

USANA HEALTH SCIENCES INC
Form 10-Q
November 10, 2010
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended October 2, 2010

OR

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

For the transition period from _____ to _____

Commission file number: 0-21116

USANA HEALTH SCIENCES, INC.

(Exact name of registrant as specified in its charter)

Utah
(State or other jurisdiction
of incorporation or organization)

87-0500306
(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 No

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 No

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

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

The number of shares outstanding of the registrant's common stock as of November 5, 2010 was 15,968,838.

Table of Contents

USANA HEALTH SCIENCES, INC.

FORM 10-Q

For the Quarterly Period Ended October 2, 2010

INDEX

	Page	
<u>PART I. FINANCIAL INFORMATION</u>		
<u>Item 1</u>	<u>Financial Statements (unaudited)</u>	
	<u>Consolidated Balance Sheets</u>	3
	<u>Consolidated Statements of Earnings – Quarter Ended</u>	4
	<u>Consolidated Statements of Earnings – Nine Months Ended</u>	5
	<u>Consolidated Statements of Stockholders' Equity and Comprehensive Income</u>	6
	<u>Consolidated Statements of Cash Flows</u>	7
	<u>Notes to Consolidated Financial Statements</u>	8 19
<u>Item 2</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	19 30
<u>Item 3</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	30 31
<u>Item 4</u>	<u>Controls and Procedures</u>	31
<u>PART II. OTHER INFORMATION</u>		
<u>Item 1</u>	<u>Legal Proceedings</u>	32
<u>Item 1A</u>	<u>Risk Factors</u>	32 36
<u>Item 2</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	36
<u>Item 6</u>	<u>Exhibits</u>	37-38
<u>Signatures</u>		39

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(in thousands)

	As of January 2, 2010 (1)	As of October 2, 2010 (unaudited)
ASSETS		
Current assets		
Cash and cash equivalents	\$ 13,658	\$ 22,928
Inventories	25,761	32,605
Prepaid expenses and other current assets	10,391	15,155
Deferred income taxes	2,116	2,622
Total current assets	51,926	73,310
Property and equipment, net	57,241	58,327
Goodwill	5,690	16,930
Intangible assets, net		40,872
Other assets	8,581	12,086
	\$ 123,438	\$ 201,525
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$ 5,810	\$ 8,485
Line of credit - short term		19,000
Other current liabilities	34,668	43,017
Total current liabilities	40,478	70,502
Line of credit - long term	7,000	
Other long-term liabilities	1,587	1,076
Stockholders' equity		
Common stock, \$0.001 par value; Authorized 50,000 shares, issued and outstanding 15,309 as of January 2, 2010 and 15,760 as of October 2, 2010	15	16
Additional paid-in capital	16,425	43,705

Edgar Filing: USANA HEALTH SCIENCES INC - Form 10-Q

Retained earnings	56,410	83,272
Accumulated other comprehensive income	1,523	2,954
Total stockholders' equity	74,373	129,947
	\$ 123,438	\$ 201,525

(1) Derived from audited financial statements.

The accompanying notes are an integral part of these statements.

Table of Contents

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EARNINGS

(U.S. dollars in thousands, except per share data)

(unaudited)

	Quarter Ended	
	October 3, 2009	October 2, 2010
Net sales	\$ 110,764	\$ 135,006
Cost of sales	22,637	25,157
Gross profit	88,127	109,849
Operating expenses:		
Associate incentives	50,799	60,560
Selling, general and administrative	25,414	30,751
Total operating expenses	76,213	91,311
Earnings from operations	11,914	18,538
Other income (expense):		
Interest income	15	36
Interest expense	(105)	(42)
Other, net	200	557
Other income, net	110	551
Earnings before income taxes	12,024	19,089
Income taxes	4,112	6,240
Net earnings	7,912	12,849
Earnings per common share		
Basic	\$ 0.52	\$ 0.83
Diluted	\$ 0.51	\$ 0.79
Weighted-average common shares outstanding		
Basic	15,345	15,562
Diluted	15,547	16,247

The accompanying notes are an integral part of these statements.

Table of Contents

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EARNINGS

(U.S. dollars in thousands, except per share data)

(unaudited)

	Nine Months Ended	
	October 3, 2009	October 2, 2010
Net sales	\$ 320,156	\$ 380,104
Cost of sales	66,236	70,912
Gross profit	253,920	309,192
Operating expenses:		
Associate incentives	143,010	171,743
Selling, general and administrative	75,463	87,358
Total operating expenses	218,473	259,101
Earnings from operations	35,447	50,091
Other income (expense):		
Interest income	45	70
Interest expense	(540)	(68)
Other, net	640	301
Other income, net	145	303
Earnings before income taxes	35,592	50,394
Income taxes	12,243	17,134
Net earnings	23,349	33,260
Earnings per common share		
Basic	\$ 1.52	\$ 2.16
Diluted	\$ 1.51	\$ 2.11
Weighted-average common shares outstanding		
Basic	15,349	15,397
Diluted	15,421	15,763

The accompanying notes are an integral part of these statements.

Table of Contents

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME

Nine Months Ended October 3, 2009 and October 2, 2010

(in thousands)

(unaudited)

	Common Stock Shares	Common Stock Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
For the Nine Months Ended October 3, 2009						
Balance at January 3, 2009	15,350	15	8,089	24,107	(375)	31,836
Comprehensive income						
Net earnings				23,349		23,349
Foreign currency translation adjustment, net of tax benefit of \$1,427					1,708	1,708
Comprehensive income						25,057
Common stock repurchased and retired	(33)		(249)	(773)		(1,022)
Equity-based compensation expense			6,916			6,916
Common stock issued under equity award plans, including tax expense of \$19	9		57			57
Balance at October 3, 2009	15,326	\$ 15	\$ 14,813	\$ 46,683	\$ 1,333	\$ 62,844
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					1,431	1,431

Edgar Filing: USANA HEALTH SCIENCES INC - Form 10-Q

Comprehensive income										34,691
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	\$	2,954	\$ 129,947

The accompanying notes are an integral part of these statements.

Table of Contents

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Nine Months Ended	
	October 3, 2009	October 2, 2010
Cash flows from operating activities		
Net earnings	\$ 23,349	\$ 33,260
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation and amortization	5,312	5,641
Loss (gain) on sale of property and equipment	(155)	87
Equity-based compensation expense	6,916	7,107
Excess tax benefit from equity-based payment arrangements	(11)	(792)
Deferred income taxes	(2,179)	(1,221)
Provision for inventory valuation	780	989
Changes in operating assets and liabilities:		
Inventories	(1,364)	(5,040)
Prepaid expenses and other assets	3,776	30
Accounts payable	(1,311)	41
Other liabilities	(14,585)	6,137
Total adjustments	(2,821)	12,979
Net cash provided by operating activities	20,528	46,239
Cash flows from investing activities		
Acquisition, net of cash acquired	\$	\$ (42,694)
Receipts on notes receivable	169	
Increase in notes receivable	(143)	
Proceeds from sale of property and equipment	837	32
Purchases of property and equipment	(2,871)	(3,676)
Net cash used in investing activities	(2,008)	(46,338)
Cash flows from financing activities		
Proceeds from equity awards exercised	\$ 76	\$ 4,640
Excess tax benefits from equity-based payment arrangements	11	792
Repurchase of common stock	(1,022)	(8,630)
Borrowings on line of credit	55,710	23,350
Payments on line of credit	(73,700)	(11,350)
Net cash (used in) provided by financing activities	(18,925)	8,802
Effect of exchange rate changes on cash and cash equivalents	389	567
Net increase (decrease) in cash and cash equivalents	(16)	9,270

Edgar Filing: USANA HEALTH SCIENCES INC - Form 10-Q

Cash and cash equivalents, beginning of period	13,281	13,658
Cash and cash equivalents, end of period	\$ 13,265	\$ 22,928
Supplemental disclosures of cash flow information		
Cash paid during the period for:		
Interest	\$ 503	\$ 62
Income taxes	17,874	18,582
Non-cash financing activities		
Common stock issued in connection with acquisitions		17,716

The accompanying notes are an integral part of these statements.

Table of Contents

USANA HEALTH SCIENCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except per share data)

(unaudited)

Basis of Presentation

The condensed balance sheet as of January 2, 2010, derived from audited financial statements, and the unaudited interim consolidated financial information of USANA Health Sciences, Inc. and its subsidiaries (collectively, the Company or USANA) 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 2, 2010 and results of operations for the quarters and nine months ended October 3, 2009 and October 2, 2010. 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 2, 2010. The results of operations for the quarter and nine months ended October 2, 2010, may not be indicative of the results that may be expected for the fiscal year 2010 ending January 1, 2011.

NOTE A ORGANIZATION

USANA 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 Company's products are sold throughout the United States (including direct sales from the United States to the United Kingdom and the Netherlands), Canada, Mexico, Australia, New Zealand, Singapore, Malaysia, the Philippines, Hong Kong, Taiwan, Japan, South Korea, and as of August 2010, the People's Republic of China (China or PRC).

NOTE B ACQUISITION

On August 16, 2010, the Company indirectly acquired 100% of BabyCare Ltd. (BabyCare), a limited liability company incorporated under the laws of the PRC, for the purchase price of \$62,716, which consisted of \$45,000 cash paid and \$17,716 common stock issued (400,000 shares of USANA common stock at \$44.29).

BabyCare is a direct selling company in China that is principally engaged in developing, manufacturing and selling nutritional products for the entire family, with an emphasis on infant nutrition, through both a distributor sales force and a chain of retail centers. This acquisition was accomplished in the following simultaneous transactions. The Company acquired Pet Lane, Inc., a Delaware corporation (Pet Lane), which is the record owner of BabyCare in China. Simultaneously, the Company entered into and closed a share purchase agreement (the Purchase

Edgar Filing: USANA HEALTH SCIENCES INC - Form 10-Q

Agreement) by and among the Company and the following parties: Pet Lane; Yaolan Ltd., an exempted company organized under the laws of the Cayman Islands (Yaolan); and BabyCare Holdings, Ltd., an exempted company organized under the laws of the Cayman Islands (BabyCare Holdings). Pursuant to the Purchase Agreement, the Company, through its acquisition entity Pet Lane, acquired all of the issued and outstanding shares of BabyCare Holdings (the Shares) from Yaolan. BabyCare Holdings is the beneficial owner of BabyCare. As a result of its acquisition of Pet Lane and BabyCare Holdings, the Company, indirectly, has acquired both record and beneficial ownership of BabyCare.

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

(in thousands, except per share data)

(unaudited)

NOTE B ACQUISITION CONTINUED

The acquisition was accounted for as a business combination and as such, the results of operations for BabyCare have been included in the consolidated financial statements since the effective date of acquisition. This acquisition contributed \$3,358 in net sales and net earnings of \$130 for the quarter ended October 2, 2010. Unaudited supplemental pro forma information had the acquisition occurred at the beginning of each period is as follows:

	Quarter Ended		Nine Months Ended	
	October 3, 2009	October 2, 2010	October 3, 2009	October 2, 2010
Net sales	\$ 114,474	\$ 136,592	\$ 330,824	\$ 389,726
Net earnings	6,570	12,338	19,600	30,782

The assets acquired and liabilities assumed were recorded at estimated fair values as of the date of the acquisition. The purchase price allocation for BabyCare is as follows:

August 16,
2010

Assets Acquired and Liabilities Assumed	
Cash and cash equivalents	\$ 3,006
Inventories	1,702
Prepaid expenses and other current assets	4,663
Property and equipment	1,517
Goodwill	10,540
Intangible assets	41,000
Other assets	3,375
Accounts payable	(2,552)
Other current liabilities	(535)
	\$ 62,716

Goodwill of \$10,540 has been recognized for the excess of consideration transferred over the acquisition-date fair value of net assets acquired. In accordance with accounting standards governing the subsequent measurement of goodwill, goodwill will not be amortized, but will be tested at least annually for impairment. The fair value of intangible assets acquired in the amount of \$41,000 was derived using various methodologies applied within the income approach. For further information on intangible assets, see Note G to these consolidated financial statements. For tax purposes, \$52,323 of goodwill and other intangible assets will be deducted over a period of 15 years in computing the Company's United States

Edgar Filing: USANA HEALTH SCIENCES INC - Form 10-Q

tax obligation. The anticipated benefits associated with the acquired goodwill and other intangibles include facilitating our expansion and growth in China. The most significant intangible asset is a direct selling license held by BabyCare from the Chinese government to engage in direct selling activities in the Municipality of Beijing. This direct selling license allows BabyCare to engage non-employee distributors to sell their products away from fixed retail locations.

The costs related to the acquisition of BabyCare totaled \$1,895 which included; advisory, legal, accounting, valuation, and other professional fees. These costs were expensed as incurred in the periods in which services were received and recognized in the consolidated statements of earnings in Selling, General and Administrative expenses.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except per share data)

(unaudited)

NOTE C 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 2, 2010, the fair value of term deposits in the consolidated balance sheet totaled \$3,588, consisting of \$598 classified in cash and cash equivalents, and \$2,990 in prepaid expenses and other current assets.

NOTE D INVENTORIES

Inventories consist of the following:

Edgar Filing: USANA HEALTH SCIENCES INC - Form 10-Q

	January 2, 2010		October 2, 2010
Raw materials	\$ 6,785	\$	8,551
Work in progress	5,003		5,027
Finished goods	13,973		19,027
	\$ 25,761	\$	32,605

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

(in thousands, except per share data)

(unaudited)

NOTE E PREPAID EXPENSES AND OTHER CURRENT ASSETS

Prepaid expenses and other current assets consist of the following:

	January 2, 2010	October 2, 2010
Prepaid insurance	\$ 1,165	\$ 331
Other prepaid expenses	2,263	2,117
Federal income taxes receivable	505	1,736
Miscellaneous receivables, net	2,775	3,492
Deferred commissions	2,738	3,122
Other current assets	945	4,357
	\$ 10,391	\$ 15,155

NOTE F PROPERTY AND EQUIPMENT

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

	Years	January 2, 2010	October 2, 2010
Buildings	40	\$ 37,346	\$ 38,226
Laboratory and production equipment	5-7	16,242	17,610
Sound and video library	5	600	600
Computer equipment and software	3-5	27,419	29,057
Furniture and fixtures	3-5	4,561	4,820
Automobiles	3-5	256	289
Leasehold improvements	3-5	4,478	5,171
Land improvements	15	2,025	2,041
		92,927	97,814
Less accumulated depreciation and amortization		43,714	47,916

Edgar Filing: USANA HEALTH SCIENCES INC - Form 10-Q

	49,213	49,898
Land	7,352	7,811
Deposits and projects in process	676	618
	\$ 57,241	\$ 58,327

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

(in thousands, except per share data)

(unaudited)

NOTE G INTANGIBLE ASSETS

Intangible assets consist of the following:

	Gross Carrying Amount	As of October 2, 2010 Accumulated Amortization	Net Carrying Amount	Weighted-average amortization period (years)
Amortized intangible assets				
Trade Name & Trademarks	\$ 3,900	\$ (49)	\$ 3,851	10
Customer Relationships	1,900	(79)	1,821	3
	5,800	(128)	5,672	
Unamortized intangible assets				
Product Formulas	8,600		8,600	
Direct Sales License	26,600		26,600	
	35,200		35,200	
	\$ 41,000		\$ 40,872	
The Aggregate Amortization Expense:				
For quarter ended October 2, 2010	\$ 128			
Estimated Amortization Expense:				
Remainder of 2010	\$ 266			
2011	1,023			
2012	1,023			
2013	780			
2014	390			
Thereafter	2,190			
	\$ 5,672			

NOTE H LINE OF CREDIT

The Company has a \$40,000 line of credit. At October 2, 2010, there was an outstanding balance of \$19,000 associated with the line of credit, with a weighted-average interest rate of 1.26%. The interest rate is computed at the bank's Prime Rate or LIBOR, adjusted by features specified in the Credit Agreement. The collateral for this line of credit is the pledge of the capital stock of certain subsidiaries of the Company, as set forth in a separate pledge agreement with the bank. The Credit Agreement contains restrictive covenants based on adjusted EBITDA and a debt coverage ratio. The Company will be required to pay the balance on this line of credit in full at the time of maturity in May 2011 unless the line of credit is replaced or terms are renegotiated.

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

(in thousands, except per share data)

(unaudited)

NOTE I OTHER CURRENT LIABILITIES

Other current liabilities consist of the following:

	January 2, 2010	October 2, 2010
Associate incentives	\$ 8,008	\$ 9,777
Accrued employee compensation	8,508	11,637
Income taxes	284	1,716
Sales taxes	3,683	4,178
Associate promotions	1,026	1,200
Deferred revenue	7,387	8,536
Provision for returns and allowances	1,115	1,014
All other	4,657	4,959
	\$ 34,668	\$ 43,017

NOTE J EQUITY-BASED COMPENSATION

Equity-based compensation expense for the quarters ended October 3, 2009, and October 2, 2010, was \$2,298 and \$2,967, respectively. The related tax benefit for these periods was \$845 and \$1,180, respectively. Expense for the nine months ended October 3, 2009, and October 2, 2010, was \$6,916 and \$7,107, respectively. The related tax benefit for these periods was \$2,492 and \$2,693, respectively.

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 2, 2010. This table does not include an estimate for future grants that may be issued.

Remainder of 2010	\$ 3,286
2011	12,545
2012	10,455
2013	6,409
2014	3,904
2015	1,651
	\$ 38,250

Edgar Filing: USANA HEALTH SCIENCES INC - Form 10-Q

The cost above is expected to be recognized over a weighted-average period of 2.4 years.

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 3, 2009	October 2, 2010	October 3, 2009	October 2, 2010
Expected volatility	55.8%	54.8%	41.0%	54.9%
Risk-free interest rate	2.1%	1.4%	1.8%	1.7%
Expected life	4.1 yrs.	4.2 yrs.	4.0 yrs.	4.2 yrs.
Expected dividend yield				
Weighted-average grant price	\$ 27.99	\$ 43.73	\$ 26.43	\$ 38.23

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

(in thousands, except per share data)

(unaudited)

NOTE J EQUITY-BASED COMPENSATION CONTINUED

A summary of the Company's stock option and stock-settled stock appreciation right activity for the nine months ended October 2, 2010 is as follows:

	Shares	Weighted- average grant price	Weighted-average remaining contractual term	Aggregate intrinsic value*
Outstanding at January 2, 2010	4,267	\$ 30.26	3.8	\$ 17,173
Granted	1,098	38.23		
Exercised	(430)	28.21		
Canceled or expired	(89)	32.98		
Outstanding at October 2, 2010	4,846	\$ 32.20	3.5	\$ 41,142
Exercisable at October 2, 2010	1,821	\$ 32.38	3.0	\$ 14,671

* 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 weighted-average fair value of stock-settled stock appreciation rights that were granted during the nine-month periods ended October 3, 2009, and October 2, 2010 was \$9.07 and \$17.07, respectively. The total intrinsic value of awards that were exercised during the nine-month periods ended October 3, 2009, and October 2, 2010 was \$194 and \$6,057, respectively.

A summary of the Company's deferred stock unit activity for the nine months ended October 2, 2010 is as follows:

	Shares	Weighted- average Fair Value
Nonvested at January 2, 2010		\$
Granted	100	\$ 44.29
Vested		\$
Canceled or expired		\$

Edgar Filing: USANA HEALTH SCIENCES INC - Form 10-Q

Nonvested at October 2, 2010

100 \$

44.29

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

(in thousands, except per share data)

(unaudited)

NOTE K 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.

	For the Quarter Ended	
	October 3, 2009	October 2, 2010
Net earnings available to common shareholders	\$ 7,912	\$ 12,849
Basic EPS		
Shares		
Common shares outstanding - entire period		
Weighted-average common shares:	15,350	15,309
Issued during period	4	320
Canceled during period	(9)	(67)
Weighted-average common shares outstanding during period	15,345	15,562
Earnings per common share from net earnings - basic	\$ 0.52	\$ 0.83
Diluted EPS		
Shares		
Weighted-average shares outstanding during period - basic	15,345	15,562
Dilutive effect of equity awards	202	685
Weighted-average shares outstanding during period - diluted	15,547	16,247
Earnings per common share from net earnings - diluted	\$ 0.51	\$ 0.79

Equity awards for 1,295 and 434 shares of stock were not included in the computation of diluted EPS for the quarters ended October 3, 2009, and October 2, 2010, respectively, due to the fact that their exercise prices were greater than the average market price of the shares.

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

(in thousands, except per share data)

(unaudited)

NOTE K COMMON STOCK AND EARNINGS PER SHARE CONTINUED

	For the Nine Months Ended	
	October 3, 2009	October 2, 2010
Net earnings available to common shareholders	\$ 23,349	\$ 33,260
Basic EPS		
Shares		
Common shares outstanding - entire period		
Weighted-average common shares:	15,350	15,309
Issued during period	2	110
Canceled during period	(3)	(22)
Weighted-average common shares outstanding during period	15,349	15,397
Earnings per common share from net earnings - basic	\$ 1.52	\$ 2.16
Diluted EPS		
Shares		
Weighted-average shares outstanding during period - basic	15,349	15,397
Dilutive effect of equity awards	72	366
Weighted-average shares outstanding during period - diluted	15,421	15,763
Earnings per common share from net earnings - diluted	\$ 1.51	\$ 2.11

Equity awards for 1,571 and 1,627 shares of stock were not included in the computation of diluted EPS for the nine-month periods ended October 3, 2009, and October 2, 2010, respectively, due to the fact that their exercise prices were greater than the average market price of the shares.

NOTE L COMPREHENSIVE INCOME

Total comprehensive income consisted of the following:

Edgar Filing: USANA HEALTH SCIENCES INC - Form 10-Q

	Quarter Ended		Nine Months Ended	
	October 3, 2009	October 2, 2010	October 3, 2009	October 2, 2010
Net earnings	\$ 7,912	\$ 12,849	\$ 23,349	\$ 33,260
Foreign currency translation adjustment	797	1,894	1,708	1,431
Comprehensive income	\$ 8,709	\$ 14,743	\$ 25,057	\$ 34,691

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

(in thousands, except per share data)

(unaudited)

NOTE M 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.

Product Line	Quarter Ended		Nine Months Ended	
	October 3, 2009	October 2, 2010	October 3, 2009	October 2, 2010
USANA® Nutritionals	76%	78%	76%	77%
USANA Foods	12%	12%	12%	12%
Sensé beautiful science®	9%	7%	9%	8%

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
- Canada
- Mexico

- Asia Pacific
- Southeast Asia Pacific Australia, New Zealand, Singapore, Malaysia, and the Philippines
- Greater China(1) Hong Kong, Taiwan, and China(2)
- North Asia Japan and South Korea

(1) Formerly referred to as East Asia.

(2) Our business in China is that of BabyCare, which was indirectly acquired on August 16, 2010.

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

(in thousands, except per share data)

(unaudited)

NOTE M 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 3, 2009	October 2, 2010	October 3, 2009	October 2, 2010
Net Sales to External Customers				
North America				
United States	\$ 38,098	\$ 38,228	\$ 114,495	\$ 113,826
Canada	16,661	16,419	48,051	52,352
Mexico	5,535	5,314	16,384	16,416
North America Total	60,294	59,961	178,930	182,594
Asia Pacific				
Southeast Asia Pacific	25,227	25,730	69,683	74,231
Greater China	20,262	43,456	56,866	106,156
North Asia	4,981	5,859	14,677	17,123
Asia Pacific Total	50,470	75,045	141,226	197,510
Consolidated Total	\$ 110,764	\$ 135,006	\$ 320,156	\$ 380,104

	As of	
	January 2, 2010	October 2, 2010
Total Assets		
North America		
United States	\$ 63,145	\$ 83,489
Canada	4,902	3,853
Mexico	4,904	3,170
North America Total	72,951	90,512
Asia Pacific		
Southeast Asia Pacific	30,104	26,591
Greater China	14,505	77,571

Edgar Filing: USANA HEALTH SCIENCES INC - Form 10-Q

North Asia	5,878	6,851
Asia Pacific Total	50,487	111,013
Consolidated Total	\$ 123,438	\$ 201,525

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (continued)

(in thousands, except per share data)

(unaudited)

NOTE M SEGMENT INFORMATION CONTINUED

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

	Quarter Ended		Nine Months Ended	
	October 3, 2009	October 2, 2010	October 3, 2009	October 2, 2010
Net Sales:				
United States	\$ 38,098	\$ 38,228	\$ 114,495	\$ 113,826
Hong Kong	14,756	34,518	41,049	85,385
Canada	16,661	16,419	48,051	52,352
			As of	
			January 2, 2010	October 2, 2010
Long-lived Assets:				
United States			\$ 46,310	\$ 45,165
Australia			14,116	15,139
China*				56,425

* Long-lived assets in China represent recently acquired tangible long-term assets, goodwill, and intangible assets.

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 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 2, 2010, 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.

Our fiscal year end is the Saturday closest to December 31st of each year. Fiscal year 2010 will end on January 1, 2011, and fiscal year 2009 ended on January 2, 2010.

Overview

We develop and manufacture high-quality 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 2, 2010, we had approximately 234,000 active Associates and approximately 74,000 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 us at any time during the most recent three-month period, either for personal use or for resale.

Table of Contents

We group and present the countries in which we have ongoing operations as follows:

- North America

- United States

- Canada

- Mexico

- Asia Pacific

- Southeast Asia Pacific Australia, New Zealand, Singapore, Malaysia, and the Philippines

- Greater China(1) Hong Kong, Taiwan, and China(2)

- North Asia Japan and South Korea

(1) Formerly referred to as East Asia.

(2) Our business in China is that of BabyCare, Ltd. (BabyCare), which was indirectly acquired on August 16, 2010. BabyCare is a direct selling company that is principally engaged in developing, manufacturing and selling nutritional products for the entire family, with an emphasis on infant nutrition. Its products are sold through both a distributor sales force and a chain of retail centers. BabyCare holds a license from the Chinese government to engage in direct selling activities in the Municipality of Beijing and is working to obtain similar licenses in other Chinese provinces. This direct selling license allows BabyCare to engage non-employee distributors to sell BabyCare s products away from fixed retail locations.

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

Edgar Filing: USANA HEALTH SCIENCES INC - Form 10-Q

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:

Product Line	Nine Months Ended	
	October 3, 2009	October 2, 2010
USANA® Nutritionals		
Essentials	33%	30%
Optimizers	43%	47%
USANA Foods	12%	12%
Sensé beautiful science®	9%	8%
All Other	3%	3%

Key Product	Nine Months Ended	
	October 3, 2009	October 2, 2010
USANA® Essentials	19%	18%
HealthPak 100	12%	10%
Proflavanol®	11%	11%

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. 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

Table of Contents

Associates and Preferred Customers purchasing 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 2, 2010. In general, the volume of recurring monthly product purchases by an Associate or a Preferred Customer, in their local currencies, remain relatively constant over time. Accordingly, sales growth in local currencies is driven primarily by an increased number of active Associates and Preferred Customers. 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 3, 2009		As of October 2, 2010		Change from Prior Year	Percent Change
North America:						
United States	61,000	30.7%	55,000	23.5%	(6,000)	(9.8)%
Canada	26,000	13.1%	25,000	10.7%	(1,000)	(3.8)%
Mexico	15,000	7.5%	11,000	4.7%	(4,000)	(26.7)%
North America Total	102,000	51.3%	91,000	38.9%	(11,000)	(10.8)%
Asia Pacific:						
Southeast Asia Pacific	49,000	24.6%	46,000	19.7%	(3,000)	(6.1)%
Greater China*	40,000	20.1%	89,000	38.0%	49,000	122.5%
North Asia	8,000	4.0%	8,000	3.4%		0.0%
Asia Pacific Total	97,000	48.7%	143,000	61.1%	46,000	47.4%
	199,000	100.0%	234,000	100.0%	35,000	17.6%

*Active Associate count as of October 2, 2010 includes those of BabyCare, which was acquired in August, 2010.

Active Preferred Customers By Region						
	As of October 3, 2009		As of October 2, 2010		Change from Prior Year	Percent Change
North America:						
United States	40,000	58.8%	37,000	50.0%	(3,000)	(7.5)%
Canada	15,000	22.1%	14,000	18.9%	(1,000)	(6.7)%
Mexico	3,000	4.4%	3,000	4.1%		0.0%
North America Total	58,000	85.3%	54,000	73.0%	(4,000)	(6.9)%
Asia Pacific:						
Southeast Asia Pacific	8,000	11.7%	7,000	9.5%	(1,000)	(12.5)%
Greater China*	1,000	1.5%	12,000	16.2%	11,000	1100.0%
North Asia	1,000	1.5%	1,000	1.3%		0.0%
Asia Pacific Total	10,000	14.7%	20,000	27.0%	10,000	100.0%
	68,000	100.0%	74,000	100.0%	6,000	8.8%

*Active Preferred Customer count as of October 2, 2010 includes those of BabyCare, which was acquired in August, 2010.

Table of Contents

Total Active Customers By Region						
	As of October 3, 2009		As of October 2, 2010		Change from Prior Year	Percent Change
North America:						
United States	101,000	37.8%	92,000	29.9%	(9,000)	(8.9)%
Canada	41,000	15.4%	39,000	12.7%	(2,000)	(4.9)%
Mexico	18,000	6.7%	14,000	4.5%	(4,000)	(22.2)%
North America Total	160,000	59.9%	145,000	47.1%	(15,000)	(9.4)%
Asia Pacific:						
Southeast Asia Pacific	57,000	21.3%	53,000	17.2%	(4,000)	(7.0)%
Greater China*	41,000	15.4%	101,000	32.8%	60,000	146.3%
North Asia	9,000	3.4%	9,000	2.9%		0.0%
Asia Pacific Total	107,000	40.1%	163,000	52.9%	56,000	52.3%
	267,000	100.0%	308,000	100.0%	41,000	15.4%

*Total active customer count as of October 2, 2010 includes those of BabyCare, which was acquired in August, 2010.

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

We believe that our high-quality products and our financially rewarding Associate Compensation Plan are the key components to attracting and retaining Associates and the continued success and growth of our business. In accordance with the direct selling laws in China, BabyCare Associates do not participate in our compensation plan. Instead, they are compensated under BabyCare's compensation plan, which we believe is among the most rewarding compensation plans in China. For ease of reference, USANA's compensation plan and BabyCare's compensation plan are sometimes referred to in this report collectively as Compensation Plan. To 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.

Our primary growth strategy continues to be focused on attracting and retaining Associates. This strategy includes our increased investment in Associate events and training materials, periodic new and enhanced product introductions, and Associate education on the marketing of our Compensation Plan. Additionally, we frequently evaluate opportunities for entering new markets and also may evaluate strategic acquisition opportunities.

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

Forward-Looking Statements and Certain Risks

The statements contained in this report that are not purely historical are considered to be forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and Section 21E of the Securities Exchange Act. These

Table of Contents

statements represent our expectations, hopes, beliefs, anticipations, commitments, intentions, and strategies regarding the future. They may be identified by the use of words or phrases such as believes, expects, anticipates, should, plans, estimates, and potential, among others. Forward-looking statements include, but are not limited to, statements contained in Management's Discussion and Analysis of Financial Condition and Results of Operations regarding our financial performance, revenue, and expense levels in the future and the sufficiency of our existing assets to fund our future operations and capital spending needs. Readers are cautioned that actual results could differ materially from the anticipated results or other expectations that are expressed in these forward-looking statements for the reasons that are detailed in our most recent Annual Report on Form 10-K and in Item 1A of Part II of this report. The fact that some of these risk factors may be the same or similar to those in our past SEC reports means only that the risks are present in multiple periods. We believe that many of the risks detailed here and in our other SEC filings are part of doing business in the industry in which we operate and will likely be present in all periods reported. The fact that certain risks are common in the industry does not lessen their significance. The forward-looking statements contained in this report, are made as of the date of this report, and we assume no obligation to update them or to update the reasons why our actual results could differ from those that we have projected. Among others, risks and uncertainties that may affect our business, financial condition, performance, development, and results of operations include:

- Our ability to attract and maintain a sufficient number of Associates;
- Our dependence upon a network marketing system to distribute our products and the activities of our independent Associates;
- Our planned expansion into international markets, including delays in commencement of sales in any new market, delays in compliance with local marketing or other regulatory requirements, or changes in target markets;
- General economic conditions, both domestically and internationally;
- Potential political events, natural disasters, or other events that may negatively affect economic conditions;
- Potential effects of adverse publicity regarding the Company, nutritional supplements, or the network marketing industry;
- Reliance on key management personnel;
- Extensive government regulation of the Company's products, manufacturing, and network marketing system;
- Potential inability to sustain or manage growth, including the failure to continue to develop new products;

- An increase in the amount of Associate incentives;
- Our reliance on the use of information technology;
- The adverse effect of the loss of a high-level sponsoring Associate, together with a group of leading Associates, in that person's downline;
- The loss of product market share or Associates to competitors;
- Potential adverse effects of customs, duties, taxation, and transfer pricing regulations, including regulations governing distinctions between and Company responsibilities to employees and independent contractors;
- The fluctuation in the value of currencies compared to the U.S. dollar;
- Our reliance on outside suppliers for raw materials and certain manufactured items;
- Shortages of raw materials that we use in certain of our products;
- Significant price increases of our key raw materials;

Table of Contents

- Product liability claims and other risks that may arise with our manufacturing activity;
- Intellectual property risks;
- Liability claims that may arise with our Athlete Guarantee program;
- Continued compliance with debt covenants;
- Disruptions to shipping channels that are used to distribute our products to international warehouses;
- The introduction of new laws or changes to existing laws, both domestically and internationally; or
- The outcome of regulatory and litigation matters.

Results of Operations

Summary of Financial Results and Recent Developments

Net sales for the third quarter of 2010 increased \$24.2 million to \$135.0 million, or 21.9% when compared with the third quarter of 2009. Our growth continues to be driven by increased product sales volumes resulting from an overall increase in the number of active Associates. This growth came largely from the success in Greater China. Net sales during the quarter also benefited from changes in currency exchange rates by approximately \$3.5 million.

As discussed above, on August 16, 2010 we indirectly acquired BabyCare, Ltd, a direct selling company organized under the laws of China. During the third quarter, BabyCare added \$3.4 million in net sales and added 10,000 active Associates and 10,000 active Preferred Customers to our existing customer base. Our acquisition of BabyCare is significant to us in that it provides the platform necessary to introduce our products into that market. In the short-term, BabyCare will continue to operate independently from USANA, however, we are currently working to get USANA products registered and approved to sell in China. Upon gaining this approval, we anticipate that our sales growth will accelerate in BabyCare.

Net earnings during the third quarter of 2010 increased 62.4% to \$12.8 million from \$7.9 million in the prior year. This increase was primarily the result of higher net sales, improved gross profit, lower relative Associate incentives expense, and a lower effective tax rate.

Also during the third quarter, we held our annual international convention in Salt Lake City where we launched several new products and a new manufacturing technology, introduced a new interactive presentation tool, and announced enhancements to our Associate recognition and rewards programs. Two of the products that we launched feature our new manufacturing technology, which we call Nutritional Hybrid Technology. This technology allows us to combine two distinct formulas into one bi-layered tablet, allowing for advanced ingredient combinations, while providing product stability. Our new interactive presentation tool, called Health and Freedom Solution, was created and designed to help our Associates explain and share the USANA opportunity, including the benefits of our products and our award-winning Compensation Plan.

Table of Contents**Quarters Ended October 3, 2009 and October 2, 2010****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)				Change from prior year	Percent change	Approximate impact of currency exchange	Change excluding the impact of currency exchange
	October 3, 2009	Quarter Ended	October 2, 2010					
North America:								
United States	\$ 38,098	34.4%	\$ 38,228	28.3%	\$ 130	0.3%	\$ N/A	0.3%
Canada	16,661	15.0%	16,419	12.2%	(242)	(1.5)%	800	(6.3)%
Mexico	5,535	5.0%	5,314	3.9%	(221)	(4.0)%	200	(7.6)%
North America Total	60,294	54.4%	59,961	44.4%	(333)	(0.6)%	1,000	(2.2)%
Asia Pacific:								
Southeast Asia Pacific	25,227	22.8%	25,730	19.1%	503	2.0%	2,000	(5.9)%
Greater China	20,262	18.3%	43,456	32.2%	23,194	114.5%	100	114.0%
North Asia	4,981	4.5%	5,859	4.3%	878	17.6%	400	9.6%
Asia Pacific Total	50,470	45.6%	75,045	55.6%	24,575	48.7%	2,500	43.7%
	\$ 110,764	100.0%	\$ 135,006	100.0%	\$ 24,242	21.9%	\$ 3,500	18.7%

North America: The decrease in net sales in this region was the result of lower product sales volume resulting from a decrease in the number of active Associates and Preferred Customers in this region. This decrease was partially offset by a slight increase in customer spending in the United States and Mexico. Part of the decline in the number of active Associates is due to an increase in the number of North America-based Associates building their businesses in Asia, which results in growth in sales and Associates in Asia Pacific rather than North America. We also believe that continued economic challenges, particularly in the consumer products segment, contributed to this decrease in active Associates. Over the last couple of years we have implemented certain price increases, including a price increase of nearly ten percent on our products in Mexico. While our profitability in Mexico has improved, we believe that the price increases in this market contributed to the decline in our sales and active Associate count.

Asia Pacific: The increase in net sales in this region was primarily due to higher product sales volume resulting from a 47.4% increase in the number of active Associates. This increase came predominantly from Greater China. This growth was led by Hong Kong, where the number of active Associates increased 142.9% year-over-year and net sales increased 133.9%.

Additionally, our acquisition of BabyCare added approximately \$3.4 million in net sales, 10,000 active Associates, and 10,000 active Preferred Customers to this region. Excluding BabyCare, net sales in this region increased 42.0%, the number of active Associates increased 37.1%, and the number of active Preferred Customers remained unchanged. We also experienced double-digit growth in the Philippines, Japan, and South Korea. The increase in total Asia Pacific sales, on a local currency basis, was partially offset by a decline in sales and Associates in Southeast Asia Pacific in the third quarter.

Table of Contents

Gross Profit

Gross profit increased to 81.4% of net sales for the third quarter of 2010, from 79.6% of net sales for the third quarter of 2009. This increase in gross profit can be attributed to a decrease in overall raw materials cost, currency benefits, lower relative freight costs on shipments to our customers, production and shipping efficiency due to capital investments, and leverage gained on increased net sales. Additionally, we have implemented certain price increases, notably on some of our larger packs and flagship products, which have contributed to our improved gross profit.

Associate Incentives

As a percentage of net sales, Associate incentives during the third quarter of 2010 decreased to 44.9%, compared with 45.9% for the third quarter of 2009. This decrease was primarily due to the strategic initiative we implemented during the second quarter of 2010 to further reduce Associate incentives expense, partially offset by an increased payout under our Matching Bonus program.

Notably, our Associate Incentives expense has decreased modestly as a percentage of net sales on a sequential quarter basis since the fourth quarter of 2009. We expect that Associate incentives expense will continue to decline relative to sales in the fourth quarter.

Selling, General and Administrative Expenses

Selling, general and administrative expenses as a percentage of net sales were relatively flat at 22.8% of net sales for the third quarter of 2010, compared with 22.9% for the third quarter in 2009. The leverage that we gained on this expense during the quarter was a result of higher sales and was mostly offset by the acquisition costs that we incurred related to BabyCare.

In absolute terms, our selling, general and administrative expenses increased by \$5.3 million for the third quarter of 2010, compared with the third quarter in 2009. The most significant components of this increase in absolute terms were as follows:

- An increase in wage-related expenses of approximately \$3.1 million, some of which includes the addition of expenses related to BabyCare;
- Non-recurring acquisition costs related to BabyCare of approximately \$1.2 million; and

- An increase in credit card fees of approximately \$0.5 million related to an increase in sales.

Notably, in connection with the acquisition of BabyCare we issued equity awards to certain BabyCare executives, which are expected to add approximately \$0.9 million per quarter to our selling, general and administrative expenses. The \$3.1 million in wage-related expenses referenced above includes approximately \$0.4 million in expense relating to these equity awards.

Other Income (Expense)

Other income increased to \$0.5 million in the third quarter of 2010 compared with \$0.1 million in the third quarter of 2009. This increase was primarily due to a \$0.6 million gain from the impact of changes in currency exchange rates on intercompany transactions during the quarter. Additionally, our interest expense decreased as a result of a lower average balance on our line of credit during the third quarter of 2010 compared with the third quarter of 2009.

Income Taxes

Income taxes totaled 32.7% of earnings before income taxes in the third quarter of 2010 compared to 34.2% in the third quarter of 2009. This decrease is due to greater tax benefits from a reduction in tax reserves related to uncertain tax positions, the qualified production activities deduction, and stock option exercises during the quarter.

Table of Contents**Diluted Earnings Per Share**

Diluted earnings per share increased \$0.28, or 54.9%, to \$0.79 for the third quarter of 2010 compared with the third quarter of 2009. This increase was due to higher net sales combined with improved gross margins, lower relative Associate incentives expense, and a lower effective tax rate. These improvements were partially offset by acquisition costs and an increase in the average number of diluted shares outstanding.

Nine Months Ended October 3, 2009 and October 2, 2010**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)				Change from prior year	Percent change	Approximate impact of currency exchange	Change excluding the impact of currency exchange				
	Nine Months Ended October 3, 2009		October 2, 2010									
North America:												
United States	\$	114,495	35.8%	\$	113,826	29.9%	\$	(669)	(0.6)%	\$	N/A	(0.6)%
Canada		48,051	15.0%		52,352	13.8%		4,301	9.0%		5,800	(3.1)%
Mexico		16,384	5.1%		16,416	4.3%		32	0.2%		1,100	(6.5)%
North America Total		178,930	55.9%		182,594	48.0%		3,664	2.0%		6,900	(1.8)%
Asia Pacific:												
Southeast Asia/Pacific		69,683	21.8%		74,231	19.6%		4,548	6.5%		8,600	(5.8)%
Greater China		56,866	17.7%		106,156	27.9%		49,290	86.7%		500	85.8%
North Asia		14,677	4.6%		17,123	4.5%		2,446	16.7%		1,400	7.1%
Asia Pacific Total		141,226	44.1%		197,510	52.0%		56,284	39.9%		10,500	32.4%
	\$	320,156	100.0%	\$	380,104	100.0%	\$	59,948	18.7%	\$	17,400	13.3%

North America: The decrease in net sales in this region, on a local currency basis, was the result of lower product sales volume resulting from a decrease in the average number of active Associates and Preferred Customers in this region. This decrease was partially offset by a slight increase in customer spending in the United States and Mexico. Part of the decline in the number of active Associates is due to an increase in the number of North America-based Associates building their businesses in Asia, which results in growth in sales and Associates in Asia Pacific rather than North America. We also believe that continued economic challenges, particularly in the consumer products segment, contributed to this decrease in active Associates. Over the last couple of years we have implemented certain price increases, including a price increase of nearly ten percent on our products in Mexico. While our profitability in Mexico has improved, we believe that the price increases in this market contributed to the decline in our active Associate count.

Edgar Filing: USANA HEALTH SCIENCES INC - Form 10-Q

Asia Pacific: The increase in net sales in this region was primarily due to higher product sales volume resulting from an increase in the average number of active Associates. This increase came predominantly from Greater China where the growth was led by Hong Kong. We also experienced double-digit growth in the Philippines and South Korea. The increase in total Asia Pacific sales was partially offset by a decline in sales and the average number of active Associates in Southeast Asia Pacific.

Table of Contents

Gross Profit

Gross profit increased to 81.3% of net sales during the nine months ended October 2, 2010, from 79.3% of net sales for the same period of 2009. This increase in gross profit can primarily be attributed to a decrease in overall raw materials cost, currency benefits, lower relative freight costs on shipments to our customers, and leverage gained on increased net sales. Additionally, we have implemented certain price increases, notably on some of our larger packs and flagship products, and we discontinued several of our lower gross margin product pack offerings, which have contributed to our improved gross profit.

Associate Incentives

Associate incentives increased to 45.2% of net sales during nine months ended October 2, 2010, compared with 44.7% for the same period of 2009. This increase was primarily the result of higher utilization of our Matching Bonus program and an increase in base commissions under our Compensation Plan related to the year-over-year change in currency exchange rates. As discussed above, however, Associate incentives as a percentage of net sales have decreased on a sequential quarter basis since the fourth quarter of 2009 due primarily to actions that we have taken to reduce this expense.

Selling, General and Administrative Expenses

Selling, general and administrative expenses decreased to 23.0% of net sales for the nine months ended October 2, 2010, compared with 23.6% for the same period of 2009. This decrease is the result of leverage gained on higher net sales and was partially offset by expenses related to our Asia Pacific convention that was held during the second quarter of 2010 (since this convention was not held during 2009), as well as acquisition costs related to BabyCare.

In absolute terms, our selling, general and administrative expenses increased by \$11.9 million for the nine months ended October 2, 2010, compared with the same period in 2009. The most significant components of this increase in absolute terms were as follows:

- An increase in wage-related expenses of approximately \$5.5 million;
- Non-recurring acquisition costs related to BabyCare of approximately \$1.9 million;
- Expenses related to our Asia-Pacific convention of approximately \$1.6 million;

- An increase in credit card fees of approximately \$1.4 million related to an increase in sales; and
- An increase in customer recognition and promotional activities of approximately \$0.6 million.

Income Taxes

Income taxes totaled 34.0% of earnings before income taxes for the nine months ended October 2, 2010 compared to 34.4% in the same period of 2009. This decrease is due to greater tax benefits from the deduction for qualified production activities.

Liquidity and Capital Resources

We have historically met our working capital and capital expenditure requirements by using both net cash flow from operations and by drawing on our line of credit. Our principal source of liquidity is our operating cash flow. There are no material restrictions on our ability to transfer and remit funds among our international markets.

Table of Contents

Operating cash flow

We typically generate positive cash flow due to our strong operating margins. During the first nine months of 2010, we had a net cash flow from operating activities of \$46.2 million, compared with \$20.5 million for the same period in 2009. The most significant factors of this change were an increase in net sales during the first nine months of 2010, and the unfavorable effect of \$14.4 million in payments made during 2009 for an unanticipated arbitration award and an IRS tax settlement. The overall improvement in operating cash flow was partially offset by increased cash spent on the buildup of inventory to accommodate higher sales, inventory for our Asia Pacific convention in the second quarter of 2010, and for our annual international convention in the third quarter of 2010.

As a U.S.-based, multi-national company, reporting in U.S. dollars, our net sales and earnings can be significantly affected by changes in currency exchange rates and it is difficult to estimate the impact that these changes may have on our future operating results. In general, our reported sales and earnings are affected positively by a weakening of the U.S. dollar and negatively by a strengthening of the U.S. dollar relative to the currencies in the countries where we have operations. During the nine months ended October 2, 2010, we received a benefit to net sales of approximately \$17.4 million related to changes in currency exchange rates.

Acquisition of BabyCare

On August 16, 2010, we indirectly acquired BabyCare Ltd. for \$62.7 million. The purchase price consisted of \$28.5 million from our existing cash balance, \$16.5 million from our line of credit, and 400,000 shares of our common stock.

Line of credit

We currently maintain a \$40.0 million credit facility with Bank of America. As of October 2, 2010, our balance on this line of credit, which is now a short-term liability with a maturity date in May 2011, was \$19.0 million with a weighted-average interest rate of 1.26%. Of this balance, \$16.5 million was used in our acquisition of BabyCare.

The agreement for this line of credit (Credit Agreement) contains restrictive covenants, which require us to maintain a consolidated rolling four-quarter adjusted earnings before interest, taxes, depreciation and amortization (adjusted EBITDA) equal to or greater than \$50.0 million, and a ratio of consolidated funded debt to adjusted EBITDA of 2.5 to 1.0 at the end of each quarter. The adjusted EBITDA under the Credit Agreement is modified for certain non-cash expenses. As of October 2, 2010, we were in compliance with these covenants. Management is not aware of any issues currently impacting Bank of America's ability to honor their commitment to extend credit under this facility.

This line of credit matures in May 2011, at which time we will be required to pay any outstanding balance unless the line is replaced or terms are renegotiated. There can be no assurance that we will be able to secure the same or similar credit terms on a new line of credit upon maturity of our existing Credit Agreement or that we will have the same amount available to us. We do, however, expect to pay the line of credit in full prior to maturity in May 2011.

Working capital

Cash and cash equivalents increased to \$22.9 million at October 2, 2010, from \$13.7 million at January 2, 2010. Net working capital decreased to \$2.8 million at October 2, 2010, from \$11.4 million at January 2, 2010. The increase in cash and cash equivalents was due primarily to an increase in net cash flow from operating activities and also from proceeds on equity awards exercised. These improvements to cash and cash equivalents were offset in large part by our acquisition of BabyCare and the cash spent on share repurchases. The decrease in net working capital was the result of our acquisition of BabyCare and the related effects on cash and cash equivalents and our line of credit, which is now a short-term liability.

Table of Contents

Share repurchase

We have a share repurchase plan that has been ongoing since the fourth quarter of 2000. Our Board of Directors has periodically approved additional dollar amounts for share repurchases under that plan. Share repurchases are made from time-to-time, in the open market, through block trades or otherwise, and are based on market conditions, the level of cash balances, general business opportunities, and other factors. During the nine months ended October 2, 2010, we repurchased and retired 199 thousand shares of common stock for a total investment of \$8.6 million, at an average market price of \$43.43. Also, during the quarter ended October 2, 2010, our Board of Directors authorized an additional \$40.0 million for share repurchases under the plan. There currently is no expiration date on the remaining approved repurchase amount of \$40.1 million and no requirement for future share repurchases.

Summary

We believe that current cash balances, future cash provided by operations, and amounts available under our line of credit will be sufficient to cover our operating and capital needs in the ordinary course of business for the foreseeable future. If we experience an adverse operating environment or unusual capital expenditure requirements, additional financing may be required. No assurance can be given, however, that additional financing, if required, would be available or on favorable terms. We might also require or seek additional financing for the purpose of expanding into new markets, growing our existing markets, or for other reasons. Such financing may include the use of additional debt or the sale of additional equity securities. Any financing which involves the sale of equity securities or instruments that are convertible into equity securities could result in immediate and possibly significant dilution to our existing shareholders.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our earnings, cash flows, and financial position are affected by fluctuations in currency exchange rates, interest rates, and other uncertainties that are inherent in doing business and selling product in more than one currency. In addition, our operations are exposed to risks that are associated with changes in social, political, and economic conditions in our international operations. This includes changes in the laws and policies that govern investment in international countries where we have operations, as well as, to a lesser extent, changes in United States laws and regulations relating to international trade and investment.

Currency Risks. Net sales outside the United States represented 64.2% and 70.1% of our net sales in the nine-month periods ended October 3, 2009 and October 2, 2010, respectively. Because such a significant portion of our sales are generated outside of the United States, currency fluctuations have a significant effect on our sales and earnings. This risk is partially mitigated by the fact that our sales are spread across 15 countries, with Hong Kong (where the local currency is tied to the U.S. dollar) being our largest international market, at 22.5% of net sales in the nine months ended October 2, 2010, followed by Canada at 13.8%. The local currency of each international subsidiary is considered the functional currency, with all revenue and expenses being translated at weighted-average currency exchange rates for the applicable periods. In general, our reported sales and earnings are affected positively by a weakening of the U.S. dollar and negatively by a strengthening of the U.S. dollar relative to the currencies in the countries where we have operations. Changes in currency exchange rates may also affect our product margins because we manufacture the majority of our products in the U.S. and sell them to our international subsidiaries in their respective functional currencies. We are unable to reasonably estimate the effect that currency fluctuations may have on our future business, results of operations, or financial condition. This is due to the uncertainty in, and the varying degrees and type of exposure that we face from, fluctuations in various currencies.

Edgar Filing: USANA HEALTH SCIENCES INC - Form 10-Q

At times we have sought to reduce exposure to fluctuations in currency exchange rates by creating offsetting positions through the use of currency exchange contracts on cash that we repatriate. We do not use derivative financial instruments for trading or speculative purposes. We have also considered the costs and benefits of managing currency impacts on net sales and certain balance sheet items. There can be no assurance that our practices will be successful in eliminating all or substantially all of the risks that may be encountered in connection with our currency transactions. As of October 2, 2010, we had no currency exchange contracts in place.

Table of Contents

Following are the average exchange rates of currency units to one U.S. dollar for each of our international markets for the quarterly periods indicated:

	First	2009 Second	Third	First	2010 Second	Third
Canadian Dollar	1.24	1.16	1.09	1.04	1.03	1.04
Australian Dollar	1.50	1.31	1.20	1.10	1.14	1.10
New Zealand Dollar	1.87	1.65	1.48	1.41	1.43	1.39
Hong Kong Dollar	7.75	7.75	7.75	7.76	7.78	7.77
Japanese Yen	93.83	97.09	93.28	90.74	91.80	85.65
New Taiwan Dollar	33.98	33.11	32.75	31.92	31.86	31.88
Korean Won	1,411.30	1,250.00	1,234.60	1,142.55	1,166.79	1,179.66
Singapore Dollar	1.51	1.47	1.44	1.40	1.39	1.35
Mexican Peso	14.35	13.28	13.29	12.75	12.59	12.78
Chinese Yuan	6.84	6.83	6.83	6.83	6.82	6.77
Malaysian Ringitt	3.63	3.54	3.52	3.36	3.24	3.15
Philippine Peso	47.68	47.62	48.06	45.92	45.55	45.10

Interest Rate Risks. As of October 2, 2010, we had a balance of \$19.0 million outstanding on our line of credit, with a weighted-average interest rate of 1.26%. This interest rate is computed at the bank's Prime Rate, or LIBOR, adjusted by features specified in our loan agreements, with fixed rate term options of up to six months. The annual impact on after-tax expense of a 100-basis-point increase in the interest rate on the above balance would not materially affect our earnings. If, however, we are unable to meet the covenants in our loan agreement, we would be required to renegotiate the terms of credit under the loan agreement, including the interest rate. There can be no assurance that any renegotiated terms of credit would not materially impact our earnings.

Item 4. CONTROLS AND PROCEDURES**Disclosure Controls and Procedures**

We maintain disclosure controls and procedures that are designed to ensure that information that is required to be disclosed in our Exchange Act reports is recorded, processed, summarized, and reported within the time periods that are specified in the SEC's rules and forms and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding any required disclosure. In designing and evaluating these disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

As of the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act). Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of October 2, 2010.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the quarter ended October 2, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

Chirco vs. USANA et. al

On April 17, 2009, USANA, and certain of its present and former officers and directors, were named as defendants in this purported class action lawsuit in State District Court in Clark County, Nevada. The complaint alleged a number of purported material misrepresentations to the market in violation of state pyramid law, deceptive business practices, and business fraud law. On September 29, 2010, the Nevada State District Court dismissed this lawsuit with prejudice. The sole plaintiff in the case agreed to petition the court to dismiss the case after the plaintiff reviewed the evidence and determined that the lawsuit should not continue.

Item 1A. RISK FACTORS

The risk factors presented below update the risk factors presented in our Annual Report on Form 10-K for the 2009 fiscal year and should be read in conjunction with the risk factors and information disclosed in such annual report. Please refer to our recent SEC filings, including our Annual Report on Form 10-K for the 2009 fiscal year, and Current Reports of Form 8-K, for a detailed discussion of risks associated with our business.

Our net sales are significantly affected by our success in growing existing markets, as well as opening new markets. As we continue to expand into international markets, our business becomes increasingly subject to political, economic, legal and other risks. Changes in these markets could adversely affect our business. We have a history of expanding into new international markets. We believe that our ability to achieve future growth is dependent in part on our ability to continue our international expansion efforts. There can be no assurance, however, that we will be able to grow in our existing international markets, enter new international markets on a timely basis, or that new markets will be profitable. We must overcome significant regulatory and legal barriers before we can begin marketing in any international market. Also, before marketing commences in a new country or market, it is difficult to assess the extent to which our products and sales techniques will be accepted or successful in any given country. In addition to significant regulatory barriers, we may also encounter problems conducting operations in new markets with different cultures and legal systems from those encountered elsewhere. We may be required to reformulate certain of our products before commencing sales in a given country. Once we have entered a market, we must adhere to the regulatory and legal requirements of that market. No assurance can be given that we will be able to successfully reformulate our products in any of our current or potential international markets to meet local regulatory requirements or to attract local customers. Our failure to do so could have a material adverse effect on our business, financial condition, or results of operations. There can be no assurance that we will be able to obtain and retain necessary permits and approvals in new markets, or that we will have sufficient capital to finance our expansion efforts in a timely manner.

In many market areas, other network marketing companies already have significant market penetration, the effect of which could be to desensitize the local Associate population to a new opportunity, such as USANA, or to make it more difficult for us to attract qualified Associates. Even if we are able to commence operations in new markets, there may not be a sufficient population of persons who are interested in our network marketing system. We believe our future success will depend in part on our ability to seamlessly integrate our compensation plan across all markets where legally permissible. There can be no assurance, however, that we will be able to utilize our compensation plan

Edgar Filing: USANA HEALTH SCIENCES INC - Form 10-Q

seamlessly in all existing or future markets. For example, in August 2010, we indirectly acquired BabyCare, Ltd. (BabyCare), a nutritional supplement company that is licensed by the government of the People's Republic of China (the PRC or China) to engage in direct selling in the Municipality of Beijing. Under Chinese law, single-level compensation models are permitted, but multi-level compensation models, as practiced by USANA and many other direct selling companies, are not. BabyCare utilizes a single-level compensation model in connection with its business in China, which is separate and different from our compensation plan in our other markets. In order to comply with China law, BabyCare will continue to utilize its compensation model and USANA's compensation plan will not be integrated into BabyCare or utilized in China.

Introduction of new laws or changes to existing laws by the Chinese government may adversely affect our business. Our newest market is the PRC by virtue of our indirect acquisition of BabyCare. Our business and operations in China and those of BabyCare are governed by the Chinese legal system, which is codified in laws, regulations, circulars, administrative

Table of Contents

directives and internal guidelines. The Chinese government is in the process of developing its commercial legal system to meet the needs of foreign investors and encourage foreign investment. The Chinese economy is developing and growing very rapidly. Despite this rapid growth, the legal system in China has not always kept pace with the growth of the economic sector. This raises the level of uncertainty regarding the application of existing laws and regulations to new economic events and circumstances. As a consequence, Chinese laws, regulations and legal requirements relevant to our business may change frequently, and their requirements, interpretation and enforcement involve uncertainties and potential inconsistencies.

Chinese administrative and court authorities have significant discretion in interpreting and implementing statutory and regulatory requirements. As a consequence, uncertainties and inconsistencies in the requirements, interpretation and enforcement of these laws, regulations and legal requirements could materially and adversely affect our business and operations and could expose us to potential liabilities, including potential fines and other penalties, if it is determined that we have failed to comply with the requirements of such laws, regulations and legal requirements. Unlike the United States legal system, in China, the precedents of interpretation, implementation and enforcement of Chinese laws and regulations in certain business matters may be limited and Chinese court decisions are not binding on lower courts. As a result, the outcome of dispute resolutions may not be as consistent or predictable as in other more commercially advanced jurisdictions. Therefore, it may be difficult to obtain timely and equitable enforcement of Chinese laws, or to obtain enforcement in China of a judgment by a foreign court or jurisdiction.

Our ability to enforce BabyCare's material agreements in China is uncertain Chinese law will govern BabyCare's material operating agreements. There is no assurance that BabyCare will be able to enforce those material agreements or that remedies will be available outside China. The Chinese judiciary is relatively inexperienced in enforcing corporate and commercial laws, leading to a substantial degree of uncertainty as to the outcome of litigation. The inability to enforce or obtain a remedy under our agreements may have a material adverse impact on our operations.

We may incur unanticipated costs because of the unpredictability of the Chinese legal system. The Chinese legal system has many uncertainties. The Chinese legal system is based on written statutes. Prior court decisions may be cited for reference but have limited precedential value. Since 1979, Chinese legislation and regulations have enhanced the protections afforded to various forms of foreign investments in China. However, China has not developed a fully integrated legal system, and recently-enacted laws and regulations may not sufficiently cover all aspects of economic activities in China. In particular, because these laws and regulations are relatively new, and because of the limited volume of published decisions and their nonbinding nature, the interpretation and enforcement of these laws and regulations involve uncertainties. In addition, the Chinese legal system is based in part on government policies and internal rules (some of which are not published on a timely basis or at all) that may have a retroactive effect. As a result, we may not be aware of our violation of these policies and rules until some time after the violation. In addition, any litigation in China may be protracted and result in substantial costs and diversion of resources and management attention.

A return to profit repatriation controls may limit the ability to expand business and reduce the attractiveness of investing in Chinese business opportunities. Chinese law allows enterprises owned by foreign investors to remit their profits, dividends and bonuses earned in China to other countries, and the remittance does not require prior approval by the State Administration of Foreign Exchange (SAFE). SAFE regulations require extensive documentation and reporting, some of which was burdensome and slowed payments. If there is a return to payment restrictions and reporting, the ability of a Chinese company to attract investors will be reduced. Also, current investors may not be able to obtain the profits of the businesses they own for other reasons. Relevant Chinese law and regulation permit payment of dividends only from retained earnings, if any, determined in accordance with Chinese accounting standards and regulations. It is possible that the Chinese tax authorities may require changes in the calculation of distributable net income of BabyCare that may limit its ability to pay dividends and other distributions to stockholders. Chinese law requires companies to set aside a portion of net income to fund certain reserves, which amounts are not distributable as dividends. These rules and possible changes could restrict BabyCare from repatriating funds.

The slowdown of China's economy caused in part by the recent challenging global economic conditions may adversely affect our ability to grow our business in China. China's economy has experienced a slowdown after the second quarter of 2007, when the quarterly growth rate of China's gross domestic product reached 11.9%. A number of factors have contributed to this slowdown, including appreciation of China's currency, the Renminbi, which has adversely affected China's exports, and tightening macroeconomic measures and monetary policies adopted by the Chinese government aimed at preventing

Table of Contents

overheating of China's economy and controlling China's high level of inflation. The slowdown has been further exacerbated by the challenging global economic conditions in the financial services and credit markets, which in recent months has resulted in extreme volatility and dislocation of the global capital and credit markets. It is uncertain how long the challenging global economic conditions in the financial services and credit markets will continue and how much of an adverse impact this will have on the global economy in general and the Chinese economy specifically. In response to the challenging global economic conditions, in September 2008 the Chinese government began to loosen economic measures and monetary policies by reducing interest rates and decreasing the statutory reserve rates for banks. On November 5, 2008, the State Council of China announced an economic stimulus plan in the amount of \$585 billion to stimulate economic growth and bolster domestic demand. We cannot assure you that the economic stimulus plan or various macroeconomic measures and monetary policies adopted by the Chinese government to guide economic growth and the allocation of resources will be effective in sustaining the growth of the Chinese economy. The slowdown of China's economy could lead to lower demand for BabyCare's products in China, because demand for BabyCare's products is dependent on strong general economic activities and conditions, which may adversely and materially affect our ability to grow our business in China.

Our business will be adversely affected if Chinese regulatory authorities view our direct selling and other corporate activities as noncompliant with applicable Chinese laws and regulations. Our operations in China may be deemed to be subject to numerous Chinese commercial laws, including restrictions on foreign investments. In addition, the Chinese regulatory authorities with jurisdiction over our operations may change applicable laws and regulations, or impose additional requirements and conditions with which we may be unable to comply. BabyCare is licensed to engage in direct selling activity in the Municipality of Beijing. We have not sought confirmation from Chinese regulatory governmental authorities whether our structure and business arrangement with BabyCare comply with applicable Chinese laws and regulations, including regulation of direct selling business in China. If:

- Chinese authorities deem BabyCare's corporate activities as violating applicable Chinese laws and regulations (including restrictions on foreign investments);
- Chinese regulatory authorities change applicable laws and regulations or impose additional requirements and conditions with which BabyCare is unable to comply; or
- BabyCare is found to violate any existing or future Chinese laws or regulations;

the relevant Chinese authorities would have broad discretion to deal with such a violation by levying fines, revoking business licenses, requiring us to restructure BabyCare's ownership or operations, and requiring BabyCare and/or USANA to discontinue some or all of their business in China. Any of these actions would adversely affect our business.

Our operations in China are subject to significant government scrutiny and may be harmed by the results of such scrutiny. Because of the government's significant concerns about direct selling activities, government regulators in China closely scrutinize activities of direct selling companies or activities that resemble direct selling. The regulatory environment in China with regard to direct selling is evolving, and officials in multiple national and local levels in the Chinese government often exercise broad discretion in deciding how to interpret and apply applicable regulations. In the past, the government has taken significant actions against companies that the government has found have been engaging in direct selling activities in violation of applicable law, including shutting down their businesses and imposing substantial fines.

Any determination that our operations or activities, or the activities of our sales employees, contractual sales promoters, direct sellers or Associates are not in compliance with applicable regulations could result in substantial fines, extended interruptions of business, termination of necessary licenses and permits, including our direct selling licenses, or restrictions on our ability to open new stores, obtain approvals for service centers or expand into new locations, all of which could harm our business.

If direct selling regulations in China are interpreted or enforced by government authorities in a manner that negatively impacts BabyCare's business model there, our business in China could be harmed. Chinese regulators have adopted anti-pyramiding and direct selling regulations that contain significant restrictions and limitations, including a restriction on multi-level compensation for independent distributors who sell away from a fixed location. These regulations also impose various

Table of Contents

requirements on individuals before they can become direct sellers, including the passage of an examination. The regulations adopted by China are in many ways more burdensome than in our other markets, which could negatively impact the willingness of some people to sign up to become direct sellers. There continues to be some confusion and uncertainty as to the interpretation and enforcement of the regulations.

The direct selling license granted to BabyCare is limited in its scope. To engage in direct selling activity outside the Municipality of Beijing, BabyCare will be required to obtain licenses from other municipalities and provinces within China. If BabyCare is unable to obtain additional necessary national and local government approvals in China as quickly as we would like, our ability to expand and grow our business could be negatively impacted. The process for obtaining the necessary government approvals to conduct direct selling continues to evolve. The process is time-consuming and expensive. The complexity of the approval process, as well as the government's continued cautious approach as direct selling develops in China, makes it difficult to predict the timeline for obtaining additional approvals. If the results of the government's evaluation of our direct selling activities result in further delays in obtaining licenses elsewhere, or if the current processes for obtaining approvals are delayed further for any reason or are changed or are interpreted differently than currently understood, BabyCare's ability to expand direct selling in China and its growth prospects in this market, could be negatively impacted. BabyCare currently is only allowed by the PRC to sell through direct selling the limited number of products that are manufactured by BabyCare itself. If BabyCare wishes to sell additional products (other than those already approved) through the direct-selling channel, it must successfully complete a product approval process similar to the process described above. We cannot assure you that BabyCare will be successful in obtaining such additional product approvals on a timely basis or at all.

Intellectual property rights are difficult to enforce in China. Chinese commercial law is relatively undeveloped compared to most of our other major markets, and, as a result, we may have limited legal recourse in the event we encounter significant difficulties with patent or trademark infringers. Limited protection of intellectual property is available under Chinese law, and the local manufacturing of our products may subject us to an increased risk that unauthorized parties may attempt to manufacture and sell counterfeit products or copy or otherwise obtain or use our product formulations. As a result, we cannot assure that we will be able to adequately protect our product formulations or other intellectual property in China.

We may be subject to fines and legal sanctions if we or our employees who are PRC citizens fail to comply with PRC regulations relating to employee stock options granted by overseas listed companies to PRC citizens. On December 25, 2006, the People's Bank of China issued the Administration Measures on Individual Foreign Exchange Control, and its Implementation Rules were issued by SAFE on January 5, 2007, which both took effect on February 1, 2007. Under these regulations, all foreign exchange matters involved in an employee stock holding plan, stock option plan or similar plan in which PRC citizens participate require approval from SAFE or its authorized branch. On March 28, 2007, SAFE promulgated the Application Procedure of Foreign Exchange Administration for Domestic Individuals Participating in Employee Stock Holding Plan or Stock Option Plan of Overseas-Listed Company, or the Stock Option Rule. Under the Stock Option Rule, PRC citizens who are granted stock options or restricted share units, or issued restricted shares by an overseas publicly listed company are required, through a PRC agent or PRC subsidiary of such overseas publicly-listed company, to complete certain other procedures and transactional foreign exchange matters upon the examination by, and approval of, SAFE. In connection with our acquisition of BabyCare, certain executives of BabyCare were granted equity awards in connection with the transaction and their continued employment with BabyCare. The equity awards provided to these individuals were issued under the USANA Health Sciences, Inc. 2006 Equity Incentive Award Plan and contain vesting, termination and other provisions similar to awards USANA has historically granted to its executives and employees. We and the BabyCare employees who are PRC citizens who have been granted these equity awards may be subject to the Stock Option Rule. If the relevant PRC regulatory authority determines that BabyCare's PRC employees who hold such awards or BabyCare fail to comply with these regulations, such employees and BabyCare may be subject to fines and legal sanctions.

The new provisions of the PRC Employment Contract Law may substantially increase our labor-related costs in the future. The PRC Employment Contract Law, which became effective as of January 1, 2008, contains provisions more favorable to employees than prior labor regulations in effect in China. The legislation formalized workers' rights concerning overtime hours, pensions, layoffs, employment contracts and the role of trade unions. Considered one of the strictest labor laws in the world, among other things, this law provides for specific standards and

procedures for the termination of an employment contract and places the burden of proof on the employer. In addition, the law requires the payment of a statutory severance pay

Table of Contents

upon the termination of an employment contract in most cases, including the case of the expiration of a fixed-term employment contract. Further, the law requires an employer to conclude an employment contract without a fixed-term with any employee who either has worked for the same employer for 10 consecutive years or more or has had two consecutive fixed-term contracts with the same employer. An employment contract without a fixed term can no longer be terminated due to the expiration of the contract, although it can still be terminated pursuant to the standards and procedures set forth under the new law. Because of the lack of implementing rules for the new law and the precedents for the enforcement of such a law, the standards and procedures set forth under the law in relation to the termination of an employment contract have raised concerns among foreign investment enterprises in the PRC that such employment contracts without a fixed term might in fact become a lifetime, permanent employment contract. The requirement to comply with this law may substantially increase BabyCare's labor-related costs in its future operations, which may have a material adverse effect on our business, financial condition and results of operations.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) Sales of Equity Securities

On August 16, 2010, we filed a Current Report on Form 8-K, which disclosed that we indirectly acquired BabyCare Ltd., a direct selling company in China and that we issued 400,000 shares of USANA common stock as part of the purchase price for BabyCare. We filed a registration statement with the SEC on Form S-3 to register these shares on October 14, 2010.

(c) Repurchases

Issuer Purchases of Equity Securities

(amounts in thousands, except per share data)

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs *
Fiscal July (Jul. 4, 2010 through Aug. 7, 2010)	0	\$ 0.00	0	\$ 8,736
Fiscal August (Aug. 8, 2010 through Sept. 4, 2010)	161	\$ 43.82	161	\$ 41,698
Fiscal September (Sept. 5, 2010 through Oct. 2, 2010)	38	\$ 41.78	38	\$ 40,106
	199	\$ 43.43	199	

* The Company's share repurchase plan has been ongoing since the fourth quarter of 2000, with the Company's Board of Directors periodically approving additional dollar amounts for share repurchases under the plan. As announced in a publicly issued press release on August 31, 2010, the Board of Directors approved an additional \$40,000 for share repurchases under the plan. There currently is no expiration date on the approved repurchase amount.

Edgar Filing: USANA HEALTH SCIENCES INC - Form 10-Q

Table of Contents

Item 6. Exhibits

Exhibit Number	Description
3.1	Amended and Restated Articles of Incorporation (Incorporated by reference to Report on Form 8-K, filed April 25, 2006)
3.2	Bylaws (Incorporated by reference to Report on Form 8-K, filed April 25, 2006)
4.1	Specimen Stock Certificate for Common Stock, no par value (Incorporated by reference to Registration Statement on Form 10, File No. 0-21116, effective April 16, 1993)
10.1	2002 USANA Health Sciences, Inc. Stock Option Plan (Incorporated by reference to Registration Statement on Form S-8, filed July 18, 2002)*
10.2	Form of employee or director non-statutory stock option agreement under the 2002 Stock Option Plan (Incorporated by reference to Report on Form 10-K, filed March 6, 2006)*
10.3	Form of employee incentive stock option agreement under the 2002 Stock Option Plan (Incorporated by reference to Report on Form 10-K, filed March 6, 2006)*
10.4	Credit Agreement by and between Bank of America, N.A. and USANA Health Sciences, Inc. (Incorporated by reference to Report on Form 10-Q for the period ended July 3, 2004)
10.5	Amendment dated May 17, 2006 to Credit Agreement dated June 16, 2004 (Incorporated by reference to Report on Form 10-Q for the period ended September 30, 2006)
10.6	Amendment dated April 24, 2007 to Credit Agreement dated June 16, 2004 (Incorporated by reference to Report on Form 10-Q for the period ended March 31, 2007)
10.7	USANA Health Sciences, Inc. 2006 Equity Incentive Award Plan (Incorporated by reference to Report on Form 8-K, filed April 25, 2006)*
10.8	Form of Stock Option Agreement for award of non-statutory stock options to employees under the USANA Health Sciences, Inc. 2006 Equity Incentive Award Plan (Incorporated by reference to Report on Form 8-K, filed April 26, 2006)*
10.9	Form of Stock Option Agreement for award of non-statutory stock options to directors who are not employees under the USANA Health Sciences, Inc. 2006 Equity Incentive Award Plan (Incorporated by reference to Report on Form 8-K, filed April 26, 2006)*
10.10	Form of Incentive Stock Option Agreement under the USANA Health Sciences, Inc. 2006 Equity Incentive Award Plan (Incorporated by reference to Report on Form 8-K, filed April 26, 2006)*
10.11	Form of Stock-Settled Stock Appreciation Rights Award Agreement for employees under the USANA Health Sciences, Inc. 2006 Equity Incentive Award Plan (Incorporated by reference to Report on Form 8-K, filed April 26, 2006)*
10.12	Form of Stock-Settled Stock Appreciation Rights Award Agreement for directors who are not employees under the USANA Health Sciences, Inc. 2006 Equity Incentive Award Plan (Incorporated by reference to Report on Form 8-K, filed April 26, 2006)*
10.13	Form of Deferred Stock Unit Award Agreement for grants of deferred stock units to directors who are not employees under the USANA Health Sciences, Inc. 2006 Equity Incentive Award Plan (Incorporated by reference to Report on Form 8-K, filed April 26, 2006)*

10.14 Form of Indemnification Agreement between the Company and its directors (Incorporated by reference to Report on Form 8-K, filed May 24, 2006)*

Table of Contents

10.15	Form of Indemnification Agreement between the Company and certain of its officers (Incorporated by reference to Report on Form 8-K, filed May 24, 2006)*
10.16	Share Purchase Agreement, dated as of August 16, 2010, among USANA Health Sciences, Inc., Petlane, Inc., Yaolan Ltd., and BabyCare Holdings Ltd. (Incorporated by Reference to Report on Form 8-K, filed August 16, 2010)
11.1	Computation of Net Income per Share (included in Notes to Consolidated Financial Statements)
31.1	Certification of Chief Executive Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350
32.2	Certification of Chief Financial Officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350

* Denotes a management contract or compensatory plan or arrangement.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

USANA HEALTH SCIENCES, INC.

Date: November 10, 2010

/s/ Jeffrey A. Yates
Jeffrey A. Yates
Chief Financial Officer
(Principal Financial and Accounting Officer)