,735)		(40,958)
Common stock awarded to Associates	2	1	100			101
Equity-based compensation expense			4,789			4,789
Common stock issued under stock option plan, including tax benefit of $6,198	559		9,745			9,745
Balance at December 30, 2006	17,859	$ 18	$ 15,573	$ 44,251	$ 355	$ 60,197

The accompanying notes are an integral part of these statements.

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USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Year ended 2004	**2005**	**2006**
Increase (decrease) in cash and cash equivalents			
Cash flows from operating activities			
Net earnings	$ 30,777	$ 38,994	$ 41,266
Adjustments to reconcile net earnings to net cash provided by operating activities			
Depreciation and amortization	4,840	5,904	5,562
(Gain) loss on sale of property and equipment		10	(1)
Equity-based compensation expense			4,789
Excess tax benefit from equity-based payment arrangements			(4,963)
Common stock awarded to Associates			101
Allowance for inventory valuation	1,732	1,830	2,346
Deferred income taxes	(29)	(631)	(1,304)
Changes in operating assets and liabilities:			
Inventories	(4,832)	(6,420)	(2,224)
Prepaid expenses and other assets	(2,457)	(1,625)	(3,266)
Accounts payable	(208)	(107)	4,374
Other current liabilities	8,360	10,063	13,840
Total adjustments	7,406	9,024	19,254
Net cash provided by operating activities	38,183	48,018	60,520
Cash flows from investing activities			
Acquisitions, net of cash acquired	(2,140)	(1,406)	
Purchases of property and equipment	(6,952)	(4,311)	(11,038)
Increase in notes receivable			(660)
Proceeds from sale of property and equipment	29	19	18
Net cash used in investing activities	(9,063)	(5,698)	(11,680)
Cash flows from financing activities			
Proceeds from stock options exercised	1,418	2,961	3,547
Excess tax benefits from equity-based payment arrangements			4,963
Retirement of common stock	(34,941)	(49,199)	(40,958)
Net cash used in financing activities	(33,523)	(46,238)	(32,448)
Effect of exchange rate changes on cash and cash equivalents	505	(570)	58
Net increase (decrease) in cash and cash equivalents	(3,898)	(4,488)	16,450
Cash and cash equivalents, beginning of year	18,965	15,067	10,579
Cash and cash equivalents, end of year	$ 15,067	$ 10,579	$ 27,029
Supplemental disclosures of cash flow information			
Cash paid during the year for:			
Interest	$	$ 11	$ 6
Income taxes	8,984	15,156	19,040

The accompanying notes are an integral part of these statements.

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USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except per share data)

NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Significant accounting policies consistently applied in the preparation of the accompanying Consolidated Financial Statements follow.

1. *Financial statement presentation*

The accounting and reporting policies of USANA Health Sciences, Inc. and Subsidiaries (the Company) conform with accounting principles generally accepted in the United States of America (US GAAP) and general practices in the manufacturing industry.

2. *Principles of consolidation*

The Consolidated Financial Statements include the accounts and operations of USANA Health Sciences, Inc. and its wholly owned subsidiaries in each of its two business segments. Direct Selling is the Company s primary business segment and includes subsidiaries in North America, which includes the United States, Canada, Mexico, and direct sales to the United Kingdom and the Netherlands, and in Asia Pacific, which includes Australia, New Zealand, Hong Kong, Japan, Taiwan, South Korea, and Singapore. The Company has a relatively small amount of revenue coming through its Contract Manufacturing segment. Operations for the Contract Manufacturing segment are principally conducted in a facility located in Draper, Utah. The Company also owns a facility located in Tianjin, China, which is a small part of the Contract Manufacturing segment. All significant intercompany accounts and transactions have been eliminated in consolidation.

3. *Business activity*

In its Direct Selling segment, the Company develops and manufactures nutritional and personal care products that are distributed through a network marketing system throughout the United States, Canada, Mexico, the United Kingdom, the Netherlands, Australia, New Zealand, Hong Kong, Japan, Taiwan, South Korea, and Singapore. Operations for the Contract Manufacturing segment are conducted primarily at the Company s Draper, Utah facility and also at a facility located in Tianjin, China.

4. *Fiscal year*

The Company operates on a 52-53 week year, ending on the Saturday closest to December 31. Fiscal years 2004, 2005, and 2006 were 52-week years. Fiscal year 2004 covered the period January 4, 2004 to January 1, 2005 (hereinafter 2004). Fiscal year 2005 covered the period January 2, 2005 to December 31, 2005 (hereinafter 2005). Fiscal year 2006 covered the period January 1, 2006 to December 30, 2006 (hereinafter 2006).

5. *Cash and cash equivalents*

The Company considers all highly liquid investments with an original maturity of three months or less, when purchased, to be cash equivalents. The Company is required to maintain cash deposits with banks in certain subsidiary locations for various operating purposes. This cash that is restricted as to withdrawal or usage is segregated from cash and cash equivalents and is reported in other current assets.

6. *Internal software development costs*

Software development costs for internally used software are capitalized beginning when adequate funds are committed and technological feasibility for the project is established up to the time the product is

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(in thousands, except per share data)

NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

ready for use. Amortization of capitalized costs begins when the software is ready for its intended use and after substantially all tests to determine whether the software is operational have been completed. Internally developed software is amortized over the lesser of expected useful life or three to five years.

7. *Inventories*

Inventories consist of raw materials and finished goods and are stated at the lower of cost or market, using the first-in, first-out method.

8. *Depreciation and amortization*

Depreciation is provided in amounts sufficient to relate the cost of depreciable assets to operations over the estimated useful lives. Leasehold improvements are amortized over the shorter of the life of the respective lease or the service life of the improvements. The straight-line method of depreciation and amortization is followed for financial reporting purposes. Maintenance, repairs, and renewals, which neither materially add to the value of the property nor appreciably prolong its life, are charged to expense as incurred. Gains or losses on dispositions of property and equipment are included in earnings. The Company capitalizes assets with a cost in excess of one thousand dollars.

9. *Revenue recognition and deferred revenue*

The Company receives payment, primarily via credit card in the Direct Selling segment, for the sale of products at the time customers place orders. Sales, and shipping and handling billed to customers, are recorded as revenue when the product is shipped and title passes to the customer, net of applicable sales discounts. Payments received for unshipped products are recorded as deferred revenue and are included in other current liabilities. Certain incentives offered to our Associates, including sales discounts, are classified as a reduction of revenue. A provision for product returns and allowances is provided for and is founded on historical experience. Additionally, the Company collects an annual renewal fee from Associates that is deferred on receipt and recognized as income on a straight-line basis over a subsequent twelve-month period.

10. *Goodwill*

Goodwill represents the excess of purchase price paid over the fair market value of identifiable net assets of companies acquired. The Company has adopted SFAS No. 142, Goodwill and Other Intangible Assets, in connection with the goodwill resulting from the acquisitions of Wasatch Products Development, Inc., effective July 2003, and FMG Productions, LLC, effective February 2004. In accordance with SFAS No. 142, goodwill is not amortized; however, it is tested at least annually for impairment or more frequently if events or changes in circumstances indicate impairment.

11. *Income taxes*

The Company accounts for income taxes using the asset and liability method as prescribed by SFAS No. 109, Accounting for Income Taxes. This method requires recognition of deferred tax assets and liabilities for the expected future tax consequences of the differences between the financial statement assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(in thousands, except per share data)

NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

is recognized in income in the period that includes the enactment date. Deferred tax expense or benefit is the result of changes in deferred tax assets and liabilities. The Company evaluates the probability of realizing the future benefits of its deferred tax assets and provides a valuation allowance for the portion of any deferred tax assets where the likelihood of realizing an income tax benefit in the future does not meet the more likely than not criteria for recognition.

12. *Product return policy*

All returned product within the first 30 days of purchase will be refunded at 100% of the sales price to all non-Associate customers. This 30-day return policy is offered to Associates only on their first order. All other returned product that is unused and resalable will be refunded up to one year from the date of purchase at 100% of the sales price, less a 10% restocking fee. Returned product that was damaged during shipment to the customer is 100% refundable. Return of product by an Associate, other than that which was damaged at the time of receipt, may constitute cancellation of the distributorship according to the terms of the Associate Agreement. Returns as a percentage of net sales were 2.1% in 2004, 1.5% in 2005, and 1.6% in 2006.

13. *Research and development*

Research and development costs are charged to expense as incurred.

14. *Advertising*

Advertising costs are charged to expense as incurred.

15. *Earnings per share*

Basic earnings per common share (EPS) are based on the weighted-average number of common shares outstanding during each period. Diluted earnings per common share are based on shares outstanding (computed as under basic EPS) and potentially dilutive common shares. Potential common shares that are included in the diluted earnings per share calculation include in-the-money equity-based awards that have been granted but have not been exercised.

16. *Fair value of financial instruments*

The carrying values of the Company s cash and cash equivalents, accounts receivable, payables, and line of credit approximate fair values due to the short-term maturity of the instruments.

17. *Translation of foreign currencies*

The Company s foreign subsidiaries asset and liability accounts, which are originally recorded in the appropriate local currency, are translated, for consolidated financial reporting purposes, into U.S. dollar amounts at period-end exchange rates. Revenue and expense accounts are translated at the weighted-average rates for the period. Equity accounts are translated at historical rates. Foreign currency translation adjustments are accumulated as a component of other comprehensive income.

18. *Common stock and Additional Paid-in Capital*

The Company records cash received upon the exercise of options by crediting common stock and additional paid-in capital. The Company received $3,547 in cash proceeds from the exercise of stock

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

options in 2006. The Company also realizes an income tax benefit from the exercise of certain stock options. For stock options earned prior to January 1, 2006, this tax benefit resulted in a decrease in current income taxes payable and an increase in additional paid-in capital. In 2006, the total tax benefit recorded in additional paid-in capital was $6,198. For stock options earned after January 1, 2006, the tax benefits are recorded in accordance with SFAS No. 123(R), Share-Based Payment. Under SFAS No. 123(R), the Company establishes deferred tax assets for the value of the stock options. Upon exercise, the deferred tax assets are reversed and the difference between the deferred tax assets and the realized tax benefit creates a tax windfall or shortfall that increases or decreases the additional paid-in capital pool (APIC Pool) explained further in Note K. If the APIC Pool is reduced to zero, additional shortfalls are treated as current tax expense.

The Company has a stock repurchase plan in place that has been authorized by the Board of Directors. As of December 30, 2006, $39,842 was available to repurchase shares under this plan.

19. *Segment information*

The Company s operations involve two reportable business segments; Direct Selling and Contract Manufacturing. The Direct Selling segment constitutes our principal line of business: developing, manufacturing, and distributing nutritional and personal care products through a network marketing system. Operating activities for the Contract Manufacturing segment include the manufacture of the Company s Sensé line of skin and personal care products, and also include contract manufacturing services provided to a limited number of external customers. No Associate within the Direct Selling segment accounted for more than 10% of net segment sales for the years ended 2004, 2005, or 2006. In the Contract Manufacturing segment, we had one customer in 2004, and two customers in both 2005 and 2006 that each accounted for more than 10% of net segment sales.

20. *Use of estimates*

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and the related notes. Significant estimates for the Company include obsolescence, sales returns, and goodwill. Actual results could differ from those estimates.

21. *Foreign currency contracts*

Derivative instruments are carried at fair value. Gains and losses on forward and option contracts that qualify as hedges are deferred and recognized as an adjustment of the carrying amount of the hedged asset, liability, or identifiable foreign currency firm commitment.

Gains and losses on foreign currency exchange and option contracts that do not qualify as hedges are recognized in income based on changes in the fair market value of the contracts.

22. *Equity-Based Compensation*

The Company has applied the disclosure provisions of SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure An Amendment of FASB Statement No. 123, for fiscal years 2004 and 2005. Effective January 1, 2006, the Company adopted the provisions of SFAS No. 123(R) using the modified prospective application. Under this method, compensation expense includes the estimated

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

fair value previously calculated for pro forma disclosures under SFAS No. 148. The pro forma effects on net earnings and earnings per share as if the Company had applied the fair value recognition provisions of SFAS No. 123, as amended by SFAS No. 148, to equity-based compensation for 2004 and 2005, as well as equity-based compensation expense included in the Company s Consolidated Statement of Earnings for 2006, are shown in Note K.

23. *Recent Accounting Pronouncements*

Effective January 1, 2006, we adopted SFAS No. 123(R), Share-Based Payment, which eliminated the use of APB Opinion No. 25. See Note K Equity-Based Compensation for additional information.

Effective January 1, 2006, we adopted SFAS No. 154, Accounting Changes and Error Corrections. SFAS No. 154 replaces APB No. 20, Accounting Changes, and SFAS No. 3, Reporting Accounting changes in Interim Financial Statements, and changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS No. 154 requires retrospective application of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 defines retrospective application as the application of a different accounting principle to prior accounting periods as if that principle had always been used or as the adjustment of previously issued financial statements to reflect a change in the reporting entity. SFAS No. 154 also redefines restatement as the revising of previously issued financial statements to reflect the correction of an error. The adoption of SFAS No. 154 has not had a material impact on our financial position or results of operations.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States, and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, with earlier application encouraged. Any amounts recognized upon adoption as a cumulative effect adjustment will be recorded to the opening balance of retained earnings in the year of adoption. The Company is currently evaluating the impact of adopting SFAS No. 157 on its Consolidated Financial Statements.

In June 2006, the FASB issued FIN No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109,* which clarifies the accounting for uncertainty in income tax positions. FIN 48 defines the threshold for recognizing tax return positions in the financial statements as more likely than not that the position is sustainable, based on technical merits of the provision. FIN 48 also provides guidance on the measurement, classification and disclosure of tax return positions in the financial statements. FIN 48 is effective for the first reporting period beginning after December 15, 2006, with the cumulative effect of the change in accounting principle recorded as an adjustment to the beginning balance of retained earnings in the period of adoption. The Company s accounting for income tax contingency reserves is not based on the provisions of FIN 48 because its financial statements for the year-ended December 30, 2006 have been issued without the early adoption of the provisions of this interpretation. The Company is currently evaluating the impact of adopting FIN 48 on its Consolidated Financial Statements.

In June 2006, the FASB ratified the consensuses of Emerging Issues Task Force (EITF) Issue No. 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Presented in the Income Statement (That Is, Gross versus Net Presentation). EITF 06-3 clarifies that the scope of this Issue includes any tax assessed by a governmental authority that is imposed concurrently with or subsequent to a revenue-producing transaction between a seller and a customer and indicates that the income statement presentation on either a gross basis or a net basis of the taxes within the scope of the Issue is an accounting policy decision that should be disclosed. Furthermore, for taxes reported on a gross basis, an enterprise should disclose the amounts of those taxes in interim and annual financial statements for each period for which an income statement is presented. The consensus is effective, through retrospective application, for periods beginning after December 15, 2006. The Company currently presents taxes on a net basis within the scope of this issue.

In September 2006, the SEC issued Staff Accounting Bulletin 108 (SAB 108) Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. SAB 108 provides guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB 108 requires registrants to quantify the impact of correcting misstatements on the current year financial statements using both the rollover and iron curtain approaches. The rollover approach quantifies a misstatement based on the amount of the error originating in the current year income statement. The iron curtain approach quantifies a misstatement based on the effects of correcting the misstatement existing in the balance sheet at the end of the current year, irrespective of the misstatement s year(s) of origination. The Company was required to adopt the provisions of SAB 108 for its fiscal year ending December 30, 2006. The adoption of SAB 108 did not have a material effect on our financial position or results of operations.

24. *Reclassification*

Minor reclassifications relating to net sales and Associate incentives expense have been made to the Company s financial statements in order to comply with EITF 01-09. Under these guidelines, certain incentives offered to our Associates are classified as sales discounts, resulting in a reduction of revenue with a corresponding reduction to Associate incentives. Historical net sales and Associate incentives expense numbers reflected throughout this document have been adjusted for comparability purposes. The impact of this reclassification reduced previously reported net sales by 1.3% and 1.4% during 2004 and 2005, respectively. In addition, 2006 reported net sales were 1.6% lower than what would have been otherwise reported had this change not been implemented. These minor reclassifications had no effect on our earnings from operations, net earnings, or earnings per share.

NOTE B ACQUISITIONS

2005 Acquisitions

In October 2005, the Company acquired a manufacturing facility in Tianjin, China for $1,406 in cash. The purchase was made through a newly formed wholly owned subsidiary of the Company.

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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NOTE B ACQUISITIONS (Continued)

The assets acquired were recorded at estimated fair values as of the date of the acquisition as determined by the Company s management and are summarized below:

	At October 2, 2005
Assets acquired	
Inventories	$ 45
Property and equipment	1,165
Intangible asset	196
Total assets acquired	1,406
Net assets acquired	$ 1,406

In accordance with SFAS No. 141, we have recognized a contract-based intangible asset in relation to employment contracts with the previous owners of the facility. The intangible asset will be amortized over the life of the contracts, which is 36 months from the date of acquisition.

2004 Acquisitions

In February 2004, the Company completed the acquisition of the net assets of FMG Productions, LLC (FMG), a Utah limited liability company that produces video and audio promotional and training materials for large companies and sales organizations, including the Company. The aggregate investment was $2,140, including $2,060 in cash and $80 for professional fees that were directly associated with the acquisition. The purchase was made through a newly formed wholly owned subsidiary of the Company, which operates the business formerly conducted by FMG. The former employees of FMG, including its founders and primary creative directors continue to operate the business now owned by USANA. The Company benefits from this acquisition principally through the materials produced by FMG for the motivation and training of its independent Associates.

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(in thousands, except per share data)

NOTE B ACQUISITIONS (Continued)

The assets acquired and liabilities assumed were recorded at estimated fair values as of the date of the acquisition as determined by the Company s management and are summarized below:

	At February 1, 2004
Assets acquired	
Accounts receivable	$ 133
Property and equipment	790
Goodwill	1,423
Total assets acquired	2,346
Liabilities assumed	
Accounts payable	23
Deferred revenue	94
Other liabilities	89
Total liabilities assumed	206
Net assets acquired	$ 2,140

Goodwill for this acquisition has been recognized in the amount of $1,423, which is the excess of the purchase price paid over the fair market value of the net assets acquired. In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, goodwill is not amortized; however, it is tested at least annually for impairment.

NOTE C INVENTORIES

Inventories consist of the following:

	December 31, 2005	December 30, 2006
Raw materials	$ 9,772	$ 8,073
Work in progress	3,437	4,227
Finished goods	9,014	10,183
	$ 22,223	$ 22,483

NOTE D PREPAID EXPENSES AND OTHER CURRENT ASSETS

Prepaid expenses and other current assets consist of the following:

	December 31, 2005	December 30, 2006
Prepaid expenses	$ 2,038	$ 2,150
Miscellaneous receivables, net	3,537	5,082
Other current assets	449	1,676
	$ 6,024	$ 8,908

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(in thousands, except per share data)

NOTE E INCOME TAXES

Income tax expense (benefit) consists of the following:

	Year ended 2004	2005	2006
Current			
Federal	$ 12,509	$ 17,411	$ 19,521
State	1,693	1,821	2,265
Foreign	171	1,209	2,033
	14,373	20,441	23,819
Deferred			
Federal	(17)	76	(1,796)
State	(1)	5	(127)
Foreign	(53)	(666)	592
	$ 14,302	$ 19,856	$ 22,488

The income tax provision, reconciled to the tax computed at the federal statutory rate of 35% for 2004, 2005, and 2006 is as follows:

	Year ended 2004	2005	2006
Federal income taxes at statutory rate	$ 15,777	$ 20,598	$ 22,314
State income taxes, net of federal tax benefit	1,275	1,576	1,351
Difference between U.S. statutory rate and foreign rate	(19)	29	14
Foreign taxes net of foreign tax credit	149	86	195
Extraterritorial income exclusion	(1,731)	(1,875)	(1,370)
Qualified production activities deduction		(343)	(332)
R&D tax credit	(321)	(418)	(598)
Prior period foreign country tax settlement	(481)		
Equity-based compensation incentive stock options			234
Non-deductible VAT Expense			406
All other, net	(347)	203	274
	$ 14,302	$ 19,856	$ 22,488

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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NOTE E INCOME TAXES (Continued)

Deferred tax assets and liabilities consist of the following:

	December 31, 2005	December 30, 2006
Current deferred tax assets (liabilities)		
Inventory capitalization	$ 429	$ 480
Intercompany sales	128	255
Deferred revenue	325	
Prepaid expenses		(583)
Vacation accrual	254	355
Inventory reserve	1,001	1,015
Allowance for bad debts	95	154
Sales returns and allowances	344	354
Foreign net operating loss carryforward	93	
All other, net	335	165
	$ 3,004	$ 2,195
Long-term deferred tax assets (liabilities)		
Accumulated depreciation/amortization	$ (790)	$ (124)
Accumulated other comprehensive income	(481)	(353)
Equity based compensation		1,350
All other, net	7	2
	$ (1,264)	$ 875

During 2006, the Company elected to change its method of accounting to deduct certain prepaid expenses in the year of payment in accordance with Internal Revenue Service guidelines. The Company recorded a current deferred tax liability of $583 in connection with this change. Also, a long-term deferred tax asset of $1,350 was established in 2006 for equity-based compensation in accordance with SFAS No. 123(R).

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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NOTE F PROPERTY AND EQUIPMENT

	Years	December 31, 2005	December 30, 2006
Buildings	40	$ 10,377	$ 10,682
Laboratory and production equipment	5-7	9,706	10,863
Sound and video library	5	600	600
Computer equipment and software	3-5	23,083	23,365
Furniture and fixtures	3-5	2,654	2,719
Automobiles	3-5	248	242
Leasehold improvements	3-5	2,709	2,834
Land improvements	15	931	931
		50,308	52,236
Less accumulated depreciation and amortization		29,605	33,330
		20,703	18,906
Land		2,064	2,070
Deposits and projects in process		535	9,347
		$ 23,302	$ 30,323

NOTE G GOODWILL

Goodwill represents the excess of the purchase price paid of acquired entities over the fair market value of the net assets acquired. As of December 30, 2006, goodwill totaled $5,690, comprising $4,267 that was associated with the July 1, 2003 acquisition of Wasatch Products Development (WPD) and $1,423 that was associated with the February 1, 2004 acquisition of FMG. In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, goodwill must be tested at least annually and if the carrying amount of goodwill exceeds its fair value, an impairment loss must be recognized in an amount equal to that excess. Based upon the results of evaluating the carrying value of goodwill for these entities during 2006, the fair market value of the net assets has been determined to be in excess of the carrying amount of the net assets, and, therefore, no impairment loss for goodwill has been recognized.

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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NOTE H OTHER CURRENT LIABILITIES

Other current liabilities consist of the following:

	December 31, 2005	December 30, 2006
Associate incentives	$ 3,528	$ 5,793
Accrued employee compensation	6,257	7,022
Income taxes	2,429	3,095
Sales taxes	2,354	4,031
Associate promotions	616	711
Deferred revenue	1,903	3,092
Provision for returns and allowances	943	947
All other	3,571	4,873
	$ 21,601	$ 29,564

NOTE I LONG TERM DEBT AND LINE OF CREDIT

In June 2004, the Company entered into an agreement with a financial institution to provide a $10,000 two-year revolving line of credit. The term of this agreement extended through May 30, 2006, however, an amendment to the agreement was entered into on May 17, 2006. The amendment increased the Company s line of credit to $25,000, extended its termination to May 30, 2011, and modified certain restrictive covenants in the Agreement.

At December 30, 2006, there were no outstanding balances associated with the line of credit. The Company, therefore, had the entire $25,000 available under the line of credit. The interest rate is computed at the bank s Prime Rate or LIBOR, adjusted by features specified in the Credit Agreement. The Company may choose to borrow at the bank s publicly announced Prime Rate, plus a margin per annum as specified in the Credit Agreement, or, at the option of the Company, loans within the approved commitment may be available in minimum amounts of $100 or more for specific periods ranging from one to three months at LIBOR, plus a margin specified in the Credit Agreement. The collateral for this revolving line of credit is the pledge of the capital stock of certain subsidiaries of the Company. The credit agreement contains restrictive covenants based on EBITDA and a debt coverage ratio. As of December 30, 2006, the Company was in compliance with these covenants.

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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NOTE J COMMITMENTS AND CONTINGENCIES

1. *Operating leases*

With the exception of the Company s headquarters, our facilities are generally leased. Each of the facility lease agreements is a non-cancelable operating lease and expires prior to or during year 2012. The Company utilizes equipment under non-cancelable operating leases, expiring through 2011. The minimum rental commitments under operating leases at December 30, 2006 are as follows:

Year ending	
2007	$ 3,668
2008	3,580
2009	3,506
2010	3,419
2011	3,383
Thereafter	1,106
	$ 18,662

The above amounts contain the assumption that, in the normal course of business, any facility leases that expire within the time frame represented will be renewed or replaced by leases on other properties, assuming operations continue and will extend, at a maximum, through 2011.

Additionally, in January 2007, the Company completed the purchase of a facility in Australia, which will replace the facility currently leased there. The Company expects to move operations to this new facility in late 2007 or early 2008, and will terminate its existing lease at that time. The above amounts contain the assumption that the Company s current lease of the Australia facility will extend through the first quarter of 2008.

These leases generally provide that property taxes, insurance, and maintenance expenses are the responsibility of the Company. The total rent expense for the years ended 2004, 2005, and 2006 was approximately $3,240, $3,230, and $3,412, respectively.

2. *Contingencies*

The Company is involved in various lawsuits and disputes arising in the normal course of business. In the opinion of management, based upon advice of counsel, the ultimate outcome of these lawsuits will not have a material impact on the Company s financial position or results of operations.

3. *Employee Benefit Plan*

The Company has an employee benefit plan under Section 401(k) of the Internal Revenue Code. This plan covers employees who are at least 18 years of age and have been employed by the Company longer than three months. The Company makes matching contributions of 50 cents on each one dollar of contribution up to six percent of the participating employees compensation, subject to the limits of ERISA. In addition, the Company may make a discretionary contribution based on earnings. The Company s matching contributions vest at 25% per year beginning with the first year. Contributions made by the Company to the plan in the United States for the years ended 2004, 2005, and 2006 were $289, $363, and $503, respectively. The 401(k) match balances for 2004, 2005, and 2006 were decreased by $30, $36,

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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NOTE J COMMITMENTS AND CONTINGENCIES (Continued)

and $25, respectively, due to the application of prior year forfeitures of the unvested match balances of terminated employees.

4. *Foreign currency contracts*

In order to reduce the impact of changes in foreign exchange rates on consolidated results of operations and foreign currency denominated cash flows, the Company was a party to various currency option contracts at December 30, 2006. These contracts help the Company manage currency movements affecting existing foreign currency denominated assets, liabilities, and firm commitments.

The fair value of the Company s foreign currency option contracts has been estimated based on year-end quoted market prices, and the resulting asset and expense has been recognized in the Company s Consolidated Financial Statements. The notional contract amount, fair value, and unrealized loss on outstanding foreign currency contracts as of December 30, 2006 are as follows:

	Contract Amount	Fair Value	Gain / (Loss)
Foreign currency contracts	$ 35	$ 10	$ (25)

5. *Commitments*

During 2006, the Company entered into commitments related to projects in process for property, plant, and equipment. As of December 30, 2006, the collective outstanding balance on all such commitments made prior to and through 2006 totaled $14,745, which includes $8,919 for the expansion to the corporate building, which was originally scheduled for completion during 2006, but is now expected to be complete in 2007. Additionally, during the fourth quarter of 2006 the Company entered into an agreement to purchase a facility in Australia. A deposit of $968 was placed on this facility during the fourth quarter of 2006, which left $5,049 remaining on the facility to be paid upon possession of the facility. This remaining amount was included in the commitments as of December 30, 2006, and was paid in full in January 2007.

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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NOTE K EQUITY-BASED COMPENSATION

Effective January 1, 2006, the Company adopted the provisions of SFAS No. 123(R), Share-Based Payment, using the modified prospective application. Under this method, compensation expense includes the estimated fair value of equity awards earned during the reported periods. Expense for equity awards earned is determined based on grant date fair value previously calculated for pro forma disclosures under SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure An Amendment of FASB Statement No. 123. Prior to adopting SFAS No. 123(R) the Company accounted for equity-based compensation using the intrinsic value method under the provisions of APB Opinion No. 25. Equity-based compensation expense recognized for the year ended December 30, 2006, was comprised as follows:

	Year Ended December 30, 2006
Cost of sales	$ 558
Selling, general and administrative	3,710
Research and development	521
	4,789
Related tax benefit	1,544
Net equity-based compensation expense	$ 3,245

The impact of equity-based compensation expense on net earnings and earnings per share for the year ended December 30, 2006 can be found in the pro forma table in this footnote. The following table shows the remaining unrecognized compensation expense on a pre-tax basis related to all types of equity awards outstanding as of December 30, 2006. This table does not include an estimate for future grants that may be issued.

2007	$ 5,481
2008	4,792
2009	2,878
2010	2,268
Thereafter	484
	$ 15,903

The cost above is expected to be recognized over a weighted-average period of 2.2 years.

Prior to the adoption of SFAS No. 123(R), the Company presented all tax benefits resulting from equity-based compensation as cash flows from operating activities in the condensed consolidated statements of cash flows. SFAS No. 123(R) requires cash flows resulting from tax deductions in excess of the grant-date fair value of equity awards to be included in cash flows from financing activities. The excess tax benefits of $4,963 related to equity-based compensation included in cash flows from financing activities during 2006 would have been included in cash flows from operating activities if the Company had not adopted SFAS No. 123(R).

The Company has elected to follow the transition guidance indicated in Paragraph 81 of SFAS No. 123(R) for purposes of calculating the pool of excess tax benefits available to absorb possible future

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(in thousands, except per share data)

NOTE K EQUITY-BASED COMPENSATION (Continued)

tax deficiencies. As such, the Company has calculated its historical APIC Pool of windfall tax benefits using the long-form method.

As permitted by SFAS No. 148, prior to the adoption of SFAS No. 123(R), the Company accounted for equity award expense under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, under which no compensation was recognized in the Company s Consolidated Statements of Earnings for the years ended January 1, 2005, and December 31, 2005. In connection with the modified prospective method, disclosures made for periods prior to the adoption of SFAS No. 123(R) do not reflect restated amounts.

The following table presents equity-based compensation expense included in the Company s financial statements for 2006. Also illustrated are the pro forma effects on net earnings and earnings per share as if the Company had applied the fair value recognition provisions of SFAS No. 123, as amended by SFAS No. 148, to equity-based compensation for 2004 and 2005:

		Year Ended		
		2004	2005	2006
Net earnings	As reported	$ 30,777	$ 38,994	$ 41,266
Add: Compensation cost included in reported net income				3,245
Deduct: Total compensation expense under the fair value method for all awards		(1,637)	(7,614)	(3,245)
Net earnings	Pro forma	$ 29,140	$ 31,380	$ 41,266
Earnings per share basic	As reported	$ 1.61	$ 2.07	$ 2.29
	Pro forma	$ 1.52	$ 1.66	$ 2.29
Earnings per share diluted	As reported	$ 1.51	$ 1.98	$ 2.20
	Pro forma	$ 1.43	$ 1.59	$ 2.20

In 2006, earnings per basic and diluted share were reduced $0.17 from what earnings would have been exclusive of equity-based compensation.

The Company s 2006 Equity Incentive Award Plan (the 2006 Plan), which was approved by the shareholders at the Annual Shareholders Meeting held on April 19, 2006, allows for the grant of various equity awards including stock-settled stock appreciation rights, stock options, deferred stock units, and other types of equity-based awards to the Company s officers, key employees, and non-employee directors. Prior to the approval of the 2006 Plan, the Company maintained the 2002 Stock Option Plan (the 2002 Plan), which was limited to the granting of incentive and non-qualified stock options. Between January 1, 2006 and April 19, 2006, the Company granted options for 175 shares of stock under the 2002 Plan. Options granted under the 2002 Plan generally vest 20% each year on the anniversary of the grant date and expire five to ten years from the date of grant. The 2006 Plan replaces the 2002 Plan for all future grants, and no new awards will be granted under the 2002 Plan. The 2006 Plan authorized 5,000 shares of common

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
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NOTE K EQUITY-BASED COMPENSATION (Continued)

stock for issuance, of which 4,654 shares were available for future issuance as of December 30, 2006. Of the 346 shares granted under the 2006 Plan, 340 were stock-settled stock appreciation rights, 3 were stock options, and 3 were deferred stock units. The Company s Compensation Committee has initially determined that awards to be granted to officers and key employees under the 2006 Plan will generally vest 20% each year on the anniversary of the grant date and expire five to five and one-half years from the date of grant.

Awards of stock options and stock-settled stock appreciation rights to be granted to non-employee directors will generally vest 25% each quarter commencing on the last day of the fiscal quarter in which the awards are granted, and will expire five years to five and one-half years from the date of grant. Awards of deferred stock units are full-value shares at the date of grant, vesting over the periods of service, and do not have expiration dates.

The Company continues to use the Black-Scholes option pricing model to estimate fair value of equity awards, which requires the input of highly subjective assumptions, including the expected stock price volatility. Prior to the implementation of SFAS No. 123(R), expected volatility represented the historical share prices of the Company s common stock over the expected life of the award and the risk-free interest rate was based on the U.S. Treasury yield curve on the date of grant with respect to the expected life of the award. Expected life was based on the contractual term of the award. Grant price was the market value on the date of grant, established by averaging the closing price of the Company s common stock over the five trading days preceding the date of grant.

Preceding the adoption of SFAS No. 123(R), the Company engaged a third-party valuation expert to analyze assumptions used by the Company and to determine changes necessary for a more accurate reflection of the estimated fair value of equity awards granted by the Company. Based on this analysis, the Company decided that, effective January 1, 2006, expected volatility will be calculated by averaging the historical volatility of the Company and a peer group index. The risk-free interest rate will continue to be based on the U.S. Treasury yield curve on the date of grant with respect to the expected life of the award. Also, effective January 1, 2006, due to the plain vanilla characteristics of the Company s stock options, the simplified method, as permitted by the guidance provided in Staff Accounting Bulletin No. 107, will be used to determine expected life while permitted. We estimate that the equity-based compensation expense included in earnings before income taxes for 2006 was decreased by approximately $381 due to the above mentioned changes in volatility and expected life used to estimate fair value of awards granted during 2006. Throughout 2006 we continued to determine market value on the date of grant by averaging the closing price of the Company s common stock over the five trading days preceding the date of grant.

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(in thousands, except per share data)

NOTE K EQUITY-BASED COMPENSATION (Continued)

The following table includes weighted-average assumptions used to calculate the fair value of awards granted during the periods indicated, as well as the weighted-average fair value of awards granted. Deferred stock units are full-value shares at the date of grant and have been excluded from the table below.

	Year Ended 2004	2005	2006
Expected volatility	75.31%	70.37%	57.04%
Risk-free interest rate	3.93%	4.41%	4.81%
Expected life	9.06 yrs.	8.60 yrs.	4.14 yrs.
Expected dividend yield	0.00%	0.00%	0.00%
Weighted-average grant price*	$ 29.30	$ 39.94	$ 38.00
Weighted-average fair value of awards granted	$ 22.88	$ 29.55	$ 18.77

* Awards granted at the market value on the date of grant, established by averaging the closing price of the Company s common stock over the five trading days preceding the date of grant.

The weighted-average fair value and grant price of the deferred stock units granted during 2006 was $37.60.

A summary of the Company s stock option and stock-settled stock appreciation right activity for the year ended December 30, 2006, is as follows:

	Shares	Weighted-average Exercise Price	Weighted-average Remaining Contractual Term	Aggregate Intrinsic Value*
Outstanding at January 3, 2004	2,465	$ 2.34	7.64	$ 67,650
Granted	495	$ 29.30		
Exercised	(688)	$ 2.06		
Canceled or expired	(340)	$ 2.33		
Outstanding at January 1, 2005	1,932	$ 9.35	7.29	$ 48,005
Granted	396	$ 39.94		
Exercised	(551)	$ 5.38		
Canceled or expired	(4)	$ 1.61		
Outstanding at December 31, 2005	1,773	$ 17.43	6.97	$ 37,747
Granted	518	$ 38.00		
Exercised	(559)	$ 6.35		
Canceled or expired	(12)	$ 27.69		
Outstanding at December 30, 2006	1,720	$ 27.15	5.81	$ 42,172
Exercisable at January 1, 2005	303	$ 1.49	6.32	$ 9,895
Exercisable at December 31, 2005	640	$ 20.28	7.71	$ 11,950
Exercisable at December 30, 2006	535	$ 26.37	7.23	$ 13,528

* Aggregate intrinsic value is defined as the difference between the current market value and the exercise price of awards that were in-the-money, and is estimated using the closing price of the Company s common stock on the last trading day of the period.

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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NOTE K EQUITY-BASED COMPENSATION (Continued)

Additional information about stock options and stock-settled stock appreciation rights outstanding and exercisable at December 30, 2006 is summarized as follows:

Options Outstanding				**Options Exercisable**	
Range of exercise prices	**Number outstanding**	**Weighted-average remaining contractual life**	**Weighted-average exercise price**	**Number exercisable**	**Weighted-average exercise price**
$0.74 - $3.92	383	5.2 years	$ 0.90	163	$ 0.77
7.90 - 30.36	426	6.3 years	$ 26.01	60	$ 28.10
32.36 - 37.60	353	4.7 years	$ 37.28	8	$ 35.11
39.14 - 47.23	559	6.6 years	$ 39.61	304	$ 39.54
$0.74 - $47.23	1,720	5.8 years	$ 27.15	535	$ 26.37

Total intrinsic value of awards exercised during 2004, 2005, and 2006, which includes stock options and stock-settled stock appreciation rights, was $19,056, $21,360, and $20,488 respectively.

A summary of the Company s deferred stock unit activity for the year ended December 30, 2006 is as follows:

	Shares	**Weighted-average Fair Value**
Nonvested at December 31, 2005		$
Granted	3	$ 37.60
Vested	(2)	$ 37.60
Canceled or expired		$
Nonvested at December 30, 2006	1	$ 37.60

The total fair value of awards that vested during fiscal years 2004, 2005, and 2006 was $1,018, $12,180, and $3,767, respectively. This total fair value includes equity-based awards issued in the form of stock options, stock-settled stock appreciation rights, and deferred stock units.

NOTE L SEGMENT INFORMATION

The Company s operations are distinguished by regions served and method of distribution employed. Two reportable business segments are recognized by the Company: Direct Selling and Contract Manufacturing. These operating segments are evaluated regularly by management in determining the allocation of resources and in assessing the performance of the Company. Management evaluates performance based on net sales and the amount of operating income or loss. Segment profitability is based on profit or loss from operations before income taxes. All intercompany transactions, intercompany profit, currency gains and losses, interest income and expense, and income taxes are excluded in the Company s determination of segment profit or loss.

Direct Selling

The Direct Selling segment is the Company s principal line of business: developing, manufacturing, and distributing nutritional and personal care products. Products are distributed through a network

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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NOTE L SEGMENT INFORMATION (Continued)

marketing system using independent distributors referred to as Associates. Products are also sold directly to Preferred Customers who purchase products for personal use and are not permitted to resell or distribute the products.

Selected financial information for the Direct Selling segment is reported for two geographic regions: North America and Asia Pacific. North America includes the United States, Canada, and Mexico. All other entities outside of North America are located within the Asia Pacific region, which includes Australia-New Zealand, Hong Kong, Japan, Taiwan, South Korea, and Singapore.

The profitability of each reported region within the Direct Selling segment is representative of what is controllable within that region by local management and is not necessarily indicative of actual profit or loss generated by a fully burdened region. However, the presentation of the data is consistent with how management evaluates each region and respective markets within that region.

Contract Manufacturing

Operating activities for the Contract Manufacturing segment primarily exist for the production of the Company s Sensé line of skin and personal care. In addition to the production of the Sensé product line, contract manufacturing services are provided to a limited number of external customers. This segment includes operations located in Draper, Utah and at the facility in Tianjin, China, which was acquired in October of 2005. Manufacturing and packaging activities for the Company s Sensé products began at the Draper, Utah facility during the fourth quarter of 2003.

In the Contract Manufacturing segment, we had one customer in 2004, and two customers in both 2005 and 2006 that each accounted for more than 10% of segment third-party sales.

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(in thousands, except per share data)

NOTE L SEGMENT INFORMATION (Continued)

Financial information summarized by operating segment and geographic region for the years ended 2004, 2005, and 2006 is listed below:

	Net Sales from External Customers	Intersegment Revenues	Earnings before Income Taxes	Long-lived Assets	Total Assets
Year ended 2004:					
Direct Selling					
North America(1)	$ 172,209	$ 47,096	$ 19,593	$ 21,889	$ 45,591
Asia Pacific	86,831	3,719	17,687	2,829	13,452
Segment total	259,040	50,815	37,280	24,718	59,043
Contract Manufacturing	10,311	2,353	756	6,193	11,741
Reportable segments total	269,351	53,168	38,036	30,911	70,784
Unallocated and other(2)		(53,168)	7,043	(70)	880
Consolidated total	$ 269,351	$	$ 45,079	$ 30,841	$ 71,664
Year ended 2005:					
Direct Selling					
North America(1)	$ 209,445	$ 65,875	$ 33,264	$ 21,142	$ 44,156
Asia Pacific	105,508	5,438	25,698	2,679	12,305
Segment total	314,953	71,313	58,962	23,821	56,461
Contract Manufacturing	8,136	5,794	470	7,746	14,188
Reportable segments total	323,089	77,107	59,432	31,567	70,649
Unallocated and other(2)		(77,107)	(582)	311	3,059
Consolidated total	$ 323,089	$	$ 58,850	$ 31,878	$ 73,708
Year ended 2006:					
Direct Selling					
North America(1)	$ 246,489	$ 67,276	$ 42,679	$ 28,259	$ 67,727
Asia Pacific	118,416	5,409	43,411	3,497	15,699
Segment total	364,905	72,685	86,090	31,756	83,426
Contract Manufacturing	9,285	4,721	(511)	7,637	13,033
Reportable segments total	374,190	77,406	85,579	39,393	96,459
Unallocated and other(2)		(77,406)	(21,825)	(6)	3,543
Consolidated total	$ 374,190	$	$ 63,754	$ 39,387	$ 100,002

(1) Includes results from the FMG subsidiary acquired in February 2004 and operations in Mexico initiated in March 2004.

(2) Unallocated and Other includes certain corporate items and eliminations that are not allocated to the operating segments.

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(in thousands, except per share data)

NOTE L SEGMENT INFORMATION (Continued)

The following table provides further information on markets within the Direct Selling segment representing five percent or more of consolidated net sales:

	Year ended 2004	2005	2006
Net sales:			
United States	$ 112,151	$ 134,227	$ 159,377
Canada	51,800	61,252	69,053
Australia/New Zealand	35,187	44,711	48,316
Taiwan	15,861	20,068	21,168

Due to the centralized structure of our operations at our headquarters in the United States, a significant concentration of assets exist in this market. Long-lived assets in the United States as of December 31, 2005 and December 30, 2006 totaled $20,145 and $26,764, respectively. There is no significant concentration of long-lived assets in any other market.

NOTE M RELATED PARTY TRANSACTIONS

The Company s Founder and Chairman of the Board, Dr. Myron W. Wentz, is the sole beneficial owner of the single largest shareholder of the Company, Gull Holdings, Ltd. Gull Holdings, Ltd. owned 46.23% of the Company s issued and outstanding shares as of December 30, 2006. Dr. Wentz devotes much of his personal time, expertise, and resources to a number of business and professional activities outside of the Company.

The most significant of these is the ownership and operation of Sanoviv. Dr. Wentz describes Sanoviv as a unique, fully integrated health and wellness center. Sanoviv is located near Rosarito, Mexico, and is owned in equal shares by Dr. Wentz and his son, David, President of the Company. Dr. Wentz is the sole administrator of Sanoviv. Prior to July 2002, the Company periodically advanced funds to pay expenses incurred by Dr. Wentz for Sanoviv. The Company has also provided certain services for Sanoviv. These advanced expenses and the value of the services rendered by the Company totaled approximately $9 in 2004, $31 in 2005, and $35 for the year ended December 30, 2006. Each year, these expenses were billed to and reimbursed by Dr. Wentz. Since July 2002, as a result of the passage of the Sarbanes-Oxley Act of 2002, Dr. Wentz has arranged to have a deposit on account to avoid having a loan with the Company. As of December 30, 2006, there were no outstanding amounts due to the Company from Sanoviv or Dr. Wentz. The Company has no commitment or obligation to provide additional funding or support to Sanoviv.

Denis E. Waitley, Ph.D., a director of the Company, has served as a consultant to and spokesperson for USANA since September 1996. During 2004, 2005, and 2006 the Company paid Dr. Waitley consulting fees and royalties totaling $150, $158, and $150, respectively. The consulting contract between the Company and Dr. Waitley pays him $150 per year and expires in September 2008.

Kevin Guest, the Company s Executive Vice President of Marketing, owns and operates Big Sky Sound, Inc. (BSSI), a business specializing in providing audio production equipment and services for various company events. During 2006, the Company utilized the services of BSSI in connection with the

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(in thousands, except per share data)

NOTE M RELATED PARTY TRANSACTIONS (Continued)

production of the 2006 Annual International Convention, and a smaller regional conference held for distributors. The Company paid BSSI $22 for the services related to these events.

NOTE N QUARTERLY FINANCIAL RESULTS (Unaudited)

Summarized quarterly financial information for fiscal years 2004 and 2005 is as follows:

2005	First	Second	Third	Fourth
Net sales	$ 75,527	$ 80,878	$ 81,038	$ 85,646
Gross profit	$ 57,517	$ 61,379	$ 61,278	$ 64,899
Net earnings	$ 8,928	$ 9,543	$ 10,042	$ 10,481
Earnings per share:(1)				
Basic	$ 0.47	$ 0.50	$ 0.53	$ 0.56
Diluted	$ 0.45	$ 0.48	$ 0.51	$ 0.54

2006	First	Second	Third	Fourth
Net sales	$ 88,229	$ 92,482	$ 93,698	$ 99,781
Gross profit	$ 66,891	$ 70,206	$ 71,510	$ 76,038
Net earnings	$ 9,560	$ 10,344	$ 10,223	$ 11,139
Earnings per share:(1)				
Basic	$ 0.52	$ 0.57	$ 0.57	$ 0.62
Diluted	$ 0.50	$ 0.55	$ 0.55	$ 0.61

(1) Earnings per share is computed independently for each of the quarters presented. Therefore, the sum of the quarterly earnings per share amounts does not necessarily equal the total for the year.

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES
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NOTE O EARNINGS PER SHARE

Basic earnings per share are based on the weighted-average number of shares outstanding for each period. Weighted-average shares redeemed during fiscal years 2004, 2005, and 2006 have been included in the calculation of weighted average shares outstanding for basic earnings per share. Diluted earnings per common share are based on shares outstanding (computed under basic EPS) and potentially dilutive shares. Shares included in diluted earnings per share calculations include equity awards that are in the money but have not yet been exercised.

	Year ended 2004	2005	2006
Earnings available to common shareholders	$ 30,777	$ 38,994	$ 41,266
Basic EPS			
Shares			
Common shares outstanding entire period	19,470	18,953	18,343
Weighted average common shares:			
Issued during period	265	270	257
Canceled during period	(572)	(350)	(547)
Weighted average common shares outstanding during period	19,163	18,873	18,053
Earnings per common share basic	$ 1.61	$ 2.07	$ 2.29
Diluted EPS			
Shares			
Weighted average common shares outstanding during period basic	19,163	18,873	18,053
Dilutive effect of in-the-money equity awards	1,252	848	671
Weighted average common shares outstanding during period diluted	20,415	19,721	18,724
Earnings per common share diluted	$ 1.51	$ 1.98	$ 2.20

Equity awards for 195, 17, and 163 shares of stock were not included in the computation of EPS for the years ended 2004, 2005, and 2006, respectively, due to their exercise price being greater than the average market price of the shares.