USANA HEALTH SCIENCES INC
Form 10-Q
August 10, 2011
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

**(Mark One)**

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

**For the quarterly period ended July 2, 2011**

**OR**

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

**For the transition period from to**

**Commission file number: 0-21116**

# USANA HEALTH SCIENCES, INC.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Utah** | **87-0500306** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

**3838 West Parkway Blvd., Salt Lake City, Utah 84120**

(Address of principal executive offices, Zip Code)

**(801) 954-7100**

(Registrant s telephone number, including area code)

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

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

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

| | |
|---|---|
| Large accelerated filer o | Accelerated filer x |
| Non-accelerated filer o | Smaller reporting company o |

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

The number of shares outstanding of the registrant s common stock as of August 1, 2011 was 15,078,394.

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**USANA HEALTH SCIENCES, INC.**

**FORM 10-Q**

**For the Quarterly Period Ended July 2, 2011**

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## PART I. FINANCIAL INFORMATION

### Item 1. Financial Statements

## USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

**(in thousands)**

| | | As of January 1, 2011 (1) | | As of July 2, 2011 (unaudited) |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Current assets | | | | |
| Cash and cash equivalents | $ | 24,222 | $ | 24,944 |
| Inventories | | 34,078 | | 35,381 |
| Prepaid expenses and other current assets | | 20,261 | | 16,325 |
| Deferred income taxes | | 1,711 | | 2,607 |
| Total current assets | | 80,272 | | 79,257 |
| | | | | |
| Property and equipment, net | | 57,568 | | 60,564 |
| | | | | |
| Goodwill | | 16,930 | | 16,930 |
| Intangible assets, net | | 40,616 | | 40,105 |
| Other assets | | 8,416 | | 9,072 |
| | $ | 203,802 | $ | 205,928 |
| | | | | |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | | | |
| Current liabilities | | | | |
| Accounts payable | $ | 6,445 | $ | 8,345 |
| Other current liabilities | | 51,179 | | 46,144 |
| Total current liabilities | | 57,624 | | 54,489 |
| | | | | |
| Other long-term liabilities | | 1,012 | | 1,020 |
| | | | | |
| Stockholders equity | | | | |
| Common stock, $0.001 par value; Authorized 50,000 shares, issued and outstanding 15,985 as of January 1, 2011 and 15,173 as of July 2, 2011 | | 16 | | 15 |
| Additional paid-in capital | | 51,222 | | 46,878 |
| Retained earnings | | 90,207 | | 98,800 |
| Accumulated other comprehensive income | | 3,721 | | 4,726 |
| Total stockholders equity | | 145,166 | | 150,419 |

| | | | | |
|---|---|---|---|---|
| | $ | 203,802 | $ | 205,928 |

(1) Derived from audited financial statements

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)**

**(unaudited)**

| | Quarter Ended | |
|---|---|---|
| | July 3, 2010 | July 2, 2011 |
| Net sales | $ 126,011 | $ 148,925 |
| Cost of sales | 22,735 | 26,208 |
| Gross profit | 103,276 | 122,717 |
| Operating expenses: | | |
| Associate incentives | 57,065 | 67,760 |
| Selling, general and administrative | 29,149 | 33,803 |
| Total operating expenses | 86,214 | 101,563 |
| Earnings from operations | 17,062 | 21,154 |
| Other income (expense): | | |
| Interest income | 16 | 54 |
| Interest expense | (5) | (2) |
| Other, net | (598) | (52) |
| Other expense, net | (587) | |
| Earnings before income taxes | 16,475 | 21,154 |
| Income taxes | 5,705 | 7,298 |
| Net earnings | $ 10,770 | $ 13,856 |
| Earnings per common share | | |
| Basic | $ 0.70 | $ 0.89 |
| Diluted | $ 0.69 | $ 0.88 |
| Weighted average common shares outstanding | | |
| Basic | 15,318 | 15,530 |
| Diluted | 15,697 | 15,752 |

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)**

**(unaudited)**

| | Six Months Ended July 3, 2010 | Six Months Ended July 2, 2011 |
|---|---|---|
| Net sales | $ 245,098 | $ 292,491 |
| Cost of sales | 45,755 | 51,870 |
| Gross profit | 199,343 | 240,621 |
| Operating expenses: | | |
| Associate incentives | 111,183 | 132,567 |
| Selling, general and administrative | 56,607 | 69,673 |
| Total operating expenses | 167,790 | 202,240 |
| Earnings from operations | 31,553 | 38,381 |
| Other income (expense): | | |
| Interest income | 34 | 104 |
| Interest expense | (26) | (8) |
| Other, net | (256) | 5 |
| Other income (expense), net | (248) | 101 |
| Earnings before income taxes | 31,305 | 38,482 |
| Income taxes | 10,894 | 13,276 |
| Net earnings | $ 20,411 | $ 25,206 |
| Earnings per common share | | |
| Basic | $ 1.33 | $ 1.60 |
| Diluted | $ 1.31 | $ 1.58 |
| Weighted average common shares outstanding | | |
| Basic | 15,315 | 15,720 |
| Diluted | 15,609 | 15,964 |

The accompanying notes are an integral part of these statements.

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**USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME**

**Six Months Ended July 3, 2010 and July 2, 2011**

**(in thousands)**

**(unaudited)**

| | Common Stock Shares | Common Stock Value | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total |
|---|---|---|---|---|---|---|
| **For the Six Months Ended July 3, 2010** | | | | | | |
| Balance at January 2, 2010 | 15,309 | $ 15 | $ 16,425 | $ 56,410 | $ 1,523 | $ 74,373 |
| Comprehensive income | | | | | | |
| Net earnings | | | | 20,411 | | 20,411 |
| Foreign currency translation adjustment, net of tax benefit of $317 | | | | | (463) | (463) |
| Comprehensive income | | | | | | 19,948 |
| Equity-based compensation expense | | | 4,140 | | | 4,140 |
| Common stock issued under equity award plans, including tax benefit of $38 | 10 | | 97 | | | 97 |
| Balance at July 3, 2010 | 15,319 | $ 15 | $ 20,662 | $ 76,821 | $ 1,060 | $ 98,558 |
| **For the Six Months Ended July 2, 2011** | | | | | | |
| Balance at January 1, 2011 | 15,985 | $ 16 | $ 51,222 | $ 90,207 | $ 3,721 | $ 145,166 |
| Comprehensive income | | | | | | |
| Net earnings | | | | 25,206 | | 25,206 |
| Foreign currency translation adjustment, net of tax expense of $560 | | | | | 1,005 | 1,005 |
| Comprehensive income | | | | | | 26,211 |
| Equity-based compensation expense | | | 4,802 | | | 4,802 |
| Common stock repurchased and retired | (827) | (1) | (8,725) | (16,613) | | (25,339) |
| Common stock issued under equity award plans, including tax benefit of $49 | 15 | | 88 | | | 88 |
| Tax impact of cancelled vested equity awards | | | (509) | | | (509) |
| Balance at July 2, 2011 | 15,173 | $ 15 | $ 46,878 | $ 98,800 | $ 4,726 | $ 150,419 |

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)**

**(unaudited)**

| | Six Months Ended July 3, 2010 | Six Months Ended July 2, 2011 |
|---|---|---|
| Cash flows from operating activities | | |
| Net earnings | $ 20,411 | $ 25,206 |
| Adjustments to reconcile net earnings to net cash provided by operating activities | | |
| Depreciation and amortization | 3,623 | 4,246 |
| Loss on sale of property and equipment | 7 | 9 |
| Equity-based compensation expense | 4,140 | 4,802 |
| Excess tax benefits from equity-based payment arrangements | (61) | (48) |
| Deferred income taxes | (2,240) | (1,981) |
| Inventory valuation | 601 | 575 |
| Changes in operating assets and liabilities: | | |
| Inventories | (5,781) | (1,136) |
| Prepaid expenses and other assets | 996 | 4,109 |
| Accounts payable | 1,312 | 1,914 |
| Other liabilities | 2,319 | (6,295) |
| Total adjustments | 4,916 | 6,195 |
| Net cash provided by operating activities | 25,327 | 31,401 |
| Cash flows from investing activities | | |
| Proceeds from sale of property and equipment | 4 | 1 |
| Purchases of property and equipment | (3,666) | (5,794) |
| Net cash used in investing activities | (3,662) | (5,793) |
| Cash flows from financing activities | | |
| Proceeds from equity awards exercised | 59 | 39 |
| Excess tax benefits from equity-based payment arrangements | 61 | 48 |
| Repurchase of common stock | | (25,339) |
| Payments on line of credit | (7,000) | |
| Net cash used in financing activities | (6,880) | (25,252) |
| Effect of exchange rate changes on cash and cash equivalents | (16) | 366 |

| | | | | |
|---|---|---|---|---|
| Net increase in cash and cash equivalents | | 14,769 | | 722 |
| Cash and cash equivalents, beginning of period | | 13,658 | | 24,222 |
| Cash and cash equivalents, end of period | $ | 28,427 | $ | 24,944 |
| <u>Supplemental disclosures of cash flow information</u> | | | | |
| Cash paid during the period for: | | | | |
| Interest | $ | 32 | $ | 9 |
| Income taxes | | 12,513 | | 13,483 |

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)**

**(unaudited)**

**Organization, Consolidation, and Basis of Presentation**

USANA Health Sciences, Inc. develops and manufactures high-quality nutritional and personal care products that are sold internationally through a network marketing system, which is a form of direct selling.  The Consolidated Financial Statements include the accounts and operations of USANA Health Sciences, Inc. and its wholly-owned subsidiaries (collectively, the Company or USANA ) in two geographic regions: North America and Asia Pacific, which is further divided into three sub-regions; Southeast Asia/Pacific, Greater China, and North Asia.  North America includes the United States, Canada, Mexico, and direct sales from the United States to the United Kingdom and the Netherlands.  Southeast Asia/Pacific includes Australia, New Zealand, Singapore, Malaysia, and the Philippines; Greater China includes Hong Kong, Taiwan and China; and North Asia includes Japan and South Korea.  All significant inter-company accounts and transactions have been eliminated in this consolidation.

The condensed balance sheet as of January 1, 2011, derived from audited financial statements, and the unaudited interim consolidated financial information of the Company have been prepared in accordance with Article 10 of Regulation S-X promulgated by the Securities and Exchange Commission.  Certain information and footnote disclosures that are normally included in financial statements that have been prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations.  In the opinion of management, the accompanying interim consolidated financial information contains all adjustments, consisting of normal recurring adjustments that are necessary to present fairly the Company s financial position as of July 2, 2011 and results of operations for the quarters and six months ended July 3, 2010 and July 2, 2011.  These financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto that are included in the Company s Annual Report on Form 10-K for the year ended January 1, 2011.  The results of operations for the quarter and six months ended July 2, 2011, may not be indicative of the results that may be expected for the fiscal year 2011 ending December 31, 2011.

**Recent Accounting Pronouncements**

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (ASU 2011-04).  ASU 2011-04 updates existing guidance in Topic 820 to establish common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. Generally Accepted Accounting Principles (U.S. GAAP) and International Financial Reporting Standards (IFRS).  ASU 2011-04 is effective prospectively for fiscal years, and interim periods, beginning after December 15, 2011.  Early adoption is not permitted.  The Company does not expect adoption of this standard to have a material impact on its consolidated financial statements.

In June 2011, the FASB issued Accounting Standards Update No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income (ASU 2011-05).  The objective of ASU 2011-05 is to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. To increase the prominence of items reported in other comprehensive income and to facilitate the convergence of U.S. GAAP and IFRS, ASU 2011-05 eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders equity. Under the amendments in this update, an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Regardless of which option is chosen, items that are reclassified from other comprehensive income to net income must be presented on the face of the financial statements. These amendments do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. Also, the amendments do not change the option for an entity to present components of other comprehensive income either net of related tax effects or before related tax effects, with one amount shown for the aggregate income tax expense or benefit related to the total of other comprehensive income items. ASU 2011-05 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted. The Company does not expect adoption of this standard to have a material impact on its consolidated financial statements.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

**(in thousands, except per share data)**

**(unaudited)**

**NOTE A FAIR VALUE OF FINANCIAL INSTRUMENTS**

The Company reports term deposits in accordance with established authoritative guidance, which requires a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date.

The three levels are defined as follows:

- Level 1 inputs are quoted market prices in active markets for identical assets or liabilities that are accessible at the measurement date.

- Level 2 inputs are from other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly or indirectly.

- Level 3 inputs are unobservable and are used to measure fair value in situations where there is little, if any, market activity for the asset or liability at the measurement date.

The fair values of term deposits placed with banks are determined based on the pervasive interest rates in the market, which are also the interest rates as stated in the contracts with the banks. The Company classifies the valuation techniques that use the pervasive interest rates input as Level 2. The carrying values of these term deposits approximate their fair values due to their short-term maturities. As of July 2, 2011, the fair value of term deposits in the consolidated balance sheet totaled $1,856, consisting of $309, classified in cash and cash equivalents, and $1,547 in prepaid expenses and other current assets.

**NOTE B INVENTORIES**

Inventories consist of the following:

| | | January 1, 2011 | | July 2, 2011 |
|---|---|---|---|---|
| Raw materials | $ | 9,372 | $ | 9,931 |
| Work in progress | | 5,791 | | 5,821 |
| Finished goods | | 18,915 | | 19,629 |
| | $ | 34,078 | $ | 35,381 |

**NOTE C PREPAID EXPENSES AND OTHER CURRENT ASSETS**

Prepaid expenses and other current assets consist of the following:

| | | January 1, 2011 | | July 2, 2011 |
|---|---|---|---|---|
| Prepaid insurance | $ | 1,175 | $ | 660 |
| Other prepaid expenses | | 2,583 | | 3,501 |
| Federal income taxes receivable | | 3,108 | | 1,741 |
| Miscellaneous receivables, net | | 3,735 | | 3,067 |
| Deferred commissions | | 4,867 | | 3,535 |
| Term deposits | | 3,034 | | 1,547 |
| Other current assets | | 1,759 | | 2,274 |
| | $ | 20,261 | $ | 16,325 |

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

**(in thousands, except per share data)**

**(unaudited)**

**NOTE D PROPERTY AND EQUIPMENT**

Cost of property and equipment and their estimated useful lives is as follows:

| | Years | January 1, 2011 | July 2, 2011 |
|---|---|---|---|
| Buildings | 40 | $ 38,732 | $ 39,466 |
| Laboratory and production equipment | 5-7 | 17,723 | 18,517 |
| Sound and video library | 5 | 600 | 600 |
| Computer equipment and software | 3-5 | 27,788 | 29,780 |
| Furniture and fixtures | 3-5 | 4,953 | 4,904 |
| Automobiles | 3-5 | 290 | 292 |
| Leasehold improvements | 3-5 | 5,404 | 5,533 |
| Land improvements | 15 | 2,051 | 2,063 |
| | | 97,541 | 101,155 |
| Less accumulated depreciation and amortization | | 48,298 | 51,898 |
| | | 49,243 | 49,257 |
| Land | | 8,107 | 8,443 |
| Deposits and projects in process | | 218 | 2,864 |
| | | $ 57,568 | $ 60,564 |

**NOTE E OTHER CURRENT LIABILITIES**

Other current liabilities consist of the following:

| | January 1, 2011 | July 2, 2011 |
|---|---|---|
| Associate incentives | $ 11,379 | $ 12,453 |

| | | | | |
|---|---|---|---|---|
| Accrued employee compensation | | 14,395 | | 8,645 |
| Income Taxes | | 1,571 | | 1,731 |
| Sales taxes | | 4,671 | | 4,302 |
| Associate promotions | | 1,491 | | 1,417 |
| Deferred revenue | | 11,772 | | 9,422 |
| Provision for returns and allowances | | 929 | | 898 |
| All other | | 4,971 | | 7,276 |
| | | | | |
| | $ | 51,179 | $ | 46,144 |

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

**(in thousands, except per share data)**

**(unaudited)**

**NOTE F EQUITY BASED COMPENSATION**

Equity-based compensation expense for the quarters ended July 3, 2010, and July 2, 2011, was $2,184 and $1,567, respectively. The related tax benefit for these periods was $787 and $568, respectively. Expense for the six months ended July 3, 2010, and July 2, 2011, was $4,140 and $4,802, respectively. The related tax benefit for these periods was $1,514 and $1,751, respectively.

During the quarter ended July 2, 2011, certain executives left the Company, which resulted in the cancellation of these executives equity awards. The recapture of equity compensation expense related to the cancellation of unvested equity awards reduced equity-based compensation expense for the quarter and six months ended July 2, 2011 by $1,230. The related tax impact for these cancellations was $424.

The following table shows the remaining unrecognized compensation expense on a pre-tax basis for all types of equity awards that were outstanding as of July 2, 2011. This table does not include an estimate for future grants that may be issued.

| | | |
|---|---|---|
| Remainder of 2011 | $ | 5,480 |
| 2012 | | 9,083 |
| 2013 | | 5,457 |
| 2014 | | 3,419 |
| 2015 and beyond | | 1,611 |
| | $ | 25,050 |

The cost above is expected to be recognized over a weighted-average period of 2.1 years.

During the quarter ended July 2, 2011, the Company s shareholders approved a 5,000 increase in the number of new shares authorized for issuance under the Company s 2006 Equity Incentive Award Plan (the 2006 Plan ). This increase brings the total shares authorized under the 2006 Plan to 10,000. The 2006 Plan is currently the only plan utilized by the Company for the issuance of equity awards. As of July 2, 2011, a total of 4,971 units had been issued under this plan, comprising 4,849 stock-settled stock appreciation rights, 114 deferred stock units, and 8 stock options. Also, as of July 2, 2011, 761 units had been cancelled and added back to the number of units available for issuance under the 2006 Plan.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

**(in thousands, except per share data)**

**(unaudited)**

**NOTE F EQUITY BASED COMPENSATION CONTINUED**

A summary of the Company s stock option and stock-settled stock appreciation right activity for the six months ended July 2, 2011 is as follows:

| | Shares | Weighted-average grant price | Weighted-average remaining contractual term | Aggregate intrinsic value* |
|---|---|---|---|---|
| Outstanding at January 1, 2011 | 4,047 | $ 32.46 | 3.5 | $ 45,263 |
| Granted | 25 | 39.31 | | |
| Exercised | (57) | 28.66 | | |
| Canceled or expired | (558) | 31.74 | | |
| Outstanding at July 2, 2011 | 3,457 | $ 32.69 | 3.1 | $ 13,672 |
| Exercisable at July 2, 2011 | 1,209 | $ 33.37 | 2.7 | $ 4,385 |

* Aggregate intrinsic value is defined as the difference between the current market value at the reporting date (the closing price of the Company s common stock on the last trading day of the period) and the exercise price of awards that were in-the-money. The closing price of the Company s common stock at January 1, 2011 and July 2, 2011, was $43.45 and $33.54, respectively.

The weighted-average fair value of stock-settled stock appreciation rights that were granted during the six-month periods ended July 3, 2010, and July 2, 2011 was $15.50 and $17.47, respectively. The total intrinsic value of awards that were exercised during the six-month periods ended July 3, 2010, and July 2, 2011 was $246 and $555, respectively.

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

| | Quarter Ended | | Six Months Ended | |
|---|---|---|---|---|
| | July 3, 2010 | July 2, 2011 | July 3, 2010 | July 2, 2011 |
| Expected volatility | 54.8% | * | 54.9% | 54.8% |

| | | | | |
|---|---|---|---|---|
| Risk-free interest rate | 2.0% | * | 2.0% | 1.5% |
| Expected life | 4.2 yrs. | * | 4.2 yrs. | 4.2 yrs. |
| Expected dividend yield | | * | | |
| Weighted-average grant price | $35.47 | * | $34.46 | $39.31 |

* No equity awards were issued during the quarter ended July 2, 2011.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

**(in thousands, except per share data)**

**(unaudited)**

**NOTE G COMMON STOCK AND EARNINGS PER SHARE**

Basic earnings per share are based on the weighted-average number of shares outstanding for each period. Shares that have been repurchased and retired during the periods specified below have been included in the calculation of the number of weighted-average shares that are outstanding for the calculation of basic earnings per share. Diluted earnings per common share are based on shares that are outstanding (computed under basic EPS) and on potentially dilutive shares. Shares that are included in the diluted earnings per share calculations under the treasury stock method include equity awards that are in-the-money but have not yet been exercised.

| | Quarters Ended | |
|---|---|---|
| | July 3, 2010 | July 2, 2011 |
| Net earnings available to common shareholders | $ 10,770 | $ 13,856 |
| Basic EPS | | |
| Shares | | |
| Common shares outstanding entire period | 15,309 | 15,985 |
| Weighted average common shares: | | |
| Issued during period | 9 | 13 |
| Canceled during period | | (468) |
| Weighted average common shares outstanding during period | 15,318 | 15,530 |
| Earnings per common share from net earnings - basic | $ 0.70 | $ 0.89 |
| Diluted EPS | | |
| Shares | | |
| Weighted average common shares outstanding during period - basic | 15,318 | 15,530 |
| Dilutive effect of in-the-money equity awards | 379 | 222 |
| Weighted average common shares outstanding during period - diluted | 15,697 | 15,752 |
| Earnings per common share from net earnings - diluted | $ 0.69 | $ 0.88 |

Equity awards for 1,256 and 1,620 shares of stock were not included in the computation of diluted EPS for the quarters ended July 3, 2010, and July 2, 2011, respectively, due to the fact that their exercise prices were greater than the average market price of the shares.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

**(in thousands, except per share data)**

**(unaudited)**

**NOTE G COMMON STOCK AND EARNINGS PER SHARE CONTINUED**

| | Six Months Ended | |
|---|---|---|
| | July 3, 2010 | July 2, 2011 |
| Net earnings available to common shareholders | $ 20,411 | $ 25,206 |
| Basic EPS | | |
| Shares | | |
| Common shares outstanding entire period | 15,309 | 15,985 |
| Weighted average common shares: | | |
| Issued during period | 6 | 8 |
| Canceled during period | | (273) |
| Weighted average common shares outstanding during period | 15,315 | 15,720 |
| Earnings per common share from net earnings - basic | $ 1.33 | $ 1.60 |
| Diluted EPS | | |
| Shares | | |
| Weighted average common shares outstanding during period - basic | 15,315 | 15,720 |
| Dilutive effect of in-the-money equity awards | 294 | 244 |
| Weighted average common shares outstanding during period - diluted | 15,609 | 15,964 |
| Earnings per common share from net earnings - diluted | $ 1.31 | $ 1.58 |

Equity awards for 1,833 and 1,613 shares of stock were not included in the computation of diluted EPS for the six months ended July 3, 2010, and July 2, 2011, respectively, due to the fact that their exercise prices were greater than the average market price of the shares.

**NOTE H COMPREHENSIVE INCOME**

Total comprehensive income consisted of the following:

| | Quarters Ended | | Six Months Ended | |
|---|---|---|---|---|
| | July 3, 2010 | July 2, 2011 | July 3, 2010 | July 2, 2011 |
| Net Earnings | $ 10,770 | $ 13,856 | $ 20,411 | $ 25,206 |
| Foreign currency translation adjustment, net of tax | (762) | 688 | (463) | 1,005 |
| Comprehensive income | $ 10,008 | $ 14,544 | $ 19,948 | $ 26,211 |

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

**(in thousands, except per share data)**

**(unaudited)**

**NOTE I SEGMENT INFORMATION**

USANA operates in a single operating segment as a direct selling company that develops, manufactures, and distributes high-quality nutritional and personal care products that are sold through a global network marketing system of independent distributors ( Associates ). As such, management has determined that the Company operates in one reportable business segment. Performance for a region or market is primarily evaluated based on sales. The Company does not use profitability reports on a regional or market basis for making business decisions. No single Associate accounted for 10% or more of net sales for the periods presented. The table below summarizes the approximate percentage of total product revenue that has been contributed by the Company s nutritional and personal care products for the periods indicated.

| | **Quarters Ended** | | **Six Months Ended** | |
|---|---|---|---|---|
| **Product Line** | **July 3, 2010** | **July 2, 2011** | **July 3, 2010** | **July 2, 2011** |
| USANA® Nutritionals | 76% | 78% | 76% | 78% |
| USANA Foods | 13% | 12% | 13% | 12% |
| Sensé beautiful science® | 8% | 7% | 8% | 7% |

Selected financial information for the Company is presented for two geographic regions: North America and Asia Pacific, with three sub-regions under Asia Pacific. Individual markets are categorized into these regions as follows:

- North America
- United States (including direct sales from the United States to the United Kingdom and the Netherlands)
- Canada
- Mexico

- Asia Pacific
- Southeast Asia/Pacific — Australia, New Zealand, Singapore, Malaysia, and the Philippines
- Greater China — Hong Kong, Taiwan, and China*
- North Asia — Japan and South Korea

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* Our business in China is that of BabyCare, our wholly-owned subsidiary.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

**(in thousands, except per share data)**

**(unaudited)**

**NOTE I SEGMENT INFORMATION CONTINUED**

*Selected Financial Information*

Selected financial information, presented by geographic region, is listed below for the periods ended as of the dates indicated:

| | Quarters Ended | | Six Months Ended | |
|---|---|---|---|---|
| | **July 3, 2010** | **July 2, 2011** | **July 3, 2010** | **July 2, 2011** |
| Net Sales to External Customers | | | | |
| North America | | | | |
| United States | $ 37,992 | $ 37,121 | $ 75,598 | $ 74,157 |
| Canada | 18,373 | 17,462 | 35,933 | 34,789 |
| Mexico | 5,748 | 5,684 | 11,102 | 11,342 |
| North America Total | 62,113 | 60,267 | 122,633 | 120,288 |
| Asia Pacific | | | | |
| Southeast Asia/Pacific | 23,968 | 27,225 | 48,501 | 51,919 |
| Greater China | 34,437 | 53,678 | 62,700 | 105,789 |
| North Asia | 5,493 | 7,755 | 11,264 | 14,495 |
| Asia Pacific Total | 63,898 | 88,658 | 122,465 | 172,203 |
| Consolidated Total | $ 126,011 | $ 148,925 | $ 245,098 | $ 292,491 |

| | As of | |
|---|---|---|
| | **July 3, 2010** | **July 2, 2011** |
| Total Assets | | |
| North America | | |
| United States | $ 90,951 | $ 84,168 |
| Canada | 2,992 | 5,103 |
| Mexico | 3,905 | 3,213 |
| North America Total | 97,848 | 92,484 |
| Asia Pacific | | |
| Southeast Asia/Pacific | 24,119 | 28,646 |
| Greater China | 15,846 | 77,672 |
| North Asia | 5,859 | 7,126 |
| Asia Pacific Total | 45,824 | 113,444 |
| Consolidated Total | $ 143,672 | $ 205,928 |

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

**(in thousands, except per share data)**

**(unaudited)**

**NOTE I SEGMENT INFORMATION CONTINUED**

The following table provides further information on markets representing ten percent or more of consolidated net sales and long-lived assets, respectively:

| | Quarters Ended | | Six Months Ended | |
|---|---|---|---|---|
| | **July 3, 2010** | **July 2, 2011** | **July 3, 2010** | **July 2, 2011** |
| Net sales: | | | | |
| United States | $ 37,992 | $ 37,121 | $ 75,598 | $ 74,157 |
| Hong Kong | 28,858 | 41,785 | 50,867 | 81,988 |
| Canada | 18,373 | 17,462 | 35,933 | 34,789 |

| | As of | |
|---|---|---|
| | **January 1, 2011** | **July 2, 2011** |
| Long-lived Assets: | | |
| United States | $ 44,017 | $ 46,415 |
| Australia | 15,779 | 16,367 |
| China | 56,182 | 55,797 |

**NOTE J LONG-TERM DEBT AND LINE OF CREDIT**

During the quarter ended July 2, 2011, the Company entered into an Amended and Restated Credit Agreement with Bank of America. This agreement, among other things, extends the term of the Company s line of credit through May 2016 and increases the amount that may be borrowed under the credit facility from $40,000 to $60,000. The agreement for this line of credit contains restrictive covenants based on adjusted EBITDA and a debt coverage ratio. The interest rate on funds drawn from this line is computed at the bank s Prime Rate or LIBOR, adjusted by features specified in the Credit Agreement. The Company did not draw on this line of credit during the quarter, and, as of July 2, 2011 there was no outstanding balance on this line of credit.

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

The following discussion and analysis of USANA s financial condition and results of operations is presented in six sections:

- Overview
- Customers
- Current Focus
- Results of Operations
- Liquidity and Capital Resources
- Forward-Looking Statements and Certain Risks

This discussion and analysis should be read in conjunction with the Unaudited Consolidated Financial Statements and Notes thereto that are contained in this quarterly report, as well as Management s Discussion and Analysis of Financial Condition and Results of Operations that are included in our Annual Report on Form 10-K for the year ended January 1, 2011, and our other filings, including Current Reports on Form 8-K, that have been filed with the Securities and Exchange Commission ( SEC ) through the date of this report.

**Overview**

We develop and manufacture high-quality, science-based nutritional and personal care products that are distributed internationally through a network marketing system, which is a form of direct selling. Our customer base comprises two types of customers: Associates and Preferred Customers. Associates are independent distributors of our products who also purchase our products for their personal use. Preferred Customers purchase our products strictly for their personal use and are not permitted to resell or to distribute the products. As of July 2, 2011, we had approximately 222,000 active Associates and approximately 68,000 active Preferred Customers worldwide. For purposes of this report, we only count as active customers those Associates and Preferred Customers who have purchased product from USANA at any time during the most recent three-month period, either for personal use or for resale.

We have ongoing operations in the following markets, which are grouped and presented as follows:

- North America

- United States
- Canada
- Mexico
- Asia Pacific
- Southeast Asia/Pacific — Australia, New Zealand, Singapore, Malaysia, and the Philippines
- Greater China — Hong Kong, Taiwan, and China*
- North Asia — Japan and South Korea

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* Our business in China is that of BabyCare, our wholly-owned subsidiary.

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Our primary product lines consist of USANA® Nutritionals, USANA Foods, and Sensé beautiful science® (Sensé), which is our line of personal care products. The USANA Nutritionals product line is further categorized into two separate classifications: Essentials and Optimizers. The following tables summarize the approximate percentage of total product revenue that has been contributed by our major product lines and our top-selling products for the current and prior-year periods indicated:

| | Six Months Ended | |
|---|---|---|
| **Product Line** | **July 3, 2010** | **July 2, 2011** |
| USANA® Nutritionals | | |
| Essentials | 30% | 29% |
| Optimizers | 46% | 49% |
| USANA Foods | 13% | 12% |
| Sensé beautiful science® | 8% | 7% |
| All Other | 3% | 3% |

| | Six Months Ended | |
|---|---|---|
| **Key Product** | **July 3, 2010** | **July 2, 2011** |
| USANA® Essentials | 18% | 18% |
| Proflavanol® | 11% | 12% |
| HealthPak 100 | 10% | 9% |

We believe that our ability to attract and retain Associates and Preferred Customers to sell and consume our products is positively influenced by a number of factors. Some of these factors include: the general public s heightened awareness and understanding of the connection between diet and long-term health, the aging of the worldwide population as older people generally tend to consume more nutritional supplements, and the growing desire for a secondary source of income and small business ownership.

We believe that our high-quality products and our financially rewarding Associate Compensation Plan are the key components to attracting and retaining Associates. We strive to ensure that our products are up-to-date with the latest science in nutrition research and to keep our product lines relatively compact, which we believe simplifies the selling and buying process for our Associates and Preferred Customers. We also periodically make changes to our Compensation Plan in an effort to ensure that our plan is among the most rewarding in the industry and to encourage behavior that we believe leads to a more successful business for our Associates. There is a risk, however, that such changes may cause an unanticipated shift in Associate behavior, thus harming our business.

To further support our Associates in building their businesses, we sponsor meetings and events throughout the year, which offer information about our products and our network marketing system. These meetings are designed to assist Associates in their business development and to provide a forum for interaction with some of our Associate leaders and members of our management team. We also provide low cost sales tools, including online sales, business management, and training tools, which we believe are an integral part of building and maintaining a successful home-based business for our Associates. Although we provide training and sales tools, we ultimately rely on our Associates to (i) sell our products, (ii) attract new customers to purchase our products; and (iii) educate and train new Associates.

Because we have operations in multiple markets, with sales and expenses being generated and incurred in multiple currencies, our reported U.S. dollar sales and earnings can be significantly affected by fluctuations in currency exchange rates. In general, our reported sales and earnings are affected positively by a weakening of the U.S. dollar and negatively by a strengthening of the U.S. dollar. In our net sales discussions that follow, we approximate the impact of currency fluctuations on net sales by translating current year sales at the average exchange rates in effect during the comparable periods of the prior year.

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**Customers**

Because we utilize a direct selling model for the distribution of our products, the success and growth of our business is primarily based on our ability to attract new Associates and retain existing Associates to sell and consume our products. Notably, sales to Associates account for the majority of our product sales, representing 90% of product sales during the six months ended July 2, 2011. Additionally, it is important to attract and retain Preferred Customers as consumers of our products. Increases or decreases in product sales are typically the result of variations in product sales volumes relating to fluctuations in the number of active Associates and Preferred Customers purchasing our products. The number of active Associates and Preferred Customers is, therefore, used by management as a key non-financial measure.

The tables below summarize the changes in our active customer base by geographic region. These numbers have been rounded to the nearest thousand as of the dates indicated.

**Active Associates By Region**

| | As of July 3, 2010 | | As of July 2, 2011 | | Change from Prior Year | Percent Change |
|---|---|---|---|---|---|---|
| North America: | | | | | | |
| United States | 57,000 | 27.1% | 49,000 | 22.1% | (8,000) | (14.0)% |
| Canada | 26,000 | 12.4% | 24,000 | 10.8% | (2,000) | (7.7)% |
| Mexico | 12,000 | 5.7% | 10,000 | 4.5% | (2,000) | (16.7)% |
| North America Total | 95,000 | 45.2% | 83,000 | 37.4% | (12,000) | (12.6)% |
| Asia Pacific: | | | | | | |
| Southeast Asia/Pacific | 44,000 | 21.0% | 43,000 | 19.4% | (1,000) | (2.3)% |
| Greater China | 63,000 | 30.0% | 87,000 | 39.2% | 24,000 | 38.1% |
| North Asia | 8,000 | 3.8% | 9,000 | 4.0% | 1,000 | 12.5 |