USANA HEALTH SCIENCES INC
Form 10-Q
November 09, 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 October 1, 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 October 31, 2011 was 14,959,597.

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USANA HEALTH SCIENCES, INC.

FORM 10-Q

For the Quarterly Period Ended October 1, 2011

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands)

(unaudited)

	As of January 1, 2011	As of October 1, 2011
ASSETS		
Current assets		
Cash and cash equivalents	$ 24,222	$ 36,317
Inventories	34,078	36,199
Prepaid expenses and other current assets	23,377	17,461
Total current assets	81,677	89,977
Property and equipment, net	57,568	59,756
Goodwill	17,267	17,596
Intangible assets, net	41,915	42,370
Deferred tax assets	12,383	13,486
Other assets	5,826	6,108
	$ 216,636	$ 229,293
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 6,445	$ 9,096
Other current liabilities	52,584	50,193
Total current liabilities	59,029	59,289
Deferred tax liabilities	9,793	9,896
Other long-term liabilities	1,012	969
Stockholders equity		
	16	15

Common stock, $0.001 par value; Authorized 50,000 shares, issued and outstanding 15,985 as of January 1, 2011 and 14,954 as of October 1, 2011				
Additional paid-in capital		51,222		46,834
Retained earnings		90,207		106,170
Accumulated other comprehensive income		5,357		6,120
Total stockholders equity		146,802		159,139
	$	216,636	$	229,293

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 October 2, 2010	Quarter Ended October 1, 2011
Net sales	$ 135,006	$ 143,501
Cost of sales	25,157	25,202
Gross profit	109,849	118,299
Operating expenses:		
Associate incentives	60,560	66,158
Selling, general and administrative	30,751	33,365
Total operating expenses	91,311	99,523
Earnings from operations	18,538	18,776
Other income (expense):		
Interest income	36	42
Interest expense	(42)	(1)
Other, net	557	92
Other income, net	551	133
Earnings before income taxes	19,089	18,909
Income taxes	6,240	6,524
Net earnings	$ 12,849	$ 12,385
Earnings per common share		
Basic	$ 0.83	$ 0.82
Diluted	$ 0.79	$ 0.81
Weighted average common shares outstanding		
Basic	15,562	15,043
Diluted	16,247	15,205

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)

	Nine Months Ended	
	October 2, 2010	**October 1, 2011**
Net sales	$ 380,104	$ 435,992
Cost of sales	70,912	77,072
Gross profit	309,192	358,920
Operating expenses:		
Associate incentives	171,743	198,725
Selling, general and administrative	87,358	103,038
Total operating expenses	259,101	301,763
Earnings from operations	50,091	57,157
Other income (expense):		
Interest income	70	146
Interest expense	(68)	(9)
Other, net	301	97
Other income, net	303	234
Earnings before income taxes	50,394	57,391
Income taxes	17,134	19,800
Net earnings	$ 33,260	$ 37,591
Earnings per common share		
Basic	$ 2.16	$ 2.43
Diluted	$ 2.11	$ 2.39
Weighted average common shares outstanding		
Basic	15,397	15,495
Diluted	15,763	15,712

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

Nine Months Ended October 2, 2010 and October 1, 2011

(in thousands)

(unaudited)

	Common Stock Shares	Common Stock Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total
For the Nine Months Ended October 2, 2010						
Balance at January 2, 2010	15,309	$ 15	$ 16,425	$ 56,410	$ 1,523	$ 74,373
Comprehensive income						
Net earnings				33,260		33,260
Foreign currency translation adjustment, net of tax benefit of $614					2,305	2,305
Comprehensive income						35,565
Common stock repurchased and retired	(199)		(2,232)	(6,398)		(8,630)
Common stock issued in connection with acquisition	400	1	17,715			17,716
Equity-based compensation expense			7,107			7,107
Common stock issued under equity award plans, including tax benefit of $50	250		4,690			4,690
Balance at October 2, 2010	15,760	$ 16	$ 43,705	$ 83,272	$ 3,828	$ 130,821
For the Nine Months Ended October 1, 2011						
Balance at January 1, 2011	15,985	$ 16	$ 51,222	$ 90,207	$ 5,357	$ 146,802
Comprehensive income						
Net earnings				37,591		37,591
Foreign currency translation adjustment, net of tax benefit of $491					763	763

Comprehensive income						38,354
Equity-based compensation expense			7,739			7,739
Common stock repurchased and retired	(1,095)	(1)	(11,072)	(21,628)		(32,701)
Common stock issued under equity award plans, including tax expense of $309	64		(270)			(270)
Tax impact of canceled vested equity awards			(785)			(785)
Balance at October 1, 2011	14,954	$ 15	$ 46,834	$ 106,170	$ 6,120	$ 159,139

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)

	Nine Months Ended October 2, 2010		Nine Months Ended October 1, 2011	
Cash flows from operating activities				
Net earnings	$	33,260	$	37,591
Adjustments to reconcile net earnings to net cash provided by operating activities				
Depreciation and amortization		5,641		6,361
Loss on sale of property and equipment		87		44
Equity-based compensation expense		7,107		7,739
Excess tax benefits from equity-based payment arrangements		(792)		(48)
Deferred income taxes		(1,221)		(1,473)
Inventory valuation		989		888
Changes in operating assets and liabilities:				
Inventories		(5,040)		(3,552)
Prepaid expenses and other assets		30		6,063
Accounts payable		41		2,614
Other liabilities		6,137		(2,759)
Total adjustments		12,979		15,877
Net cash provided by operating activities		46,239		53,468
Cash flows from investing activities				
Acquisitions, net of cash acquired	$	(42,694)	$	
Proceeds from sale of property and equipment		32		1
Purchases of property and equipment		(3,676)		(8,558)
Net cash used in investing activities		(46,338)		(8,557)
Cash flows from financing activities				
Proceeds from equity awards exercised	$	4,640	$	39
Excess tax benefits from equity-based payment arrangements		792		48
Repurchase of common stock		(8,630)		(32,701)
Borrowings on line of credit		23,350		
Payments on line of credit		(11,350)		
Net cash used in financing activities		8,802		(32,614)
Effect of exchange rate changes on cash and cash equivalents		567		(202)
Net increase in cash and cash equivalents		9,270		12,095

Cash and cash equivalents, beginning of period		13,658		24,222
Cash and cash equivalents, end of period	$	22,928	$	36,317
Supplemental disclosures of cash flow information				
Cash paid during the period for:				
Interest	$	62	$	10
Income taxes		18,582		19,281
Non-cash financing activities				
Common stock issued in connection with acquisitions		17,716		

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 October 1, 2011 and results of operations for the quarters and nine months ended October 2, 2010 and October 1, 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 nine months ended October 1, 2011, may not be indicative of the results that may be expected for the fiscal year 2011 ending December 31, 2011.

Revisions

Revisions relating to deferred taxes and intangible assets have been made to the Company s financial statements to reflect adjustments made to correct the presentation of deferred taxes on a gross rather than net basis, and to record the impact of currency translation on intangible assets acquired as part of the 2010 purchase of BabyCare Holdings Ltd. These adjustments revise amounts reported for periods prior to January 2, 2011 in the financial statements and related notes, for deferred taxes, goodwill, intangible assets and accumulated other comprehensive income in the Consolidated Balance Sheet, and the foreign currency translation adjustment component of comprehensive income in the Consolidated Statement of Stockholders Equity and Comprehensive Income. While the overall net deferred tax amount has not changed, certain deferred tax line items in the Consolidated Balance Sheet have been modified to reflect a gross presentation. Additionally, goodwill and intangible assets have been increased, along with a corresponding increase in accumulated other comprehensive income, to capture the changes on these assets related to foreign currency translation. These revisions had no effect on our earnings from operations, net earnings, or earnings per share.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except per share data)

(unaudited)

Revisions continued

The following tables illustrate the effects of the revision on the Company s consolidated financial statements for only those line items that were affected:

Consolidated Balance Sheet Items

(in thousands)

	As of January 1, 2011		
	As Previously Reported	Adjustment	As Revised
Prepaid expenses and other current assets, including current deferred tax assets	$ 21,972	$ 1,405	$ 23,377
Total current assets	80,272	1,405	81,677
Goodwill	16,930	337	17,267
Intangible assets, net	40,616	1,299	41,915
Other assets, including long-term deferred tax assets	8,416	9,793	18,209
Total assets	203,802	12,834	216,636
Other current liabilities	51,179	1,405	52,584
Total current liabilities	57,624	1,405	59,029
Long-term deferred tax liabilities		9,793	9,793
Accumulated other comprehensive income *	3,721	1,636	5,357
Total stockholders equity *	145,166	1,636	146,802
Total liabilities and stockholders equity	203,802	12,834	216,636

* Change also reflected in the beginning balance within the Consolidated Statement of Stockholders Equity and Comprehensive Income.

Consolidated Statement of Stockholders Equity and Comprehensive Income Items

(in thousands)

For the nine months ended October 2, 2010	
Adjustment	As Revised

	As Previously Reported		
Accumulated other comprehensive income (loss), foreign currency translation adjustment	$ 1,431	$ 874	$ 2,305
Accumulated other comprehensive income (loss), total comprehensive income	34,691	874	35,565
Accumulated other comprehensive income (loss), balance at October 2, 2010	2,954	874	3,828
Total stockholders equity at October 2, 2010	129,947	874	130,821

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except per share data)

(unaudited)

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.

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, Intangibles Goodwill and Other (Topic 350): Testing Goodwill for Impairment (ASU 2011-08). ASU 2011-08 simplifies how entities test goodwill for impairment. The amendments in this update permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. An entity also has the option to bypass the qualitative assessment for any reporting unit in any period and proceed directly to performing the first step of the two-step goodwill impairment test. An entity may resume performing the qualitative assessment in any subsequent period. Additionally, an entity no longer is permitted to carry forward its detailed calculation of a reporting unit s fair value from a prior year as previously permitted by Topic 350.

ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity s financial statements for the most recent annual or interim period have not yet been issued. The Company has early adopted this standard, which did not 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 October 1, 2011, the fair value of term deposits in the consolidated balance sheet totaled $313, classified in cash and cash equivalents.

NOTE B INVENTORIES

Inventories consist of the following:

	January 1, 2011	October 1, 2011
Raw materials	$ 9,372	$ 10,155
Work in progress	5,791	6,844
Finished goods	18,915	19,200
	$ 34,078	$ 36,199

NOTE C PREPAID EXPENSES AND OTHER CURRENT ASSETS

Prepaid expenses and other current assets consist of the following:

	January 1, 2011	October 1, 2011
Prepaid insurance	$ 1,175	$ 342
Other prepaid expenses	2,583	2,249
Federal income taxes receivable	3,108	1,985
Miscellaneous receivables, net	3,735	2,944
Deferred commissions	4,867	3,864
Term deposits	3,034	
Deferred tax assets	3,116	4,194
Other current assets	1,759	1,883
	$ 23,377	$ 17,461

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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	October 1, 2011
Buildings	40	$ 38,732	$ 39,343
Laboratory and production equipment	5-7	17,723	18,778
Sound and video library	5	600	600
Computer equipment and software	3-5	27,788	29,790
Furniture and fixtures	3-5	4,953	5,024
Automobiles	3-5	290	293
Leasehold improvements	3-5	5,404	5,344
Land improvements	15	2,051	2,040
		97,541	101,212
Less accumulated depreciation and amortization		48,298	52,794
		49,243	48,418
Land		8,107	7,780
Deposits and projects in process		218	3,558
		$ 57,568	$ 59,756

NOTE E INTANGIBLE ASSETS

Goodwill and intangible assets that have indefinite useful lives are tested annually for impairment, or more frequently if impairment indicators are present. Such indicators of impairment include, but are not limited to, changes in business climate, and operating or cash flow losses related to such assets. Goodwill and indefinite lived intangible assets are not amortized. Definite lived intangibles are amortized over their related useful lives. No events have occurred subsequent to any of our acquisitions that have resulted in an impairment of the original goodwill or intangible asset amounts that were initially recorded from the transactions.

Goodwill is as follows:

	January 1, 2011	Goodwill acquired	Currency translation adjustments	Impairment adjustments	October 1, 2011
North America	$ 6,390	$	$	$	$ 6,390
Asia Pacific	10,877		329		11,206
	$ 17,267	$	$ 329	$	$ 17,596

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except per share data)

(unaudited)

NOTE E INTANGIBLE ASSETS CONTINUED

Intangible assets are as follows:

	As of October 1, 2011			
	Gross carrying amount	Accumulated amortization	Net carrying amount	Weighted-average amortization period (years)
Amortized intangible assets				
Trade Name and Trademarks	$ 4,147	$ (467)	$ 3,680	10
Customer Relationships	2,020	(758)	1,262	3
	6,167	(1,225)	4,942	
Unamortized intangible assets				
Product Formulas	9,145		9,145	
Direct Sales License	28,283		28,283	
	37,428		37,428	
	$ 43,595		$ 42,370	
Aggregate Amortization Expense:				
For the nine months ended October 1, 2011	$ 816			
Estimated Amortization Expense:				
Remainder of 2011	272			
2012	1,088			
2013	836			
2014	415			
2015	415			
Thereafter	1,916			
	$ 4,942			

NOTE F OTHER CURRENT LIABILITIES

Other current liabilities consist of the following:

	January 1, 2011	October 1, 2011
Associate incentives	$ 11,379	$ 11,914
Accrued employee compensation	14,395	11,703
Income Taxes	1,571	2,880
Sales taxes	4,671	4,090
Deferred tax liabilities	1,405	1,501
Associate promotions	1,491	1,046
Deferred revenue	11,772	10,162
Provision for returns and allowances	929	963
All other	4,971	5,934
	$ 52,584	$ 50,193

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except per share data)

(unaudited)

NOTE G EQUITY BASED COMPENSATION

Equity-based compensation expense for the quarters ended October 2, 2010, and October 1, 2011, was $2,967 and $2,937, respectively. The related tax benefit for these periods was $1,180 and $1,073, respectively. Expense for the nine months ended October 2, 2010, and October 1, 2011, was $7,107 and $7,739, respectively. The related tax benefit for these periods was $2,693 and $2,824, respectively.

During the nine months ended October 1, 2011, certain executives left the Company, which resulted in the cancelation of these executives equity awards. The recapture of equity compensation expense related to the cancelation of unvested equity awards reduced equity-based compensation expense for the nine months ended October 1, 2011 by $1,230. The related tax impact for these cancelations 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 October 1, 2011. This table does not include an estimate for future grants that may be issued.

Remainder of 2011	$	2,800
2012		10,027
2013		6,448
2014		4,475
2015 and beyond		2,828
	$	26,578

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

During the nine months ended October 1, 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 October 1, 2011, a total of 5,363 units had been issued under this plan, comprising 5,241 stock-settled stock appreciation rights, 114 deferred stock units, and 8 stock options. Also, as of October 1, 2011, 811 units had been canceled and added back to the number of units available for issuance under the 2006 Plan.

A summary of the Company s stock option and stock-settled stock appreciation right activity for the nine months ended October 1, 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	417		28.83			
Exercised	(57)		28.66			
Canceled or expired	(607)		32.29			
Outstanding at October 1, 2011	3,800	$	32.15	3.1	$	2,623
Exercisable at October 1, 2011	1,562	$	32.50	2.6	$	1,273

* 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 October 1, 2011, was $43.45 and $27.50, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except per share data)

(unaudited)

NOTE G EQUITY BASED COMPENSATION CONTINUED

The weighted-average fair value of stock-settled stock appreciation rights that were granted during the nine-month periods ended October 2, 2010, and October 1, 2011 was $17.07 and $12.40, respectively. The total intrinsic value of awards that were exercised during the nine-month periods ended October 2, 2010, and October 1, 2011 was $6,057 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		Nine Months Ended	
	October 2, 2010	**October 1, 2011**	**October 2, 2010**	**October 1, 2011**
Expected volatility	54.8%	56.0%	54.9%	56.0%
Risk-free interest rate	1.4%	1.1%	1.7%	1.1%
Expected life	4.2 yrs.	3.8 yrs.	4.2 yrs.	3.9 yrs.
Expected dividend yield				
Weighted-average grant price	$ 43.73	$ 28.16	$ 38.23	$ 28.83

A summary of the Company s deferred stock unit activity for the nine months ended October 1, 2011 is as follows:

	Shares	**Weighted-average Fair Value**
Nonvested at January 1, 2011	100	$ 44.29
Granted		
Vested	(49)	44.29
Canceled or expired	(2)	44.29
Nonvested at October 1, 2011	49	$ 44.29

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except per share data)

(unaudited)

NOTE H 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.

	Quarter Ended			
		October 2, 2010		**October 1, 2011**
Net earnings available to common shareholders	$	12,849	$	12,385
Basic EPS				
Shares				
Common shares outstanding entire period		15,309		15,985
Weighted average common shares:				
Issued during period		320		39
Canceled during period		(67)		(981)
Weighted average common shares outstanding during period		15,562		15,043
Earnings per common share from net earnings - basic	$	0.83	$	0.82
Diluted EPS				
Shares				
Weighted average common shares outstanding during period - basic		15,562		15,043
Dilutive effect of in-the-money equity awards		685		162
Weighted average common shares outstanding during period - diluted		16,247		15,205
Earnings per common share from net earnings - diluted	$	0.79	$	0.81

Equity awards for 434 and 2,002 shares of stock were not included in the computation of diluted EPS for the quarters ended October 2, 2010, and October 1, 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 H COMMON STOCK AND EARNINGS PER SHARE CONTINUED

	Nine Months Ended	
	October 2, 2010	October 1, 2011
Net earnings available to common shareholders	$ 33,260	$ 37,591
Basic EPS		
Shares		
Common shares outstanding entire period	15,309	15,985
Weighted average common shares:		
Issued during period	110	19
Canceled during period	(22)	(509)
Weighted average common shares outstanding during period	15,397	15,495
Earnings per common share from net earnings - basic	$ 2.16	$ 2.43
Diluted EPS		
Shares		
Weighted average common shares outstanding during period - basic	15,397	15,495
Dilutive effect of in-the-money equity awards	366	217
Weighted average common shares outstanding during period - diluted	15,763	15,712
Earnings per common share from net earnings - diluted	$ 2.11	$ 2.39

Equity awards for 1,627 and 1,571 shares of stock were not included in the computation of diluted EPS for the nine months ended October 2, 2010, and October 1, 2011, respectively, due to the fact that their exercise prices were greater than the average market price of the shares.

NOTE I COMPREHENSIVE INCOME

Total comprehensive income consisted of the following:

	Quarter Ended		Nine Months Ended	
	October 2, 2010	**October 1, 2011**	**October 2, 2010**	**October 1, 2011**
Net Earnings	$ 12,849	$ 12,385	$ 33,260	$ 37,591
Foreign currency translation adjustment, net of tax	2,768	(1,259)	2,305	763
Comprehensive income	$ 15,617	$ 11,126	$ 35,565	$ 38,354

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except per share data)

(unaudited)

NOTE J 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.

	Quarter Ended		Nine Months Ended	
Product Line	**October 2, 2010**	**October 1, 2011**	**October 2, 2010**	**October 1, 2011**
USANA® Nutritionals	78%	78%	77%	78%
USANA Foods	12%	12%	12%	12%
Sensé beautiful science®	7%	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 J 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:

	Quarter Ended		Nine Months Ended	
	October 2, 2010	October 1, 2011	October 2, 2010	October 1, 2011
Net Sales to External Customers				
North America				
United States	$ 38,228	$ 37,975	$ 113,826	$ 112,132
Canada	16,419	16,107	52,352	50,896
Mexico	5,314	4,946	16,416	16,288
North America Total	59,961	59,028	182,594	179,316
Asia Pacific				
Southeast Asia/Pacific	25,730	30,117	74,231	82,036
Greater China	43,456	47,012	106,156	152,801
North Asia	5,859	7,344	17,123	21,839
Asia Pacific Total	75,045	84,473	197,510	256,676
Consolidated Total	$ 135,006	$ 143,501	$ 380,104	$ 435,992

	As of	
	October 2, 2010	October 1, 2011
Total Assets		
North America		
United States	$ 94,452	$ 98,067
Canada	3,853	3,072
Mexico	3,170	2,580
North America Total	101,475	103,719
Asia Pacific		
Southeast Asia/Pacific	26,591	25,730
Greater China	78,445	92,964
North Asia	6,851	6,880
Asia Pacific Total	111,887	125,574
Consolidated Total	$ 213,362	$ 229,293

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except per share data)

(unaudited)

NOTE J 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		Nine Months Ended	
	October 2, 2010	**October 1, 2011**	**October 2, 2010**	**October 1, 2011**
Net sales:				
United States	$ 38,228	$ 37,975	$ 113,826	$ 112,132
Hong Kong	34,518	34,826	85,385	116,814
Canada	16,419	16,107	52,352	50,896

	As of	
	January 1, 2011	**October 1, 2011**
Long-lived Assets:		
United States	$ 44,017	$ 46,981
Australia	15,779	14,572
China	57,818	59,365

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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 October 1, 2011, we had approximately 214,000 active Associates and approximately 66,000 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:

	Nine Months Ended	
	October 2, 2010	**October 1, 2011**
Product Line		
USANA® Nutritionals		
Essentials	30%	29%
Optimizers	47%	49%
USANA Foods	12%	12%
Sensé beautiful science®	8%	7%
All Other	3%	3%
Key Product		
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, to encourage behavior that we believe leads to a more successful business for our Associates, and to ensure that our plan provides us with leverage to grow sales and earnings. 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, net sales, cost of goods sold, and earnings are affected positively by a weakening of the U.S. dollar and negatively by a strengthening of the U.S. dollar. Currency fluctuations, however, have the opposite effect on our Associate incentives and selling, general and administrative expenses. 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.

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 nine months ended October 1,

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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 October 2, 2010		**As of October 1, 2011**		**Change from Prior Year**	**Percent Change**
North America:						
United States	55,000	23.5%	47,000	22.0%	(8,000)	(14.5)%
Canada	25,000	10.7%	23,000	10.7%	(2,000)	(8.0)%
Mexico	11,000	4.7%	10,000	4.7%	(1,000)	(9.1)%
North America Total	91,000	38.9%	80,000	37.4%	(11,000)	(12.1)%
Asia Pacific:						
Southeast Asia/Pacific	46,000	19.7%	47,000	22.0%	1,000	2.2%
Greater China	89,000	38.0%	78,000	36.4%	(11,000)	(12.4)%
North Asia	8,000	3.4%	9,000	4.2%	1,000	12.5%
Asia Pacific Total	143,000	61.1%	134,000	62.6%	(9,000)	(6.3)%
	234,000	100.0%	214,000	100.0%	(20,000)	(8.5)%

Active Preferred Customers By Region

	As of October 2, 2010		**As of October 1, 2011**		**Change from Prior Year**	**Percent Change**
North America:						
United States	37,000	50.0%	35,000	53.0%	(2,000)	(5.4)%
Canada	14,000	18.9%	13,000	19.7%	(1,000)	(7.1)%
Mexico	3,000	4.1%	3,000	4.6%		0.0%
North America Total	54,000	73.0%	51,000	77.3%	(3,000)	(5.6)%
Asia Pacific:						
Southeast Asia/Pacific	7,000	9.5%	7,000	10.6%		0.0%
Greater China	12,000	16.2%	7,000	10.6%	(5,000)	(41.7)%
North Asia	1,000	1.3%	1,000	1.5%		0.0%
Asia Pacific Total	20,000	27.0%	15,000	22.7%	(5,000)	(25.0)%
	74,000	100.0%	66,000	100.0%	(8,000)	(10.8)%

Current Focus

We are currently focusing our efforts on: (i) the development of China through BabyCare, (ii) growing our North American markets during a difficult economic environment, and (iii) aggressive international expansion. Additionally, in light of certain management and strategy changes that took place during the first half of the year, as well as increased competition, our management team has continued devoting significant time to meeting with our Associate sales force. These meetings have helped assure our

Associates of our commitment to supporting them and have also provided us with more opportunity to receive their input on strategies for the business.

Over the past several years, we have experienced significant growth in our Asia Pacific region, particularly in our Hong Kong market. In light of this growth and our acquisition of BabyCare in China, we believe that we are well-positioned long-term for growth in China. During 2011 our efforts in Asia Pacific are focused on integrating BabyCare into our business and motivating our successful Asian Associate base to grow BabyCare in China. This includes introducing USANA products for sale by BabyCare s Associates in China, educating our Hong Kong Associates on BabyCare s compensation plan, and working with the Chinese government to assist BabyCare in obtaining direct selling licenses in additional Chinese provinces. We have introduced several USANA products in China during 2011. During the first quarter, we rebranded several BabyCare products with USANA branding and now offer these products for sale by BabyCare s Associates. In the second quarter, we introduced five of our Sensé products to go along with the rebranded products. Finally, in the fourth quarter, we anticipate introducing four of our key nutritional products for sale through BabyCare. With this final product introduction, we will have 13 USANA products available in China, as well as 11 BabyCare branded products. We also continue to make progress on obtaining additional provincial direct selling licenses and educating our Hong Kong Associates on BabyCare s compensation plan.

Difficult economic conditions continue to present a challenge for our overall business, especially in our North American markets. Additionally, during the third quarter of 2010, we changed the commission qualification requirements for new Associates worldwide to encourage more entrepreneurial Associates to join USANA and build a downline sales force at an accelerated pace. While this change has caused us to enroll more entrepreneurial Associates, it has made it more challenging for us to enroll Associates in general, including those who simply consume our products and are less entrepreneurial. As a result, our Associate counts have decreased in most of our markets, including North America, but the average spending per Associate has increased in these markets. Although this increased spending per Associate has generated net sales growth for the Company, we are developing both short and long-term strategies to increase the number of Associates in North America and other markets. In the short-term, we plan to offer promotions and incentives for our customers to generate excitement and regain momentum. We have been working closely with our Associate leaders to develop these initiatives. We will also continue our efforts to increase our global brand recognition. In the long-term, we are evaluating strategies around personalization and product innovation, as well as longer-term incentives that will reward our top performing Associates in all of our markets.

During the third quarter we held our annual international convention in Salt Lake City, where we made several exciting announcements, including our plans to open France and Belgium in the first quarter of 2012. These two markets, together with Thailand, which we plan to open near the end of 2011, will bring USANA s country count to 18 markets worldwide. Thailand and France are among the top Direct Selling markets in the world, and we are encouraged by the growth opportunity that these markets provide.

Results of Operations

Summary of Financial Results

Net sales for the third quarter of 2011 increased 6.3%, or $8.5 million, to $143.5 million, compared with the third quarter in 2010. This increase in net sales is largely due to currency benefits of approximately $5.1 million from favorable year-over-year changes in currency exchange rates. Additionally, strong sales growth in certain markets within our Asia Pacific region, including BabyCare, contributed to the increase in net sales. Net sales in North America decreased slightly in the third quarter of 2011, compared with the third quarter of 2010.

Net earnings for the third quarter of 2011 decreased 3.6%, or $0.4 million, to $12.4 million, compared with the third quarter in 2010. This decrease was primarily the result of higher relative Associate incentives and selling, general, and administrative expenses, which were partially offset by improved gross profit margin.

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Quarters Ended October 2, 2010 and October 1, 2011

Net Sales

The following table summarizes the changes in our net sales by geographic region for the quarters ended as of the dates indicated:

	Net Sales by Region (in thousands) Quarter Ended October 2, 2010		October 1, 2011		Change from prior year	Percent change	Approximate impact of currency exchange	Change excluding the impact of currency
North America:								
United States	$ 38,228	28.3%	$ 37,975	26.5%	$ (253)	(0.7)%	$ N/A	(0.7)%
Canada	16,419	12.2%	16,107	11.2%	(312)	(1.9)%	900	(7.4)%
Mexico	5,314	3.9%	4,946	3.4%	(368)	(6.9)%	200	(10.7)%
North America Total	59,961	44.4%	59,028	41.1%	(933)	(1.6)%	1,100	(3.4)%
Asia Pacific:								
Southeast Asia/Pacific	25,730	19.1%	30,117	21.0%	4,387	17.1%	2,800	6.2%
Greater China	43,456	32.2%	47,012	32.8%	3,556	8.2%	700	6.6%
North Asia	5,859	4.3%	7,344	5.1%	1,485	25.3%	500	16.8%
Asia Pacific Total	75,045	55.6%	84,473	58.9%	9,428	12.6%	4,000	7.2%
	$ 135,006	100.0%	$ 143,501	100.0%	$ 8,495	6.3%	$ 5,100	2.5%

North America: The decrease in local currency net sales in this region was the result of lower product sales volume due to a decrease in the number of active Associates in this region. We believe that this decrease in Associates is predominantly due to difficult economic conditions in North America, coupled with the commission qualification changes we made in the third quarter of 2010. This decrease in active Associates was partially offset by an increase in average spending per Associate on a year-over-year basis, also due to the commission qualification changes for new Associates.

Asia Pacific: The increase in net sales in this region was the result of currency benefits from favorable changes in year-over-year currency exchange rates and higher product sales volume from an increase in the number of active Associates in the Philippines and South Korea. The number of active Associates in the Philippines increased 87.5% year-over-year to 15,000, and net sales increased 156.8% to $6.8 million. The number of active Associates in South Korea increased 50.0% to 6,000, and net sales increased 65.8% to $5.0 million. BabyCare sales also increased 78.1% to $6.2 million. This increase is due, partially, to a comparison of BabyCare s full third quarter 2011 operations with partial third quarter 2010 operations, as we acquired BabyCare in August 2010.

The increases noted above were partially offset by declining sales and Associate counts in other markets within this region, particularly Hong Kong. During the third quarter of 2011, the number of active Associates in Hong Kong declined 22.1% to 53,000, compared with the third quarter of 2010. Third quarter 2011 sales in Hong Kong, however, were relatively flat at $34.8 million, compared with the prior year period. Similar to North America, an increase in average spending per Associate in Hong Kong, due to our commission qualification changes, helped offset the decline in active Associates in that market.

We believe that the decline in Hong Kong Associate count during the third quarter is a function of our China integration plan and changes that have occurred throughout the process. In the second quarter of 2011, we communicated our initial China integration plan to our Hong Kong Associates. This plan included policy changes in Hong Kong that we ultimately did not implement, largely because of feedback from our Associates. Although we did not implement these particular policy changes, many of our Hong Kong Associates meaningfully increased their volume of product purchases during the second quarter in anticipation of the policy changes and,

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as a result, did not purchase from us in the third quarter. Notably, the Associates who thus did not purchase from us at all during the third quarter are not included in our active Associate count in Hong Kong for the quarter.

Additionally, the change to our China integration plan created uncertainty among many of our Hong Kong Associates. We believe that we have lost business from many Associates in Hong Kong as a result of this uncertainty. Our Asia Pacific management team is working closely with our Associates in Hong Kong to ease the integration.

Gross Profit

Gross profit increased to 82.4% of net sales for the third quarter of 2011 from 81.4% for the third quarter of 2010. This increase in gross profit can primarily be attributed to currency benefits received from our international subsidiaries, as the majority of our products sold are manufactured at our corporate headquarters in the United States and transferred to our international subsidiaries.

Associate Incentives

Associate incentives increased to 46.1% of net sales during the third quarter of 2011, compared with 44.9% for the third quarter of 2010. This increase was primarily due to a higher payout under our Matching Bonus program and the negative effect of currency fluctuations. Additionally, we had a higher payout rate on base commissions under our Associate compensation plan. On a comparable basis, this increase was partially offset by the inclusion of a full quarter of BabyCare s operations in our operating results, as BabyCare s separate compensation plan has a lower relative payout than the USANA compensation plan.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased to 23.3% of net sales for the third quarter of 2011, compared with 22.8% for the third quarter of 2010. This relative increase can be attributed to expenses associated with our increased corporate branding efforts and the inclusion of a full quarter of BabyCare s expenses in our operating results. BabyCare currently carries significantly higher selling, general, and administrative expense as a percentage of net sales. Changes in currency exchange rates also negatively affected selling, general and administrative expenses. Partially offsetting these increases was leverage gained on increased sales outside the United States in markets where selling, general and administrative expenses are lower.

In absolute terms, our selling, general and administrative expenses increased by $2.6 million for the third quarter of 2011, compared with the third quarter of 2010. The most significant components of this increase in absolute terms were as follows:

- An increase in BabyCare expense of $1.7 million, primarily due to the inclusion of a full quarter of operations during the current year;

- An increase related to our corporate branding efforts of approximately $0.8 million; and

- An increase in credit card processing and bank fees of approximately $0.3 million.

Although reflected in some of the above items, changes in currency added approximately $0.9 million to overall selling, general and administrative expense. These increases were partially offset by the decrease of $1.2 million in BabyCare acquisition costs compared with the prior year.

Other income (expense), net

Other income decreased by $0.4 million for the third quarter of 2011, compared with the third quarter of 2010 due to lower currency exchange gains on intercompany transactions during the current year quarter.

Income taxes

Income taxes totaled 34.5% of earnings before income taxes in the third quarter of 2011, compared with 32.7% in the third quarter of 2010. The income tax rate for the third quarter of 2010 was lower due to tax benefits related to changes in uncertain income tax positions, larger prior-year tax benefits, and the level of stock option exercises.

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Diluted Earnings Per Share

Although net earnings decreased by 3.6% during the third quarter of 2011, when compared with the third quarter of 2010, diluted earnings per share increased by 2.5% due to a lower number of diluted shares outstanding as a result of share repurchases over the last twelve months.

Nine Months Ended October 2, 2010 and October 1, 2011

Net Sales

The following table summarizes the changes in our net sales by geographic region for the periods ended as of the dates indicated:

	Net Sales by Region (in thousands) Nine Months Ended				Change from prior year	Percent change	Approximate impact of currency exchange	Change excluding the impact of currency
	October 2, 2010		October 1, 2011					
North America:								
United States	$ 113,826	29.9%	$ 112,132	25.7%	$ (1,694)	(1.5)%	$ N/A	(1.5)%
Canada	52,352	13.8%	50,896	11.7%	(1,456)	(2.8)%	2,800	(8.1)%
Mexico	16,416	4.3%	16,288	3.7%	(128)	(0.8)%	900	(6.3)%
North America Total	182,594	48.0%	179,316	41.1%	(3,278)	(1.8)%	3,700	(3.8)%

On February 28, 2013, the Audit Committee appointed E&Y as Peoples' independent registered public accounting firm for the fiscal year ending December 31, 2013. E&Y has served as Peoples' independent auditors/independent registered public accounting firm since 1995.

Fees

Fees for services rendered by E&Y for each of the 2012 and the 2011 fiscal years were:

	2012	2011
Audit Fees (1)	$683,267	$638,847

Audit-Related Fees (2)	—	—
Tax Fees (3)	42,500	42,500
Total	$725,767	$681,347

(1) Audit Fees pertain to professional services rendered in connection with the audit of Peoples' annual consolidated financial statements and review of the consolidated financial statements included in Peoples' Quarterly Reports on Form 10-Q, as well as internal control testing for compliance with Section 404 of the Sarbanes-Oxley Act of 2002.

(2) Audit-Related Fees pertain to services rendered in connection with statutory audits and accounting consultation.

(3) Tax Fees pertain to services rendered for tax planning and advice, tax compliance, and assistance with tax audits and appeals.

E&Y did not render any other services to Peoples or any of our subsidiaries during the 2012 or the 2011 fiscal years. All of the services described under “Audit Fees” and “Tax Fees” above were pre-approved by the Audit Committee.

Pre-Approval Policy

The Audit Committee has adopted, and the Board has ratified, an Audit and Non-Audit Services Pre-Approval Policy (the “Pre-Approval Policy”), which sets forth the procedures and conditions pursuant to which services proposed to be performed by the independent registered public accounting firm may be pre-approved. Proposed services may either be pre-approved without consideration of specific case-by-case services by the Audit Committee (“general pre-approval”), or be subject to the requirement that the specific pre-approval of the Audit Committee be obtained (“specific pre-approval”). Appendices to the Pre-Approval Policy describe the Audit, Audit-Related, Tax and All Other services that have the general pre-approval of the Audit Committee. The term of any general pre-approval is 12 months from the date of pre-approval, unless the Audit Committee states otherwise. The Audit Committee annually reviews and pre-approves the services that may be provided by the independent registered public accounting firm without obtaining specific pre-approval from the Audit Committee. The Audit Committee will add to or subtract from the list of general pre-approved services from time to time, based on subsequent reviews and determinations.

The Pre-Approval Policy does not delegate to management the Audit Committee's responsibilities to pre-approve services performed by the independent registered public accounting firm. The Audit Committee, however, may delegate pre-approval authority to one or more of its members. The member(s) to whom such authority is delegated must report, for informational purposes only, any pre-approval decisions to the Audit Committee at its next scheduled meeting. The Audit Committee has delegated both types of pre-approval authority to the Chair of the Audit Committee.

All requests or applications for services to be provided by the independent registered public accounting firm are to be submitted to the Chief Financial Officer of Peoples, and must include a detailed description of the services to be rendered. The Chief Financial Officer and the independent registered public accounting firm must determine jointly whether, in their view, the request or application is consistent with the SEC's and the Public Accounting Oversight Board's rules on auditor independence and is an appropriate service. If so, the Chief Financial Officer will request specific pre-approval from the Audit Committee (or

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its designee) as appropriate. Any proposed services exceeding pre-approved cost levels or budgeted amounts will also require specific pre-approval by the Audit Committee.

The Audit Committee has designated the Director of Risk Management of Peoples to monitor the performance of all services provided by the independent registered public accounting firm and to determine whether such services are in compliance with the Pre-Approval Policy. The Director of Risk Management reports to the Audit Committee on a periodic basis as to the results of such monitoring. Both the Director of Risk Management and management of Peoples are to immediately report to the Chair of the Audit Committee any breach of the Pre-Approval Policy that comes to the attention of the Director of Risk Management or any member of management.

PROPOSAL NUMBER 4:

RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Audit Committee of Peoples' Board has appointed E&Y to serve as Peoples' independent registered public accounting firm for the fiscal year ending December 31, 2013, and recommends that Peoples' shareholders vote for the ratification of that appointment. E&Y audited Peoples' consolidated financial statements as of and for the fiscal year ended December 31, 2012, and the effectiveness of Peoples' internal control over financial reporting as of December 31, 2012. Representatives of E&Y are expected to be present at the Annual Meeting and will be given the opportunity to make a statement if they so desire and to respond to appropriate questions.

The appointment of Peoples' independent registered public accounting firm is made annually by the Audit Committee. Peoples has determined to submit the appointment of the independent registered public accounting firm to the shareholders for ratification because of such firm's role in reviewing the quality and integrity of Peoples' consolidated financial statements and internal control over financial reporting. Before appointing E&Y, the Audit Committee carefully considered that firm's qualifications as Peoples' independent registered public accounting firm and the audit scope.

Recommendation and Vote

THE AUDIT COMMITTEE AND THE BOARD UNANIMOUSLY RECOMMEND THAT PEOPLES' SHAREHOLDERS VOTE “FOR” THE RATIFICATION OF THE APPOINTMENT OF E&Y.

The affirmative vote of a majority of the common shares represented at the Annual Meeting, in person or by proxy, and entitled to vote on the proposal, is required to ratify the appointment of E&Y as Peoples' independent registered public accounting firm for the fiscal year ending December 31, 2013. The effect of an abstention is the same as a vote “AGAINST.” Even if the appointment of E&Y is ratified by the shareholders, the Audit Committee, in its discretion, could decide to terminate the engagement of E&Y and to engage another firm if the Audit Committee determines such action is necessary or desirable. If the appointment of E&Y is not ratified, the Audit Committee will reconsider (but may decide to maintain) the appointment.

HOUSEHOLDING OF ANNUAL MEETING MATERIALS

The SEC has implemented rules regarding the delivery of proxy materials to households. This method of delivery, often referred to as “householding,” would permit Peoples to send a single annual report, proxy statement or Notice of Internet Availability of Proxy Materials, as applicable, to any household at which two or more different shareholders reside if Peoples reasonably believes such shareholders are members of the same family or otherwise share the same address or that one shareholder has multiple accounts. In each case, the shareholder(s) must consent to the householding process, and may at any time request that Peoples promptly deliver to such shareholder(s) a separate copy of the proxy materials subject to householding. Each shareholder would continue to receive a separate notice of meeting of shareholders and proxy card. The householding procedure is intended to reduce the volume of duplicate information shareholders receive and reduce Peoples' expenses. Peoples does not currently practice householding, but may institute householding in the future and will notify registered shareholders affected by householding at that time. Registered shareholders sharing an address may request delivery of a single copy of annual reports to shareholders, proxy statements and Notices of Internet Availability of Proxy Materials by contacting the Corporate Secretary of Peoples at Peoples Bancorp Inc., 138 Putnam Street, P.O. Box 738, Marietta, OH 45750-0738, Attention: Corporate Secretary.

Many brokers, financial institutions and other holders of record have instituted householding. If your family has one or more “street name” accounts under which you beneficially own common shares of Peoples, you may have received householding information from your broker, financial institution or other nominee in the past. Please contact the holder of record directly if you have questions, require additional copies of this proxy statement or Peoples' 2012 Annual Report or if you

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wish to revoke your decision to household and thereby receive multiple copies of Peoples' proxy materials. You should also contact the holder of record if you wish to institute householding.

OTHER MATTERS

As of the date of this proxy statement, the Board knows of no matter that will be presented for action by the shareholders at the Annual Meeting other than those matters discussed in this proxy statement. However, if any other matter requiring a vote of the shareholders is properly presented at the Annual Meeting, the individuals acting under the proxies solicited by the Board will vote and act according to their best judgment in light of the conditions then prevailing, to the extent permitted under applicable law.

It is important that your common shares be represented. Whether or not you plan to attend the Annual Meeting in person, please complete, sign and return the accompanying proxy card in the enclosed envelope furnished herewith, or transmit your voting instructions electronically via the Internet or by telephone by following the instructions on the proxy card.

By Order of the Board,

Charles W. Sulerzyski
President and Chief Executive Officer

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APPENDIX A
PEOPLES BANCORP INC.
Second Amended and Restated
2006 Equity Plan

The Peoples Bancorp Inc. 2006 Equity Plan was adopted on the 9th day of February, 2006, by the Board and approved by the shareholders of the Company on April 13, 2006. Section 12.1 of the Peoples Bancorp Inc. 2006 Equity Plan was amended by the Board on June 8, 2006. Section 5.7(b) of the Peoples Bancorp Inc. 2006 Equity Plan was amended by the Board on February 8, 2007. The Peoples Bancorp Inc. 2006 Equity Plan was amended and restated effective December 11, 2008. The Amended and Restated Peoples Bancorp Inc. 2006 Equity Plan is hereby further amended and restated, subject to approval by the shareholders of the Company.

ARTICLE I
PURPOSE AND EFFECTIVE DATE

1.1 PURPOSE. The purpose of the Plan is to provide financial incentives for selected Employees, Advisors and Non-Employee Directors, thereby promoting the long-term growth and financial success of the Company by: (a) attracting and retaining Employees, Advisors and Non-Employee Directors of outstanding ability; (b) strengthening the Company's capability to develop, maintain and direct a competent management team; (c) providing an effective means for selected Employees, Advisors and Non-Employee Directors to acquire and maintain ownership of Company Stock; (d) motivating Employees to achieve long-range Performance Goals and objectives; and (e) providing incentive compensation opportunities competitive with peer financial institution holding companies.

1.2 EFFECTIVE DATE AND EXPIRATION OF PLAN. The Peoples Bancorp Inc. 2006 Equity Plan originally became effective on April 13, 2006. The Amended and Restated Peoples Bancorp Inc. 2006 Equity Plan became effective on December 11, 2008. This Second Amended and Restated Peoples Bancorp Inc. 2006 Equity Plan will become effective upon the approval hereof by the shareholders of the Company. Unless earlier terminated by the Board pursuant to Section 12.2, the Plan shall terminate on the tenth anniversary of the Second Restatement Effective Date. No Award shall be made pursuant to the Plan after this termination date, but Awards made prior to this termination date may extend beyond that date. Notwithstanding the foregoing, no Incentive Stock Options may be granted after February 28, 2023.

ARTICLE II
DEFINITIONS

The following words and phrases, as used in the Plan, shall have the meanings set forth in this Article II. When applying these definitions and any other word, term or phrase used in the Plan, the form of any word, term or phrase will include any and all of its other forms.

2.1 ADVISOR means any advisor who renders bona fide services to the Company and/or one or more of the Subsidiaries as an advisory or marketing board member and who is neither an Employee nor a director of the Company or any Subsidiary; provided that the services rendered are not in connection with the offer or sale of securities in a capital-raising transaction and do not directly or indirectly promote or maintain a market for the Company's securities.

2.2 AWARD means, individually or collectively, any Option, SAR, Restricted Stock, Restricted Performance Stock, unrestricted Company Stock or Performance Unit Award.

2.3 AWARD AGREEMENT means the written agreement between the Company and each Participant that describes the terms and conditions of each Award. If there is a conflict between the terms of the Plan and the Award Agreement, the terms of the Plan will govern.

2.4 BOARD means the Board of Directors of the Company.
2.5 CAUSE with respect to any Participant, means: (a) gross negligence or gross neglect of duties; or (b) commission of a felony or of a gross misdemeanor involving moral turpitude in connection with the Participant's employment or service, as the case may be, with the Company or any of its Subsidiaries; or (c) fraud, disloyalty, dishonesty or willful violation of any law, rule or regulation or any significant Company policy committed in connection with the Participant's employment or provision of services, as the case may be; or (d) issuance of an order for removal of the Participant by any agency which regulates the activities of the Company or any of its Subsidiaries. Any determination of “Cause” under the Plan shall be made by the Committee in its sole discretion.
2.6 COMPANY means Peoples Bancorp Inc., an Ohio corporation.
2.7 COMPANY DIRECTOR means a non-employee member of the Board.
2.8 COMPANY STOCK means the Company's common shares, without par value per share.
2.9 CODE means the Internal Revenue Code of 1986, as amended or superseded after the Effective Date, and any applicable rulings or regulations issued thereunder.
2.10 COMMITTEE means the Compensation Committee of the Board or a subcommittee thereof.
2.11 DISABILITY means: (a) with respect to an Incentive Stock Option, “disabled” within the meaning of Section 22(e)(3) of the Code; (b) with respect to any Award subject to Section 409A of the Code, “disabled” as defined under Section 409A of the Code; and (c) with respect to any Award not described in subsections (a) and (b) of this Section 2.11, a long-term disability as defined by the Company's or applicable Subsidiary's group disability insurance plan, or any successor plan that is applicable to such Participant at the time of his or her Termination.
2.12 EFFECTIVE DATE means April 13, 2006, the date on which the Peoples Bancorp Inc. 2006 Equity Plan was originally approved by the shareholders of the Company.
2.13 EMPLOYEE means any person who, on any applicable date, is a common law employee of the Company or of any Subsidiary. A worker who is classified as other than a common law employee but who is subsequently reclassified as a common law employee of the Company or of any Subsidiary for any reason and on any basis will be treated as a common law employee only from the date that reclassification occurs and will not retroactively be reclassified as an Employee for any purpose of the Plan.
2.14 EXCHANGE ACT means the Securities Exchange Act of 1934, as amended.
2.15 EXERCISE PRICE means the amount, if any, that a Participant must pay to exercise an Award (other than an Option).
2.16 FAIR MARKET VALUE means, as of any specified date, an amount equal to the reported closing price on the specified date of a share of Company Stock on NASDAQ or any other established stock exchange or quotation system on which the Company Stock is then listed or traded or, if no shares of Company Stock have been traded on such date, the closing price of a share of Company Stock on NASDAQ or such other established stock exchange or quotation system as reported on the first day prior thereto on which shares of Company Stock were so traded. If the preceding sentence does not apply, Fair Market Value shall be determined: (a) with respect to Nonqualified Stock Options and SARs, by the Committee through the reasonable application of a reasonable valuation method, taking into account all information material to the value of the Company, that satisfies the requirements of Treasury Regulation § 1.409A-1(b)(5); and (b) with respect to any other Awards, in good faith by the Committee using other reasonable means.
2.17 FISCAL YEAR means the fiscal year of the Company, which is the period beginning January 1 and ending on December 31.
2.18 GOOD REASON means (a) if the Participant has entered into a “Change in Control Agreement” with the Company, the definition of good reason in the Participant's Change in Control Agreement with the Company, and (b) if no such agreement exists, without the Participant's express written consent, after written notice to the Board, and after a thirty (30) day opportunity for the Board to cure, the continuing occurrence of any of the following events:

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(i) The assignment to the Participant of any material duties or responsibilities inconsistent with the Participant's position(s), or a change in the Participant's reporting responsibilities, title(s), or office(s), or any removal of the Participant from or any failure to re-elect the Participant to any of such position(s), except in connection with the Participant's Termination for Cause, Disability, Retirement, or as a result of the Participant's death;
(ii) A reduction by the Company or any of its Subsidiaries in the Participant's base salary;
(iii) The taking of any action by the Company or any of its Subsidiaries which would adversely affect the Participant's participation in or materially reduce the Participant's benefits under any benefit plans, or the failure by the Company or its Subsidiaries, as applicable, to provide the Participant with the number of paid vacation days to which the Participant is then entitled on the basis of years of service with the Company and its Subsidiaries in accordance with the Company's normal vacation policy in effect on the Second Restatement Effective Date; or
(iv) The Company or one of its Subsidiaries directing the Participant to be reassigned to an office location fifty (50) miles or more from the current office location of the Participant except for required travel on Company or Subsidiary business to an extent substantially consistent with the Participant's present business travel obligations or, in the event the Participant consents to any relocation, the failure by the Company or one of its Subsidiaries, as applicable, to pay (or reimburse the Participant) for all reasonable moving expenses incurred by the Participant relating to a change of the Participant's principal residence in connection with such relocation and to indemnify the Participant against any loss realized on the sale of the Participant's principal residence in connection with any such change of residence.
2.19 INCENTIVE STOCK OPTION means an option within the meaning of Section 422 of the Code.
2.20 NON-EMPLOYEE DIRECTOR means either a Company Director or a Subsidiary Director.
2.21 NONQUALIFIED STOCK OPTION means an option granted under the Plan other than an Incentive Stock Option.
2.22 OPTION means either a Nonqualified Stock Option or an Incentive Stock Option, in each case to purchase Company Stock.
2.23 OPTION PRICE means the price at which Company Stock may be purchased under an Option.
2.24 PARTICIPANT means an Employee, an Advisor or a Non-Employee Director to whom an Award has been made under the Plan.
2.25 PERFORMANCE GOALS means goals established by the Committee pursuant to Section 4.5.
2.26 PERFORMANCE PERIOD means a period of time over which performance is measured.
2.27 PERFORMANCE UNIT means the unit of measure determined under Article IX by which is expressed the value of a Performance Unit Award.
2.28 PERFORMANCE UNIT AWARD means an Award granted under Article IX.
2.29 PERSONAL REPRESENTATIVE means the person or persons who, upon the death, Disability, or incompetency of a Participant, shall have acquired, by will or by the laws of descent and distribution or by other legal proceedings, the right to exercise an Option or an SAR or the right to any Restricted Stock Award or any Performance Unit Award theretofore granted or made to such Participant.
2.30 PLAN means the Peoples Bancorp Inc. Second Amended and Restated 2006 Equity Plan.
2.31 PREDECESSOR PLANS means the Peoples Bancorp Inc. 2002 Stock Option Plan, as amended, the Peoples Bancorp Inc. 1998 Stock Option Plan, the Peoples Bancorp Inc. 1995 Stock Option Plan and the Amended and Restated Peoples Bancorp Inc. 1993 Stock Option Plan.
2.32 RESTRICTED PERFORMANCE STOCK means Company Stock subject to Performance Goals.

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2.33 RESTRICTED STOCK means Company Stock subject to the terms and conditions provided in Article VI and includes Restricted Performance Stock.
2.34 RESTRICTED STOCK AWARD means an Award granted under Article VI.
2.35 RESTRICTION PERIOD means a period of time determined under Section 6.2 during which Restricted Stock is subject to the terms and conditions provided in Section 6.3.
2.36 RETIREMENT means a Termination by a Participant other than due to death or Disability on or after attaining 65 years of age and with at least 10 years of service with the Company or any Subsidiary.
2.37 SAR means a stock appreciation right granted under Section 5.7.
2.38 SECOND RESTATEMENT EFFECTIVE DATE means the date the Plan is approved by the Company's shareholders.
2.39 SHAREHOLDERS mean the shareholders of the Company.
2.40 SUBSIDIARY means any corporation or other entity that is under common control with the Company, as determined under Sections 414(b) and (c) of the Code, but modified as permitted by Section 409A of the Code.
2.41 SUBSIDIARY DIRECTOR means a non-employee member of the board of directors of a Subsidiary who is not also a Company Director.
2.42 TERMINATION means a “separation from service” as defined under Section 409A of the Code.

ARTICLE III

ADMINISTRATION

3.1 COMMITTEE TO ADMINISTER. The Plan shall be administered by the Committee, in accordance with its Charter, as amended from time to time by the Board; provided, however, that the Board has the authority to grant Awards to Company Directors.

3.2 POWERS OF COMMITTEE.

(a) The Committee and the Board shall have full power and authority to interpret and administer the Plan and to establish and amend rules and regulations for its administration. Any action or decision by the Board or the Committee shall be final, binding and conclusive with respect to the interpretation of the Plan and any Award made under it.

(b) Subject to the provisions of the Plan, the Committee or the Board, as the case may be, shall have authority, in its discretion, to determine those Employees, Advisors and Non-Employee Directors who shall receive an Award; the time or times when any such Award shall be made; the vesting schedule, if any, for the Award; and the type of Award to be granted, the number of shares of Company Stock to be subject to each Option, each SAR, and each Restricted Stock Award, the value of each Performance Unit and all other terms and conditions of any Award.

(c) The Committee or the Board, as the case may be, shall determine and set forth in an Award Agreement the terms of each Award, including such terms, restrictions, and provisions as shall be necessary to cause certain Options to qualify as Incentive Stock Options. The Committee or the Board, as the case may be, may correct any defect or supply any omission or reconcile any inconsistency in the Plan or in any Award Agreement, in such manner and to the extent the Committee or the Board, as appropriate, shall determine in order to carry out the purposes of the Plan. The Committee or the Board, as the case may be, may, in its discretion, accelerate (i) the date on which an Option or an SAR may be exercised, (ii) the date of termination of the restrictions applicable to a Restricted Stock Award, or (iii) the end of a Performance Period under a Performance Unit Award, if the Committee or the Board, as appropriate, determines that to do so will be in the best interests of the Company and the Participants in the Plan. Notwithstanding the foregoing, the Committee shall not exercise any discretion with respect to an Award that is intended to qualify as performance-based compensation under Section 162(m) of the Code that would cause the Employee to whom the Award was made to receive more than would otherwise have been paid or receivable under the Performance Goals in respect of the Award established pursuant to Section 162(m) of the Code.

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ARTICLE IV
AWARDS

4.1 AWARDS. Awards under the Plan shall consist of Incentive Stock Options, Nonqualified Stock Options, SARs, Restricted Stock, Restricted Performance Stock, unrestricted Company Stock and Performance Units. All Awards shall be subject to the terms and conditions of the Plan and to such other terms and conditions consistent with the Plan as the Committee or the Board, as the case may be, deems appropriate. Awards under a particular Article or Section of the Plan need not be uniform and Awards under two or more Articles or Sections may be combined in one Award Agreement. Any combination of Awards may be granted at one time and on more than one occasion to the same Employee, Advisor or Non-Employee Director. Awards of Performance Units and Restricted Performance Stock shall be earned solely upon attainment of Performance Goals and the Committee shall have no discretion to increase the amounts to be received or paid under such Awards.

4.2 ELIGIBILITY FOR AWARDS. An Award may be made to any Employee or Advisor selected by the Committee. In making this selection and in determining the form and amount of the Award, the Committee may give consideration to the functions and responsibilities of the respective Employee and/or Advisor, his or her present and potential contributions to the success of the Company or any of its Subsidiaries, the value of his or her services to the Company or any of its Subsidiaries, and such other factors deemed relevant by the Committee. Non-Employee Directors are eligible to receive Awards pursuant to Article VII.

4.3 SHARES AVAILABLE UNDER THE PLAN.

(a) The Company Stock to be offered under the Plan pursuant to Options, SARs, Performance Unit Awards, Restricted Performance Stock, Restricted Stock and unrestricted Company Stock Awards must be (i) Company Stock previously issued and outstanding and reacquired by the Company or (ii) authorized but unissued Company Stock not reserved for any other purpose. Subject to adjustment under Section 12.1, the number of shares of Company Stock that may be issued under the Plan (the “Section 4.3 Limit”) will be such number of common shares as shall result in an aggregate of 800,000 common shares being available for future grants of Awards on and after the Second Restatement Effective Date. Based on the number of common shares available for future grants of Awards as of February 28, 2013, the aggregate number of common shares available for issuance under the Plan (including common shares subject to outstanding Awards (199,231 common shares) and common shares previously issued in satisfaction of Awards (82,333 common shares)) would be 1,081,564 common shares.

(b) The maximum number of shares of Company Stock that may be issued subject to Incentive Stock Options is 800,000 subject to adjustment under Section 12.1. The Section 4.3 Limit shall not have counted against it: (i) the number of shares of Company Stock subject to an Option or any other Award which is equal to the number of shares of Company Stock tendered by a Participant to the Company in payment of the Option Price of such Option or the Exercise Price of such other Award, as applicable; (ii) shares of Company Stock subject to an Award granted on or after the Second Restatement Effective Date which Award for any reason thereafter terminates by expiration, forfeiture, cancellation or otherwise without having been exercised or paid; (iii) shares of Company Stock withheld from any Award to satisfy a Participant's tax withholding obligations or, if applicable, to pay the Option Price of an Option or the Exercise Price of any other Award; (iv) if an SAR is settled in whole or in part by the issuance of shares of Company Stock, the number of shares of Company Stock which represents the difference between (A) the number of shares of Company Stock which remain subject to such SAR on the date of such settlement and (B) the number of shares of Company Stock actually issued upon settlement of such SAR; or (v) the number of shares of Company Stock subject to an Option which is equal to the number of shares of Common Stock acquired by the Company on the open market using the cash proceeds received by the Company from the exercise of such Option; provided, however, that such number of shares of Company Stock shall in no event be greater than the number which is determined by dividing (A) the amount of cash proceeds received by the Company from the Participant upon the exercise of such Option by (B) the Fair Market Value of a share of the Company Stock on the date of exercise of such Option.

(c) No awards shall be granted under any Predecessor Plan on and after April 13, 2006.

4.4 LIMITATION ON AWARDS. The maximum aggregate dollar value of, and the maximum number of shares of Company Stock subject to, Restricted Stock and Performance Units awarded to any Employee or Advisor with respect to a Performance Period or Restriction Period may not exceed $500,000 and 500,000 shares of Company Stock for

each Fiscal Year included in such Performance Period or Restriction Period.
The maximum number of shares of Common Stock for which Options or SARs may be granted to any Participant in any one Fiscal Year shall not exceed 500,000 subject to adjustment under Section 12.1.

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4.5 GENERAL PERFORMANCE GOALS.

(a) Performance Goals relating to the payment or vesting of an Award that is intended to qualify as "performance-based compensation" under Section 162(m) of the Code will be comprised of one or more of the following performance criteria as the Committee may deem appropriate:

- Earnings per share (actual or targeted growth);
- Net income after capital costs;
- Net income (before or after taxes);
- Return measures (including, but not limited to, return on average assets, risk-adjusted return on capital, return on average equity, pre-provision net revenue, or return on tangible common equity);
- Efficiency ratio;
- Full-time equivalency control;
- Stock price (including, but not limited to, growth measures, share price appreciation, or total shareholder return);
- Non-interest income compared to net interest income ratio;
- Expense targets (including, but not limited to, reduction in or maintenance of non-interest expense;
- Operating efficiency;
- Economic value added or EVA(R);
- Credit quality measures;
- Customer satisfaction measures;
- Loan growth;
- Deposit growth;
- Net interest margin;
- Fee income;
- Operating expense;
- Balance sheet measures including assets, loans, charge-offs, loan loss reserves, non-performing assets, deposits, asset quality levels, and investments;
- Balance sheet management;
- Interest income;
- Investment management;
- Maintenance or improvement of net interest income;
- Market capitalization;
- Market share;
- Non-interest income growth;
- Productivity ratios;
- Revenues;
- Risk management measures including interest-sensitivity gap levels, regulatory compliance, satisfactory internal or external audits, and financial ratings; and
- Tangible common equity.

(b) For any Awards not intended to qualify as "performance-based compensation" under Section 162(m) of the Code, the Committee may establish Performance Goals based on the performance criteria listed in Section 4.5(a) or other performance criteria as it deems appropriate.

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(c) Any of the performance criteria listed in Section 4.5(a) may be applied solely with reference to the Company and/or any Subsidiary or relatively between the Company and/or any Subsidiary and one or more unrelated entities. In addition, different performance criteria may be applied to individual Participants or to groups of Participants and, as specified by the Committee, may be based on results achieved (i) separately by the Company or any Subsidiary, (ii) any combination of the Company and the Subsidiaries or (iii) any combination of business units or divisions of the Company and the Subsidiaries.
(d) With respect to each Performance Period, the Committee shall establish the Performance Goals in writing no later than the earlier of (i) 90 days after the beginning of the Performance Period or (ii) expiration of 25 percent of the Performance Period.
(e) Except as otherwise provided in the Plan or the Award Agreement, as of the end of each Performance Period, the Committee shall certify in writing the extent to which a Participant has or has not met the Participant's Performance Goal(s). To the extent consistent with Section 162(m) of the Code, Performance Goals may be calculated without regard to extraordinary items or adjusted, as the Committee deems equitable, in recognition of unusual or non-recurring events affecting the Company and/or its Subsidiaries or changes in applicable tax laws or accounting principles.

(f) To the extent permitted under Section 162(m) of the Code, if applicable, the Committee shall make (i) appropriate adjustments to performance criteria to reflect the effect on any performance criteria of any stock dividend or stock split affecting Company Stock, recapitalization, merger, consolidation, combination, spin-off, distribution of assets to Shareholders, exchange of shares or similar corporate change and (ii) similar adjustments to any portion of performance criteria that is not based on Company Stock but which is affected by an event having an effect similar to those just described.

ARTICLE V

OPTIONS AND STOCK APPRECIATION RIGHTS

5.1 AWARD OF OPTIONS. The Committee may, from time to time, and on such terms and conditions as the Committee may prescribe, award: (a) Incentive Stock Options, subject to Section 5.5, to any eligible Employee of the Company (or any subsidiary or parent corporation within the meaning of Sections 424(e) and 424(f) of the Code); and (b) Nonqualified Stock Options to any Employee or Advisor.

5.2 PERIOD OF OPTION.

(a) An Option granted under the Plan shall be exercisable only in accordance with the vesting schedule approved by the Committee. The Committee may in its discretion prescribe additional conditions, restrictions or terms on the vesting of an Option, including the full or partial attainment of Performance Goals pursuant to Section 4.5. After the Option vests, the Option may be exercised at any time during the term of the Option, in whole or in installments, as specified in the related Award Agreement. Subject to Article X and except as provided in Section 5.5, the term of each Option shall not be more than ten years from the date of grant.
(b) Except as provided in Article X or as otherwise provided by the Committee, a Participant may not exercise an Option unless such Participant is then, and continually (except for sick leave, military service, or other approved leave of absence) after the grant of the Option has been, an Employee or Advisor.

5.3 AWARD AGREEMENT. Each Option shall be evidenced by an Award Agreement. The Award Agreement shall specify whether the Option is intended to be an Incentive Stock Option or a Nonqualified Stock Option.

5.4 OPTION PRICE, EXERCISE AND PAYMENT.

(a) Except as provided in Section 5.5, the Option Price with respect to Company Stock subject to each Option shall be determined by the Committee but shall be a price not less than 100 percent of the Fair Market Value of Company Stock at the date such Option is granted.
(b) Vested Options may be exercised from time to time by giving written notice to the Chief Financial Officer of the Company or the Secretary of the Committee, or his or her designee, specifying the number of shares of Company Stock to be purchased. The notice of exercise shall be accompanied by payment in full of the Option Price in cash or the Option Price may be paid in whole or in part through the transfer to the Company of shares of Company Stock in accordance with procedures established by the Committee from time to time. In addition, in accordance with the rules

and procedures established by the Committee for this purpose, an Option may also be exercised through a cashless exercise procedure involving a broker or dealer, that affords a Participant the opportunity to sell immediately some or all of the shares of Company Stock underlying the exercised portion of the Option in order to generate sufficient cash to pay the Option Price and/or to satisfy withholding tax obligations related to the Option.

(c) In the event such Option Price is paid, in whole or in part, with shares of Company Stock, the portion of the Option Price so paid shall be equal to the value, as of the date of exercise of the Option, of such shares. The value of such shares shall be equal to the number of such shares multiplied by the Fair Market Value of such shares on the trading day coincident with the date of exercise of such Option (or the immediately preceding trading day if the date of exercise is not a trading day). The Company shall not issue or transfer Company Stock upon exercise of an Option until the Option Price is fully paid.

5.5 LIMITATIONS ON INCENTIVE STOCK OPTIONS. Each provision of the Plan and each Award Agreement relating to an Incentive Stock Option shall be construed so that each Incentive Stock Option shall be an incentive stock option as defined in Section 422 of the Code, and any provisions of the Award Agreement that cannot be so construed shall be disregarded. No Incentive Stock Option may be granted to any Employee who, at the time of such grant, owns stock possessing more than 10 percent of the total combined voting power of all classes of stock of the Company (or any subsidiary or parent corporation within the meaning of Sections 424(e) and 424(f) of the Code) unless: (a) the Option Price for such Incentive Stock Option is at least 110 percent of the Fair Market Value of a share of Company Stock on the date the Incentive Stock Option is granted; and (b) such Incentive Stock Option may not be exercised more than five years after it is granted. Notwithstanding anything in the Plan to the contrary, to the extent required by the Code, the exercise of Incentive Stock Options granted under the Plan shall be subject to the $100,000 calendar year limit as set forth in Section 422 of the Code; provided that, to the extent any grant exceeds such $100,000 calendar year limit, the portion of such granted Option in excess of such limit shall be deemed a Nonqualified Stock Option in accordance with Section 422 of the Code.

5.6 RIGHTS AND PRIVILEGES. A Participant shall have no rights as a Shareholder with respect to any shares of Company Stock covered by an Option until the issuance of such shares to the Participant.

5.7 AWARD OF SARs.

(a) The Committee may, from time to time, and on such terms and conditions as the Committee may prescribe, award SARs to any Employee and/or Advisor.

(b) An SAR shall represent the right to receive payment of an amount equal to: (i) the amount by which the Fair Market Value of one share of Company Stock on the date of exercise of the SAR exceeds the Exercise Price; multiplied by (ii) the number of shares of Company Stock covered by the SAR. Payment of the amount to which a Participant is entitled upon the exercise of an SAR shall be made in cash, Company Stock, or partly in cash and partly in Company Stock at the discretion of the Committee. The shares shall be valued at their Fair Market Value on the date of exercise.

(c) SARs awarded under the Plan shall be evidenced by an Award Agreement between the Company and the Participant.

(d) The Committee may prescribe conditions and limitations on the exercise of any SAR. SARs may be exercised only when the Fair Market Value of a share of Company Stock exceeds the Exercise Price. The Exercise Price under each SAR shall be determined by the Committee but shall be a price not less than 100 percent of the Fair Market Value of Company Stock at the date such SAR is granted.

(e) An SAR shall be exercisable only by written notice to the Chief Financial Officer of the Company or the Secretary of the Committee, or his or her designee.

(f) Subject to Article X, the term of each SAR shall not be more than ten years from the date of grant.

To the extent not previously exercised, all SARs shall automatically be exercised on the last trading day prior to their expiration, so long as the Fair Market Value of a share of Company Stock exceeds the Exercise Price, unless prior to such day the holder of an SAR instructs the Chief Financial Officer of the Company or the Secretary of the Committee otherwise in writing.

(g) Subject to Article X, each SAR shall expire on a date determined by the Committee at the time of grant.

5.8 REPRICING. Except for adjustments made pursuant to Section 12.1 or Section 12.2 of the Plan, in no event may the Board or the Committee, without obtaining shareholder approval: (a) amend the terms of an outstanding

Award to reduce the Option Price of an outstanding Option or the Exercise Price of an outstanding SAR; (b) cancel an outstanding Option or SAR in

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exchange for Options or SARs with an Option Price or Exercise Price, as applicable, that is less than the Option Price or Exercise Price of the original Option or SAR; or (c) cancel an outstanding Option or SAR with an Option Price or Exercise Price, as applicable, which is above the current Fair Market Value of the Company Stock in exchange for cash or other securities.

ARTICLE VI

RESTRICTED STOCK

6.1 AWARD OF RESTRICTED STOCK. The Committee may make a Restricted Stock Award to any Employee and/or Advisor, subject to this Article VI and to such other terms and conditions as the Committee may prescribe.

6.2 RESTRICTION PERIOD. At the time of making a Restricted Stock Award, the Committee shall establish the Restriction Period applicable to such Award. The Committee may establish different Restriction Periods from time to time and each Restricted Stock Award may have a different Restriction Period, in the discretion of the Committee. Restriction Periods, when established for a Restricted Stock Award, shall not be changed except as permitted by Section 6.3.

6.3 OTHER TERMS AND CONDITIONS. Company Stock, when awarded pursuant to a Restricted Stock Award, will be represented in a book entry account in the name of the Participant who receives the Restricted Stock Award. The Participant shall be entitled to receive dividends during the Restriction Period and shall have the right to vote such Restricted Stock and shall have all other Shareholder rights, with the exception that; (i) unless otherwise provided by the Committee, in the case of Restricted Performance Stock, dividends which would otherwise be received during the Restriction Period shall be accrued and paid to the Participant in the same proportion and at the same time as the underlying Restricted Performance Stock vests, if at all; (ii) unless otherwise provided by the Committee, if any dividends are paid in shares of Company Stock, those shares will be subject to the same restrictions as the shares of Restricted Stock with respect to which they were issued; (iii) the Participant will not be entitled to delivery of any stock certificate evidencing the Company Stock underlying the Restricted Stock Award during the Restriction Period; (iv) the Company will retain custody of the Restricted Stock during the Restriction Period; and (v) a breach of a restriction or a breach of the terms and conditions established by the Committee pursuant to the Restricted Stock Award will cause a forfeiture of the Restricted Stock Award. The Committee may, in addition, prescribe additional restrictions, terms, or conditions upon or to the Restricted Stock Award including the attainment of Performance Goals in accordance with and as contemplated by Section 4.5.

6.4 RESTRICTED STOCK AWARD AGREEMENT. Each Restricted Stock Award shall be evidenced by an Award Agreement.

6.5 PAYMENT FOR RESTRICTED STOCK. Restricted Stock Awards may be made by the Committee under which the Participant shall not be required to make any payment for the Company Stock or, in the alternative, under which the Participant, as a condition to the Restricted Stock Award, shall pay all (or any lesser amount than all) of the Fair Market Value of the Company Stock, determined as of the date the Restricted Stock Award is made. If the latter, such purchase price shall be paid in cash as provided in the Award Agreement.

ARTICLE VII

AWARDS FOR NON-EMPLOYEE DIRECTORS

7.1 AWARDS TO NON-EMPLOYEE DIRECTORS. The Board shall determine all Awards to Company Directors and the Committee shall determine all Awards to Subsidiary Directors. The Board or the Committee, as the case may be, retains the discretionary authority to make Awards to Non-Employee Directors and any type of Award (other than Incentive Stock Options) may be granted to Non-Employee Directors under the Plan. All such Awards shall be subject to the terms and conditions of the Plan and to such other terms and conditions consistent with the Plan as the Board or the Committee, as the case may be, deems appropriate.

7.2 NO RIGHT TO CONTINUANCE AS A DIRECTOR. None of the actions of the Company in establishing the Plan, the actions taken by the Company, the Board, or the Committee under the Plan, or the granting of any Award under the Plan shall be deemed (i) to create any obligation on the part of the Board or the board of directors of the applicable Subsidiary to nominate any Non-Employee Director for reelection or (ii) to be evidence of any agreement or understanding, express or implied, that the Non-Employee Director has a right to continue as a Non-Employee Director for any period of time or at any particular rate of compensation.

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ARTICLE VIII

UNRESTRICTED COMPANY STOCK AWARDS FOR EMPLOYEES AND/OR ADVISORS

8.1 The Committee may make awards of unrestricted Company Stock to Employees and/or Advisors on such terms and conditions as the Committee may prescribe.

ARTICLE IX

AWARD OF PERFORMANCE UNITS

9.1 AWARD OF PERFORMANCE UNITS. The Committee may award Performance Units to any Employee and/or Advisor. Each Performance Unit shall represent the right of a Participant to receive an amount equal to the value of the Performance Unit, determined in the manner established by the Committee at the time of Award.

9.2 PERFORMANCE PERIOD. At the time of each Performance Unit Award, the Committee shall establish, with respect to each such Award, a Performance Period during which performance shall be measured. There may be more than one Performance Unit Award in existence at any one time, and Performance Periods may differ.

9.3 PERFORMANCE GOALS. Performance Units shall be awarded to a Participant and earned contingent upon the attainment of Performance Goals in accordance with and as contemplated by Section 4.5.

9.4 PERFORMANCE UNIT VALUE. Each Performance Unit shall have a maximum dollar value established by the Committee at the time of the Award. Performance Units earned will be determined by the Committee in respect of a Performance Period in relation to the degree of attainment of Performance Goals. The measure of a Performance Unit may, in the discretion of the Committee, be equal to the Fair Market Value of one share of Company Stock.

9.5 AWARD CRITERIA. In determining the number of Performance Units to be granted to any Participant, the Committee shall take into account the Participant's responsibility level, performance, potential, cash compensation level, other incentive awards, and such other considerations as it deems appropriate.

9.6 PAYMENT.

(a) Following the end of the applicable Performance Period, a Participant holding Performance Units will be entitled to receive payment of an amount, not exceeding the maximum value of the Performance Units, based on the achievement of the Performance Goals for such Performance Period, as determined by the Committee.

(b) Awards may be paid in cash or Company Stock, or any combination thereof, as determined by the Committee. Payment shall be made in a lump sum or in installments at the discretion of the Committee and shall be subject to such other terms and conditions as shall be determined by the Committee.

9.7 PERFORMANCE UNIT AWARD AGREEMENTS. Each Performance Unit Award shall be evidenced by an Award Agreement.

ARTICLE X

GENERAL TERMINATION PROVISIONS

10.1 TERMINATION. Subject to Article XI and unless otherwise specified in the applicable Award Agreement, the following provisions will govern the treatment of a Participant's outstanding Awards following a Participant's Termination.

(a) Unless otherwise provided by the Committee, if the Participant's Termination is due to Disability or Retirement, all of the Participant's outstanding Options, SARs or Restricted Stock shall become fully vested and, if applicable, exercisable at the time and under the conditions, including attainment of the Performance Goals, as such Options, SARs and Restricted Stock would otherwise vest and become exercisable pursuant to the terms of the Award Agreement; and any Options or SARs that become exercisable pursuant to this Section 10.1(a) may be exercised by the Participant at any time before the earlier of (i) one year after the date such Option or SAR became vested, or (ii) the expiration date of the Award; provided, however, that an Option which is intended to qualify as an Incentive Stock Option will only be treated as such to the extent it complies with the requirements of Section 422 of the Code in respect of the exercise of such Option. Upon the Participant's Termination for any reason other than death, Disability or Retirement, any Awards that are not vested and/or exercisable on the date of such Termination will immediately terminate and be of no further force and effect.

(b) If the Participant Terminates for any reason other than (i) death, (ii) Disability, (iii) Retirement or (iv) for Cause, such Participant's outstanding SARs or Options may be exercised at any time within three months after such Termination, to the extent of the number of shares of Company Stock covered by such Options or SARs which are exercisable (and have not yet been exercised) at the date of such Termination; except that an Option or SAR shall not be exercisable on any date beyond the expiration date of such Option or SAR.

(c) Upon a Termination for Cause, any Options and any SARs held by the Participant (whether or not then exercisable) shall expire and any rights thereunder shall terminate immediately. Any non-vested Restricted Stock Awards of such Participant shall immediately be forfeited and any rights thereunder shall terminate.

(d) Unless otherwise provided by the Committee, upon a Termination due to the Participant's death, all Options, SARs and Restricted Stock not subject to Performance Goals shall immediately vest and, if applicable, become exercisable; a portion of the Options, SARs and Restricted Stock subject to Performance Goals, determined by multiplying the number of shares subject to such Options, SARs and Restricted Stock by a fraction, the numerator of which is the number of whole months elapsed during the Performance Period prior to the Participant's death, and the denominator of which is the number of months in the Performance Period, shall immediately vest; and any SARs and any Options that are then, or become, exercisable may be exercised by the Participant's Personal Representative at any time before the earlier of (i) one year after the Participant's death, or (ii) the expiration date of the Award.

(e) Upon a Termination due to the Participant's Disability or Retirement, any SARs and any Options that are exercisable at the time of the Participant's Termination may be exercised by the Participant at any time before the earlier of (i) one year after the date of such Termination or (ii) the expiration date of the Award; provided, however, that an Option which is intended to qualify as an Incentive Stock Option will only be treated as such to the extent it complies with the requirements of Section 422 of the Code in respect of the exercise of such Option.

(f) If a Participant who Terminates due to Retirement dies prior to exercising all of his or her outstanding Options and SARs, then such Options and such SARs may be exercised by the Participant's Personal Representative at any time before the earlier of (i) one year after the Participant's death or (ii) the expiration date of the Award; provided, however, that, an Option which is intended to qualify as an Incentive Stock Option will only be treated as such to the extent it complies with the requirements of Section 422 of the Code in respect of the exercise of such Option.

(g) Subject to Article XI, a Performance Unit Award shall terminate for all purposes if the Participant Terminates at any time during the applicable Performance Period, except as may otherwise be determined by the Committee. Subject to Article XI, in the event that a Participant holding a Performance Unit Terminates following the end of the applicable Performance Period but prior to full payment according to the terms of the Performance Unit Award, the Performance Unit Award shall terminate except when the Termination is due to death, Disability or Retirement or as may otherwise be determined by the Committee.

ARTICLE XI

CHANGE IN CONTROL OF THE COMPANY

11.1 CONTRARY PROVISIONS. Notwithstanding anything contained in the Plan to the contrary, the provisions of this Article XI shall govern and supersede any inconsistent terms or provisions of the Plan.

11.2 DEFINITION OF CHANGE IN CONTROL. For purposes of the Plan, Change in Control shall mean a change in the ownership or effective control of the Company or in the ownership of a substantial portion of the assets of the Company within the meaning of Section 409A of the Code.

11.3 EFFECT OF CHANGE IN CONTROL ON CERTAIN AWARDS.

(a) If the Company is not the surviving corporation following a Change in Control, and the surviving corporation following such Change in Control or the acquiring corporation (such surviving corporation or acquiring corporation is hereinafter referred to as the “Acquiror”) does not assume the outstanding Options, SARs, Restricted Stock, Restricted Performance Stock or Performance Units or does not substitute equivalent equity awards relating to the securities of such Acquiror or its affiliates for such outstanding Awards, then all outstanding Options and SARs shall become immediately and fully exercisable and all Restricted Stock Awards (other than Restricted Performance Stock Awards) shall become fully vested and all restrictions will immediately

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lapse. In the case of Restricted Performance Stock and Performance Units, the target payout opportunities under all outstanding Awards of Restricted Performance Stock and Performance Units shall be deemed to have been fully earned based on the target level of performance being attained as of the effective date of the Change in Control. In addition, the Board or its designee may, in its sole discretion, provide for a cash payment to be made to each Participant for the outstanding Restricted Stock, Restricted Performance Stock or Performance Units upon the consummation of the Change in Control, determined on the basis of the Fair Market Value that would be received in such Change in Control by the holders of the Company's securities relating to such Awards. Notwithstanding the foregoing, any Option intended to be an Incentive Stock Option under Section 422 of the Code shall be adjusted in a manner to preserve such status.

(b) If the Company is the surviving corporation following a Change in Control, or the Acquiror assumes the outstanding Options, SARs, Restricted Stock, Restricted Performance Stock or Performance Units or substitutes equivalent equity awards relating to the securities of such Acquiror or its affiliates for such outstanding Awards, then all such outstanding Awards or such substitutes therefor shall remain outstanding and be governed by their respective terms and the provisions of the Plan.

(c) If (i) a Participant is Terminated by the Company without Cause or the Participant Terminates for Good Reason within twenty-four (24) months following a Change in Control, and (ii) the Company is the surviving corporation following such Change in Control, or the Acquiror has assumed the outstanding Options, SARs, Restricted Stock, Restricted Performance Stock or Performance Units or substituted equivalent equity awards relating to the securities of such Acquiror or its affiliates for such outstanding Awards, then all outstanding Options and SARs or substituted equivalent equity awards shall become immediately and fully exercisable and all outstanding Restricted Stock Awards (other than Restricted Performance Stock Awards) shall become fully vested and all restrictions will immediately lapse. In the case of Restricted Performance Stock and Performance Units, the target payout opportunities under all outstanding Awards of Restricted Performance Stock and Performance Units shall be deemed to have been fully earned based on the target level of performance being attained.

(d) If (i) the employment of a Participant with the Company and its Subsidiaries is terminated for Cause within twenty-four (24) months following a Change in Control and (ii) the Company is the surviving corporation following such Change in Control, or the Acquiror has assumed the outstanding Options, SARs, Restricted Stock, Restricted Performance Stock, or Performance Units or substituted equivalent equity awards relating to the securities of such Acquiror or its affiliates for such Awards, then all outstanding Options and SARs held by such Participant shall expire, and any non-vested outstanding Restricted Stock, Restricted Performance Stock or Performance Units shall be forfeited, and any and all rights under all such outstanding Awards shall terminate immediately.

(e) Outstanding Options or SARs as to which vesting is accelerated in accordance with Section 11.3, may be exercised by the Participant following Termination subject to the provisions of Article X; provided, however, that a Participant whose Options or SARs become exercisable in accordance with Section 11.3(c) may exercise such Options or SARs at any time within one year after such Termination, except that an Option or SAR shall not be exercisable in any event on any date beyond the expiration date of such Option or SAR.

In the event of a Participant's death after such Termination, the exercisability of Options and SARs shall be treated in the same manner as that provided for Termination due to Retirement in Section 10.1(f).

11.4 AMENDMENT OR TERMINATION. This Article XI shall not be amended or terminated at any time if any such amendment or termination would adversely affect the rights of any Participant under the Plan.

ARTICLE XII

MISCELLANEOUS PROVISIONS

12.1 ADJUSTMENTS UPON CHANGES IN STOCK. In case of any reorganization, recapitalization, reclassification, stock split, stock dividend, distribution, combination of shares, merger, consolidation, rights offering, or any other change in the corporate structure or shares of the Company, appropriate adjustments shall be made by the Committee or the Board, as the case may be, (or if the Company is not the surviving corporation in any such transaction, the board of directors of the surviving corporation) in the aggregate number and kind of shares subject to the Plan, and the number and kind of shares and the Option Price per share subject to outstanding Options, the number and kind of shares and the Exercise Price per share subject to outstanding SARs, or the number and kind of shares which may be issued under outstanding Restricted Stock Awards or pursuant to unrestricted Company Stock Awards. Appropriate adjustments shall also be made by the Committee or the Board, as the case may be, in the terms of any Awards under the Plan, subject to Article XI, to reflect such changes and to modify any other terms of outstanding Awards on an equitable basis. Any such adjustments made by the Committee or the Board pursuant to this Section 12.1 shall be conclusive and binding for all purposes under the Plan. Any adjustments made pursuant to this Section 12.1 shall be made consistent with the requirements of Sections 409A of the Code, to the extent applicable.

12.2 AMENDMENT, SUSPENSION, AND TERMINATION OF PLAN.

(a) The Board may suspend or terminate the Plan or any portion thereof at any time, and may amend the Plan from time to time in such respects as the Board may deem advisable in order that any Awards thereunder shall conform to any change in applicable laws or regulations or in any other respect the Board may deem to be in the best interests of the Company; provided, however, that no such amendment shall, without Shareholder approval, (i) except as provided in Section 12.1, increase the number of shares of Company Stock which may be issued under the Plan, (ii) expand the types of awards available to Participants under the Plan, (iii) materially expand the class of employees and/or advisors eligible to participate in the Plan, (iv) materially change the method of determining the Option Price of Options or the Exercise Price of SARs; (v) delete or limit the provision in Section 5.8 prohibiting the repricing of Options and SARs; (vi) extend the termination date of the Plan or (vii) be made to the extent that Shareholder approval is required to satisfy any applicable laws or regulations or the rules or standards of any securities exchange, market or other quotation system on or through which the Company Stock is listed or traded. No such amendment, suspension, or termination shall materially adversely alter or impair any outstanding Options, SARs, shares of Restricted Stock, or Performance Units without the consent of the Participant affected thereby.

(b) The Committee may amend or modify any outstanding Options, SARs, Restricted Stock Awards, or Performance Unit Awards in any manner to the extent that the Committee would have had the authority under the Plan initially to award such Options, SARs, Restricted Stock Awards, or Performance Unit Awards as so modified or amended, including without limitation, to change the date or dates as of which such Options or SARs may be exercised, to remove the restrictions on shares of Restricted Stock, or to modify the manner in which Performance Units are determined and paid. Notwithstanding the foregoing, any amendment or modification of any Award shall be made in accordance with the requirements of Section 409A of the Code, to the extent applicable.

(c) Notwithstanding the other provisions of this Section 12.2, the Plan and any Award Agreements may be amended without any additional consideration to affected Participants to the extent necessary to comply with, or avoid penalties under, Section 409A of the Code, even if those amendments reduce, restrict or eliminate rights granted prior to such amendments.

12.3 NONUNIFORM DETERMINATIONS. The Committee's (or, if applicable, the Board's) determinations under the Plan, including without limitation, (a) the determination of the Employees, Advisors and Non-Employee Directors to receive Awards, (b) the form, amount, and timing of any Awards, (c) the terms and provisions of any Awards and (d) the Award Agreements evidencing the same, need not be uniform and may be made by it selectively among Employees, Advisors and/or Non-Employee Directors who receive, or who are eligible to receive, Awards under the Plan, whether or not such Employees, Advisors and/or Non-Employee Directors are similarly situated.

12.4 GENERAL RESTRICTION. Each Award under the Plan shall be subject to the condition that, if at any time the Committee shall determine that (a) the listing, registration, or qualification of the shares of Company Stock subject or related thereto upon NASDAQ or any other established stock exchange, market or quotation system or under any state or federal law, (b) the consent or approval of any government or regulatory body, or (c) an agreement by the Participant with respect thereto, is necessary, then such Award shall not become exercisable in whole or in part unless such listing, registration, qualification, consent, approval, or agreement shall have been effected or obtained free of any conditions not acceptable to the Committee.

12.5 NO RIGHT TO EMPLOYMENT. None of the actions of the Company in establishing or maintaining the Plan, the actions taken by the Company, the Board or the Committee under the Plan, or the granting of any Award under the Plan shall be deemed (a) to create any obligation on the part of the Company or any Subsidiary to retain any person in the employ of, or continue the provision of services by any person to, the Company or any Subsidiary, or (b) to be evidence of any agreement or understanding, express or implied, that the person has a right to continue as an employee, or advisor for any period of time or at any particular rate of compensation.

12.6 GOVERNING LAW. The provisions of the Plan shall take precedence over any conflicting provision contained in an Award Agreement. All matters relating to the Plan or to Awards granted hereunder shall be governed by and construed in accordance with the laws of the State of Ohio without regard to the principles of conflict of laws.

12.7 TRUST ARRANGEMENT. All benefits under the Plan represent an unsecured promise to pay by the Company. The Plan shall be unfunded and the benefits hereunder shall be paid only from the general assets of the Company resulting in the Participants having no greater rights than the Company's general creditors; provided, however, nothing herein shall prevent or

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prohibit the Company from establishing a trust or other arrangement for the purpose of providing for the payment of the benefits payable under the Plan.

12.8 INDEMNIFICATION OF BOARD AND COMMITTEE. Indemnification of the members of the Board and/or the members of the Committee shall be in accordance with the Code of Regulations of the Company as amended by the Shareholders from time to time.

12.9 NO IMPACT ON BENEFITS. Awards are not compensation for purposes of calculating a Participant's rights under any employee benefit plan that does not specifically require the inclusion of Awards in calculating benefits.

12.10 BENEFICIARY DESIGNATION. Each Participant may name a beneficiary or beneficiaries to receive or exercise any vested Award that is unpaid or unexercised at the Participant's death. Unless otherwise provided in the beneficiary designation, each designation will revoke all prior designations made by the same Participant, must be made on a form prescribed by the Committee and will be effective only when filed in writing with the Committee. If a Participant has not made an effective beneficiary designation, the deceased Participant's beneficiary will be the Participant's surviving spouse or, if none, the deceased Participant's estate. The identity of a Participant's designated beneficiary will be based only on the information included in the latest beneficiary designation form completed by the Participant and will not be inferred from any other evidence.

12.11 TAX WITHHOLDING. The Company shall have the power and the right to deduct or withhold, or require a Participant to remit to the Company, the minimum statutory amount to satisfy federal, state and local taxes required by law or regulation to be withheld with respect to any taxable event arising as a result of the Plan. With respect to withholding required upon any taxable event arising as a result of an Award granted hereunder, a Participant may elect, subject to the approval of the Committee, to satisfy the withholding requirement, in whole or in part, by having the Company withhold shares of Company Stock having a Fair Market Value on the date the tax is to be determined equal to the minimum statutory total tax that could be imposed on the transaction. All such elections shall be irrevocable, made in writing and signed by the Participant, and shall be subject to any restrictions or limitations that the Committee, in its sole discretion, deems appropriate.

12.12 SECTION 409A OF THE CODE. It is intended that the Plan comply with, or be exempt from, Section 409A of the Code, as the case may be, and the Plan will be interpreted, administered and operated consistent with this intent. Nothing herein shall be construed as an entitlement to or guarantee of any particular tax treatment to any Participant. None of the Company, any Subsidiary, the Board or the Committee shall have any liability to any person in the event the Plan fails to comply with the requirements of Section 409A of the Code at any time.

The Company may accelerate the time or schedule of a distribution to a Participant at any time the Plan fails to meet the requirements of Section 409A of the Code and the regulations promulgated thereunder. Such payment may not exceed the amount required to be included in income as a result of the failure to comply with the requirements of Section 409A of the Code.

12.13 CLAWBACK. Notwithstanding any other provisions in the Plan, any Award which is subject to recovery under any law, governmental regulation or stock exchange listing requirement, will be subject to such deductions and clawback as may be required to be made pursuant to such law, governmental regulation or stock exchange listing requirement (or any policy adopted by the Company whether or not such adoption was pursuant to any such law, governmental regulation or stock exchange listing requirement).

Shareowner Services
P.O. Box 64945
St. Paul, MN
55164-0945

Company #

Address Change? Mark box, sign, and indicate changes below: o

TO VOTE BY INTERNET OR TELEPHONE, SEE REVERSE SIDE OF THIS PROXY CARD.

The Board of Directors Recommends a Vote "FOR" All Director Nominees Listed In Item 1, and "FOR" the Proposals in Items 2, 3 and 4.

1. Election of directors for a three-year term expiring in 2016	01 David L. Mead 02 Susan D. Rector	03 Thomas J. Wolf	o Vote FOR all nominees (except as marked)	o Vote WITHHELD from all nominees

ò Please fold here - Do not separate ò

(Instruction: To withhold authority to vote for any individual nominee(s), mark "Vote FOR all nominees (except as marked)" and write the number(s) of the nominee(s) in the box provided to the right.)

2. Advisory resolution to approve the compensation of Peoples' named executive officers as disclosed in the Proxy Statement for the 2013 Annual Meeting of Shareholders.	o For	o Against	o Abstain
3. Approval of the Peoples Bancorp Inc. Second Amended and Restated 2006 Equity Plan.	o For	o Against	o Abstain
4. Ratification of the appointment of Ernst & Young LLP as Peoples' independent registered public accounting firm for the fiscal year ending December 31, 2013.	o For	o Against	o Abstain

THE COMMON SHARES REPRESENTED BY THIS PROXY CARD, WHEN PROPERLY EXECUTED, WILL BE VOTED AS DIRECTED OR, IF NO DIRECTION IS GIVEN, WILL BE VOTED (EXCEPT IN THE CASE OF COMMON SHARES HELD UNDER PEOPLES' RETIREMENT SAVINGS PLAN AND BROKER NON-VOTES, WHERE APPLICABLE) FOR THE ELECTION OF ALL DIRECTOR NOMINEES LISTED IN ITEM NO. 1, FOR

THE PROPOSAL IN ITEM NO. 2, FOR THE PROPOSAL IN ITEM NO. 3, AND FOR THE PROPOSAL IN ITEM NO. 4. IF ANY OTHER MATTERS ARE PROPERLY BROUGHT BEFORE THE ANNUAL MEETING OF SHAREHOLDERS OR IF A NOMINEE FOR ELECTION AS A DIRECTOR NAMED IN THE PROXY STATEMENT FOR THE ANNUAL MEETING OF SHAREHOLDERS IS UNABLE TO SERVE OR FOR GOOD CAUSE WILL NOT SERVE, THE COMMON SHARES REPRESENTED BY THIS PROXY CARD WILL BE VOTED IN THE DISCRETION OF THE INDIVIDUALS DESIGNATED TO VOTE THE COMMON SHARES REPRESENTED BY THIS PROXY CARD, TO THE EXTENT PERMITTED BY APPLICABLE LAW, ON SUCH MATTERS OR FOR SUCH SUBSTITUTE NOMINEE(S) AS THE DIRECTORS OF PEOPLES MAY RECOMMEND.

Date	Signature(s) in box
	Please sign exactly as your name(s) appears on proxy. If held in joint tenancy, all persons should sign. Trustees, administrators, etc., should include title and authority. Corporations should provide full name of corporation and title of authorized officer signing the proxy.

PEOPLES BANCORP INC.
ANNUAL MEETING OF SHAREHOLDERS
Thursday, April 25, 2013
10:00 a.m., Eastern Daylight Saving Time
Lafayette Hotel
101 Front Street
Marietta, OH 45750

Peoples Bancorp Inc.
P.O. Box 738
Marietta, OH 45740 proxy

This proxy is solicited by the Board of Directors for use at the Annual Meeting of Shareholders to be held on April 25, 2013.

The common shares of Peoples Bancorp Inc. (“Peoples”) as to which you have voting authority, including those held on your behalf in a trust account, under Peoples' Dividend Reinvestment and Stock Purchase Plan, or under Peoples' Retirement Savings Plan, will be voted as you specify on the reverse side of this proxy card.

If no choice is specified, the common shares of Peoples represented by this proxy card will be voted, except in the case of common shares held under Peoples' Retirement Savings Plan and broker non-votes, where applicable, “FOR” the election of all director nominees listed in Item No. 1, “FOR” the proposal in Item No. 2, “FOR” the proposal in Item No. 3, and “FOR” the proposal in Item No. 4.

Notice to Participants in Peoples' Retirement Savings Plan: If you participate in Peoples' Retirement Savings Plan, by completing and signing this proxy card or providing voting instructions by the Internet or telephone you will be deemed to have instructed the trustee of the Retirement Savings Plan how to vote common shares that have been allocated to your account. If you do not provide voting instructions by 11:59 p.m., Central Daylight Saving Time, on April 21, 2013, the trustee will not vote the common shares allocated to your account.

By signing this proxy card, you revoke all prior proxies to vote the common shares of Peoples you are entitled to vote at the Annual Meeting of Shareholders and appoint Richard Ferguson and Charles W. Sulerzyski, and each of them with full power of substitution, as your proxies to attend the Annual Meeting of Shareholders and vote your common shares of Peoples on the matters shown on the reverse side and in their discretion, to the extent permitted by applicable law, on any other matters (none known at the time of solicitation of this proxy) which may properly come before the Annual Meeting of Shareholders.

Vote by Internet, Telephone or Mail
24 Hours a Day, 7 Days a Week

Your telephone or Internet voting instructions authorize the named proxies to vote your common shares in the same manner as if you marked, signed and returned your proxy card.

INTERNET	PHONE	MAIL
www.eproxy.com/pebo	1-800-560-1965	
Use the internet to provide voting instructions until 11:59 p.m. (CDST) on April 24, 2013, or 11:59 p.m. (CDST) on April 21, 2013 in the case of common shares held under	Use a touch-tone telephone to provide voting instructions until 11:59 p.m. (CDST) on April 24, 2013, or 11:59 p.m. (CDST) on April 21, 2013 in the case of common shares held under	Mark, sign and date your proxy card and return it in the postage-paid envelope provided.

Peoples' Retirement Savings Plan. Peoples' Retirement Savings Plan.
If you vote your proxy by Internet or by Telephone, you do NOT need to mail back your Proxy Card.