USANA HEALTH SCIENCES INC
Form 10-K/A
May 01, 2002

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

(Mark One)

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

For the fiscal year ended December 29, 2001

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

For the transition period from to

Commission file number: 0-21116

USANA HEALTH SCIENCES, INC.

(Exact name of registrant as specified in its charter)

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

3838 West Parkway Blvd., Salt Lake City, Utah 84120
(Address of principal executive offices, Zip Code)

(801) 954-7100
(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, Par Value $0.001 Per Share

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 ý No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K/A or any amendment to this Form 10-K/A. o

The aggregate market value of common stock held by non-affiliates of the registrant as of March 20, 2002 was approximately $7,316,333.

The number of shares outstanding of the registrant s common stock as of March 20, 2002 was 9,663,837.

The registrant amends this report to update disclosure in "Item 1. Business Recent Developments" and "Item 7A. Quantitative and Qualitative Disclosures about Market Risk Forward-Looking Statements and Certain Risks" as well as Note O to the registrant's Financial Statements included in this Report.

USANA HEALTH SCIENCES, INC.

FORM 10-K/A

For the Fiscal Year Ended December 29, 2001

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PART I

Item 1. Business

General

USANA Health Sciences, Inc. (USANA or the Company) is a Utah corporation that develops and manufactures high-quality nutritional, personal care and weight management products. We distribute our products through a network marketing system. USANA refers to its independent distributors as Associates. As of December 29, 2001, we had approximately 86,000 Associates in the United States, Canada, Australia, New Zealand, Hong Kong, Japan and the United Kingdom (hereinafter includes The Netherlands). We also offer a Preferred Customer program specifically designed for customers who desire to purchase products for personal use and do not desire to resell or distribute products. As of December 29, 2001, we had approximately 77,000 Preferred Customers worldwide. Sales to Preferred Customers accounted for approximately 19% of net sales during the year ended December 29, 2001. For purposes of this report, USANA counts as Associates and Preferred Customers only those that have purchased product from USANA at any time during the most recent 12-month period.

Founded in 1992 by Myron W. Wentz, Ph.D., USANA is committed to continuous product innovation and sound scientific research. Our three primary product lines consist of USANA® Nutritionals, LEAN Lifelong™ and Sensé™. The USANA Nutritionals product line accounted for approximately 67% of net sales in 2001. Our top-selling products, USANA® Essentials and Proflavanol®, represented approximately 28% and 12%, respectively, of net sales in 2001. The LEAN Lifelong product line accounted for approximately 10% of net sales in 2001. The Sensé product line accounted for approximately 13% of net sales in 2001. High levels of bioavailability, safety and quality characterize all of USANA s products.

USANA distributes its products through a network marketing system. We believe that network marketing is an effective way to distribute our products because network marketing allows person-to-person product education, which is not readily available through traditional distribution channels. Network marketing appeals to a broad cross-section of people, particularly those seeking to supplement income, start a home-based business or pursue entrepreneurial opportunities other than conventional full-time employment. We consider the rewarding compensation program and weekly Associate incentive payments to be attractive components of the USANA network marketing system.

North America is our primary market. Sales in the United States and Canada collectively accounted for approximately 82.4% of net sales in 2001. Sales to the United Kingdom, which are shipped directly from USANA headquarters in the United States, are included in the total for the United States throughout this report for comparability purposes. Sales in the Australia-New Zealand market represented approximately 12.5% of net sales in 2001. Hong Kong, our first market in Asia, accounted for 4.6% of net sales in 2001.

We began full-scale operations in our newest Asian market, Japan, in October 2001. Customers in Japan may now purchase product directly from local operations or through the direct export program from USANA headquarters. Sales under the direct export program totaling $2.6 million in 2001are included in the total for the United States and products may be purchased in that program for personal use only. Local operations in Japan generated sales of $620,000 for the three-month period ended December 29, 2001.

Financial Information by Business Segment

USANA is principally engaged in a single line of business: the development, manufacture and distribution of nutritional, personal care and weight management products. Our reportable business segments are distinguished by geography and include the United States (including direct export sales to customers in the United Kingdom, Japan and various Caribbean countries), Canada, Australia-New Zealand, Hong Kong and Japan. Segment information for each of the last three fiscal years is included in Note K of the audited consolidated financial statements included in this report.

Recent Developments

On March 21, 2002, USANA entered into an agreement with USANA Acquisition Corp. (UAC), a Utah corporation wholly owned by Gull Holdings, under which USANA agreed to sell and UAC agreed to purchase substantially all of the operating assets and assume substantially all of the liabilities of USANA (the sale and assignment is referred to as the Transaction). The purchase price for the acquired assets was to be approximately $25 million. In addition to the assumption of liabilities, the consideration paid by UAC was to include (1) assigning for redemption, at a price of $1.60 per share, 4,786,282 shares of USANA common stock owned by Gull Holdings, (a total value of approximately $7.7 million), and (2) issuing a promissory note payable to USANA in the principal amount of $5.0 million. On April 11, 2002, USANA, UAC and Gull Holdings mutually agreed to terminate the purchase agreement. USANA will not proceed with the Transaction.

Industry Overview

The nutrition industry includes many small- and medium-sized companies that manufacture and distribute products generally intended to enhance the body s performance and wellness. The four major product categories within the nutrition industry are:

Nutritional Supplements products such as vitamins, minerals, dietary supplements, herbs, botanicals and compounds derived from these substances,

Natural and Organic Foods products such as cereals, milk, non-dairy beverages and frozen entrées,

Functional Foods products with added ingredients or fortification specifically for health or performance purposes, and

Cosmeceuticals products combining nutrition with skin care.

In the *Annual Industry Overview 2001* the Nutrition Business Journal (NBJ) stated that its research suggests the overall market for nutritional products in the United States is approximately $49.5 billion per year and growing at an estimated 6.4% annual rate. NBJ also stated that the global nutritional industry is estimated to be $140 billion. According to NBJ, of the approximate $49.5 billion sold in the United States, functional foods make up 35%, nutritional supplements 34%, natural and organic foods 23%, and cosmeceuticals 8%.

USANA believes that the following factors drive growth in the nutrition industry:

The general public s heightened awareness and understanding of the connection between diet and health,

The aging population, particularly the baby-boomer generation, which tends to use more nutritional supplementation as it ages,

The worldwide trend toward preventive health care, and

Product introductions in response to new scientific research.

Nutritional products are distributed through six major sales channels. Each channel has changed in recent years primarily due to advances in technology and communications resulting in improved product distribution and faster dissemination of information. The major sales channels are as follows:

Network marketing,

Mass market retailers, including mass merchandisers, drug stores, supermarkets and discount stores,

Natural health food retailers,

Mail order,

Practitioners, and

The Internet.

USANA primarily produces nutritional supplement products and distributes all products through the network marketing distribution channel. During 2001, there was a general weakness in the U.S. economy. An industry reporting source, Information Resources, Inc., disclosed an industry-wide decrease in the nutritional supplement segment in 2001. Following the terrorist attacks in the United States and related events that occurred in September 2001, most sales channels declined further as consumer confidence continued to weaken. However, we believe that USANA was not directly adversely affected as a result of the events in September 2001.

Operating Strengths

USANA s objective is to be a leading developer, manufacturer and distributor of science-based health products. We believe that we will be able to continue to grow and achieve this objective by capitalizing on the following operating strengths:

Science-based Products. USANA has developed a line of high-quality health products based upon a combination of published research, *in vitro* testing, in-house clinical studies and sponsored research. We believe that the identification and delivery of essential vitamins, minerals and other supplements will help individuals achieve and maintain lifelong health.

Strong Research and Development. USANA s research and development effort is directed by Dr. Wentz and is supported by a team of 22 scientists and researchers, including five scientists holding Ph.D. degrees. In its research and development laboratory, USANA s scientists and researchers:

Investigate *in vitro* activity of new natural extracts,

Identify and research combinations of nutrients that may be candidates for new products,

Study the metabolic activity of existing and newly identified nutritional supplements,

Enhance existing products as new discoveries in nutrition are made and as required to enter international markets, and

Formulate products to meet regulatory requirements of international markets.

USANA also performs retrospective analyses of anecdotal information provided by consumers of its products. In addition, we continue to perform double-blind, placebo-controlled clinical studies intended to further evaluate the efficacy of our products.

In-house Manufacturing. USANA believes that its ability to manufacture a significant portion of its products is a competitive advantage and contributes to its ability to provide high-quality products for several reasons:

USANA is able to better control the quality of raw materials and the purity and potency of finished products, USANA can more reliably monitor the manufacturing process to reduce the risk of product contamination, and

USANA believes it can continually improve the underlying costs associated with manufacturing nutritional supplements.

Attractive Associate Compensation Plan and Benefits. USANA is committed to providing a highly competitive compensation plan to attract and retain Associates, who constitute its sales force. We believe the USANA Associate compensation plan is one of the most financially rewarding in the network marketing industry. Associate incentives totaled approximately $44 million or 38.4% of net sales in 2001. USANA pays Associate incentives weekly. The USANA compensation plan is a global seamless plan, meaning that Associates can recruit and be compensated each week for their business success in any USANA market. To support the Associates, USANA sponsors events throughout the year, which offer information about products and the network marketing system. These meetings are designed to assist Associates in business development and to provide a forum for interaction with successful Associates and USANA management.

Experienced Management Team. USANA s management team includes individuals with expertise in various scientific and managerial disciplines, including nutrition, product research and development, marketing, customer network development, information technology, finance, operations and manufacturing. The current executive management team has been in place for several years and has been responsible for strengthening our internal controls, financial condition and infrastructure to support growth and international expansion.

Growth Strategy

Attract and Retain Associates and Preferred Customers. USANA recognizes the need to continue to attract and retain Associates. As of December 29, 2001, USANA had approximately 86,000 Associates and 77,000 Preferred Customers, compared to 93,000 Associates and 76,000 Preferred Customers at the end of 2000. USANA believes that the decline in the number of Associates is due in part to the adoption of the value initiative introduced in February 2000, which resulted in a shift in the customer base to a larger percentage of Preferred Customers. That trend continued during 2001. In response to this change in the customer base, USANA declared 2001 as, The Year of the Business , and determined to place greater focus on building the Associate base and assisting the Associates in building their business. This focus included holding large quarterly meetings in four different cities in the United States and Canada and introducing Health & Freedom Thursdays . The intent of these meetings was to provide additional training and resources for Associates to build a successful business with USANA. We believe this renewed emphasis on Associate building will improve the retention rate for Associates.

Enter New Markets. USANA believes that, in addition to the North American market, significant growth opportunities continue to exist in international markets. In October 2001, USANA began local operations for consumers in Japan. USANA bases the decision to enter Japan or any other new market on an assessment of several factors, including market size, anticipated demand for USANA products, receptivity to network marketing, ease of entry, including possible regulatory restrictions on the products or marketing system. USANA has begun to register certain products with regulatory and government agencies in order to prepare for further international expansion.

USANA will, wherever possible, continue to seamlessly integrate the Associate compensation plan in each market to allow Associates to receive commissions for global and not merely local product sales. This seamless downline (Associate s sales organization, including the Associate s recruits and their recruits) structure is designed to allow an Associate to build a global network by creating downlines across national borders. Associates are not required to establish new downlines or to re-qualify for higher levels of compensation in newly opened markets. USANA believes this seamless compensation plan can significantly enhance its ability to expand internationally and intends, where permitted, to integrate future markets into the plan.

Introduce New Products. USANA uses its research and development capabilities to introduce innovative products and to continuously enhance existing products. During 2001, USANA introduced several new products. USANA introduces new products throughout the year, primarily at Company-sponsored events.

Pursue Strategic Acquisitions. USANA believes that attractive acquisition opportunities may arise in the future. We intend to pursue strategic acquisition opportunities that would expand product lines, enhance manufacturing and technical expertise, allow vertical integration or otherwise complement our business or further our strategic goals.

Products

USANA s primary product lines consist of USANA® Nutritionals, LEAN Lifelong™ and Sensé™. In each of the last three years, the USANA Nutritionals product line constituted 67% or more of net sales. The principal product lines are briefly described below:

USANA® Nutritionals. This product line includes antioxidants, minerals, vitamins and other nutritional supplements. USANA s nutritional supplement products are designed to provide optimal absorption, bioavailability and efficacy. The top-selling products are the USANA® Essentials, which include Mega Antioxidant and Chelated Mineral, and Proflavanol®, which totaled approximately 28% and 12%, respectively, of net sales in 2001. Other products in this line include Body Rox™ (Essentials for Teens), Usanimals™ (Essentials for Kids), Poly C®, Procosamine II™, CoQuinone 30®, BiOmega-3™, E-Prime™, Active Calcium™, PhytoEstrin™, Palmetto Plus™, and Ginkgo-PS™.

LEAN Lifelong™. This product line includes several completely reformulated food products previously sold under the LEAN or USANA brand names. Nutrimeal™ and Fibergy® drink mixes, OptOmega®, SoyaMax™, Nutribar and Fibergy bar, a LEAN Formula for weight management and several other related products for healthy diets are now included in this product line. USANA has developed a LEAN Team program to provide a comprehensive approach to weight management, proper diet and nutrition, and healthy living. The program s underlying principles, **L**ifestyle, **E**ducation, **A**ctivity and **N**utrition, literally spell out the LEAN philosophy. Developed with the assistance of health, nutrition and fitness experts, the USANA LEAN program seeks to use the latest developments in nutritional science, psychology and exercise physiology to promote lifelong health, fitness and wellness.

Sensé™. This product line includes scientifically developed natural products designed to support healthy skin and hair by providing protection and nourishment on both the inside and outside of the dermal layers of skin. Products in this line include BeautiNutrients™, Gentle Daily Cleanser, Hydrating Toner, Daytime Protective Emulsion SPF 15, Eye Nourisher, Night Renewal (Replenishing Crème), Serum Intensive (Skin Revival Complex), Rice Bran Polisher, Nutritious Crème Masque, Revitalizing Shampoo, Nourishing Conditioner, Firming Body Nourisher and Energizing Shower Gel.

In addition to these three principal product lines, USANA has developed and sells to Associates materials designed to assist in building their business and selling the products. These resource materials or sales aids include product brochures and business forms designed by USANA and printed by outside publishers. USANA also contracts periodically with authors and publishers to produce or provide books, tapes and other items dealing with health topics and personal motivation, which are made available to Associates. USANA also writes and develops its own materials for audio and videotapes, which are produced by third parties. New Associates are required to purchase a starter kit containing USANA training materials that assist the Associates in starting and growing their business. Affinity and identity are also furthered through the sale of logo merchandise such as clothing, caps, mugs, and other products. Associates do not earn commissions on sales aids, starter kits or logo merchandise.

Research and Development

USANA is committed to continuous product innovation and improvement through sound scientific research. The mission of the research and development team is to develop, for all age groups, advanced health products that reduce the risk of chronic degenerative disease and promote life-long health. The research efforts of USANA are enhanced using a combination of published research, *in vitro* testing, in-house clinical studies and sponsored research. USANA periodically consults with a panel of physicians who provide advice on product development. Research and development expenditures totaled $1.4 million in each of the years 1999, 2000, and $1.1 million in 2001. We intend to continue to dedicate resources for the research and development of new products and reformulation of existing products.

USANA maintains a research and development program based upon established scientific research methodologies. These modern research facilities located at Salt Lake City headquarters are equipped to conduct analytical testing of raw ingredients, raw material extraction research, *in vitro* testing, cell culture procedures and human bioavailability studies. Anecdotal information from customers is reviewed and retrospective analyses are performed on this data. In-house clinical studies are conducted on selected existing products for which the retrospective analysis has demonstrated a positive effect, and also on new products to investigate efficacy.

Manufacturing and Quality Assurance

During 2001, USANA manufactured products that accounted for approximately 63% of net sales at its Salt Lake City, Utah, manufacturing facility. The production process includes the following steps:

- Identifying and evaluating suppliers of raw materials,
- Acquiring premium-quality raw materials,
- Weighing or otherwise measuring the raw materials,
- Mixing raw materials into batches,
- Forming the mixtures into tablets,
- Coating and sorting the tablets,
- Bottling and labeling the finished products, and
- Forming pouches and filling into boxes.

USANA s manufacturing process uses automatic and semi-automatic equipment. USANA conducts sample testing of raw materials and finished products for purity, potency and composition conforming to strict specifications. Constructed in 1996, the production facility is registered with the Food and Drug Administration (FDA) and Health Canada and has been inspected and certified by the Australian Therapeutic Goods Administration (TGA). The manufacture of nutritional supplements and related products requires compliance with food-level Good Manufacturing Practice regulations (GMP s) of the FDA, however USANA believes that its processes comply with that agency s more demanding drug-level GMP s. The certification by the TGA also applies to that agency s drug-level GMP s.

USANA contracts with third-party manufacturers and vendors for the production of some of its products. These third-party vendors and manufacturers produce and, in most cases, package these products according to formulations developed by or in conjunction with USANA s product development team.

USANA conducts quality assurance in its two laboratories located in Salt Lake City, Utah. In the microbiology laboratory, quality assurance personnel test for biological contamination of raw materials and finished goods. In the analytical chemistry laboratory, scientists test for chemical contamination and accurate active ingredient levels of raw materials and finished products and conduct stability tests on finished products. Our scientific staff also performs chemical assays on vitamins and mineral constituents under United States Pharmacopoeia and other validated methods.

Most of the raw ingredients used in the manufacture of our products are available from a number of suppliers. USANA has not generally experienced difficulty in obtaining necessary quantities of raw ingredients. When supplies of certain raw materials have tightened, we have been able to find alternative sources of raw materials as needed and believe we will be able to do so in the future if the need arises.

Our manufacturing facility currently produces an average of 35 million tablets a month, using approximately 60% of capacity (assuming two eight-hour shifts per day, five days per week). Our packaging equipment fills an average of 450,000 bottles a month, using approximately 50% of capacity (again assuming two eight-hour shifts per day, five days per week).

Distribution and Marketing

USANA distributes products through a network marketing system and sells directly to Preferred Customers. Network marketing is a form of person-to-person direct selling through a network of vertically organized independent Associates who purchase products at wholesale prices from the manufacturer and then make retail sales to consumers. The emergence of readily available means of mass communication such as personal computers, facsimiles, low-cost long distance telephone services, satellite conferencing and the Internet have contributed to the rapid growth of network marketing. The concept of network marketing is based on the strength of personal recommendations that frequently come from friends, neighbors, relatives and close acquaintances. USANA believes that network marketing is an effective way to distribute its products because it allows person-to-person product education, which is not as readily available through other distribution channels.

Individuals who desire to sell USANA products become Associates by being sponsored into the program by another Associate and are then part of the sponsoring Associate s downline. New Associates must sign a written contract and agree to adhere to USANA s Policies and Procedures. Associates are also required to purchase a starter kit that includes a detailed manual of Policies and Procedures. The purchase price of this kit is $49, which approximates its production and distribution cost.

An Associate may continue to distribute products until they are terminated by USANA or they voluntarily withdraw. Initial training of Associates about USANA, its products, the compensation plan, and network marketing is provided primarily by an Associate s sponsor and others in their upline sales organization . In addition, USANA develops and sells training materials and sales aids to assist in building the business and periodically, sponsors and conducts regional, national and international Associate events and intensive leadership training seminars. Attendance at these sessions is voluntary, and USANA undertakes no generalized effort to provide individualized training to Associates, although experience shows that the most effective and successful Associates participate in training activities. Associates may not sell competitive products to other USANA Associates or solicit USANA Associates to participate in other network marketing opportunities. USANA also restricts Associates advertising and representations or claims concerning USANA products or the compensation plan.

The compensation plan provides several opportunities for Associates to earn compensation, provided they are willing to consistently work at building, training and retaining their downline organizations to sell USANA products to consumers. USANA believes its compensation plan is distinctive for its weekly distributions and equitable payouts, which are designed to create appropriate incentives for the sale of USANA products. Each Associate must purchase and sell products in order to earn commissions and bonuses. Associates cannot simply recruit others for the purpose of developing a downline and earn income passively, depending solely on the efforts of the downline.

Associates can earn compensation in three ways:

Purchasing products at wholesale prices from USANA and selling them to consumers at higher retail prices,

Generating sales volume points based on the sales activity of their downlines, and

Participating in a leadership bonus pool based on certain performance requirements.

USANA seamlessly integrates the Associate compensation plan across all markets in which USANA products are sold, allowing Associates to receive commissions for global and not merely local, product sales. This seamless downline structure is designed to allow an Associate to build a global network by creating downlines across national borders. Associates may expand their downline organizations into new markets without establishing new downlines or requalifying for higher levels of compensation in the newly opened markets. USANA believes this seamless compensation plan significantly enhances its ability to expand internationally and we intend, where permitted, to continue to integrate new markets into this plan.

USANA offers a Preferred Customer program designed for consumers who desire to purchase USANA products for their personal use, but who choose not to resell or distribute the products. We believe this program gives USANA access to a market that would otherwise be missed by targeting customers who enjoy USANA products, but prefer a mail order type relationship to a sales, distribution or other business relationship with USANA. Preferred Customers may not engage in retail sales of products purchased through the program, although they may enroll as Associates at any time if they desire. Only Associates are eligible to participate in the compensation plan.

USANA s product return policy allows retail customers to return the unused portion of any product to the Associate who sold them the product for a full cash refund. USANA reimburses the Associate with product or credit on account upon receipt of proper documentation and the return of the remaining product.

All returned product within the first 30 days following purchase will be refunded at 100% of the sales price to all non-Associate customers. This 30-day return policy is offered to Associates only on their first order. All other returned product that is unused and resalable is refunded up to one year from the date of purchase at 100% of the sales price less a 10% restocking fee. Returned product that was damaged during shipment to the customer is 100% refundable. Return of product that was not damaged at the time of receipt by the Associate will result in cancellation of the Associate s distributorship according to the terms of the Associate Agreement. Returns as a percentage of net sales were 1.7% in 1999, 1.5% in 2000 and 1.4% in 2001.

Substantially all of our sales are made to Preferred Customers and through independent Associates. No single Associate accounted for 5% or more of net sales in any of the last three fiscal years. Associates are independent contractors and are not agents, employees, or legal representatives of USANA. USANA employees and affiliates cannot be Associates, although there is no prohibition on family members becoming Associates as long as they do not reside in the same household as the employee or affiliate. Associates may sell products only in markets where USANA has approved the sale of its products.

From time to time Associates fail to adhere to the USANA Policies and Procedures, including those governing the marketing of our products or making representations regarding the compensation plan. We systematically review reports of alleged Associate misbehavior. If we determine that an Associate has violated any of USANA s Policies and Procedures, we may take a number of disciplinary actions. For example, we may terminate the Associate s purchase and distribution rights completely or impose sanctions such as warnings, fines, or probation. We may also withdraw or deny awards, suspend privileges, withhold commissions until specific conditions are satisfied, or take other appropriate actions at our discretion. An in-house compliance officer and a commission auditor also routinely review Associate activities. Infractions of the Policies and Procedures are reported to a compliance committee that determines what disciplinary action may be warranted in each case.

Information Technology

USANA believes that the ability to efficiently manage distribution, compensation, manufacturing, inventory control and communications functions through the use of sophisticated and dependable information processing systems is critical to its success. During 2001, USANA developed and placed into service a new Java-based system that integrated a Web-enabled order-entry system with its inventory, production planning, fulfillment and financial systems. USANA s information systems are maintained by in-house staff and outside consultants.

Regulatory Matters

Product Regulation. Manufacturing, packaging, labeling, advertising, promoting, distributing, and the selling of USANA products are subject to regulation by numerous governmental agencies in the United States and other countries. In the United States, the FDA regulates USANA s products under the Food, Drug, and Cosmetic Act (FD&C) and regulations promulgated under that act. USANA products are also subject to regulation by, among others, the Consumer Product Safety Commission, the US Department of Agriculture, and the Environmental Protection Agency. Advertising of our products is regulated by the Federal Trade Commission (FTC) under the FTC Act. The manufacturing, labeling, and advertising of products are also regulated by various governmental agencies in each foreign country in which we distribute products.

The majority of USANA s products are regulated as dietary supplements under the FD&C. Dietary supplements are also regulated under the Dietary Supplement Health and Education Act of 1994 (DSHEA). We believe DSHEA is favorable to the dietary supplement industry. Some of our drinks, food bar and other products are regulated as foods under the Nutrition Labeling and Education Act of 1990 (NLEA). The NLEA establishes requirements for ingredient and nutritional labeling and labeling claims for foods. Although we believe our product claims comply with the law, we may need to revise some product labeling at a future date.

Under these regulations, a dietary supplement that contains a new dietary ingredient (defined as an ingredient not on the market before October 15, 1994) must have a history of use or other evidence of safety establishing that it is reasonably expected to be safe. The manufacturer must notify the FDA at least 75 days before marketing products containing new dietary ingredients and provide the FDA with the information upon which the manufacturer based its conclusion that the product has a reasonable expectation of safety.

The FDA issued final dietary supplement labeling regulations in 1997 that required a new format for product labels and necessitated revising dietary supplement product labels by March 23, 1999. All companies in the dietary supplement industry were required to comply with these new regulations. USANA updated product labels in 1997 in response to these new regulations. The FDA also announced that it is considering the adoption of new GMP s specific to dietary supplements. These GMP s, if promulgated, may be significantly more rigorous than currently applicable GMP s. USANA believes that it currently manufactures its dietary supplement products according to the standards of the FDA s drug-level GMP s. However, we may be required to expend additional capital and resources on manufacturing controls in the future in order to comply with the law if new GMP s are adopted.

Other products marketed by USANA include cosmetics and products deemed to be over-the-counter (OTC) drugs. In general, our cosmetic products currently are not subject to pre-market approval by the FDA. However, cosmetics are subject to regulation by the FDA under the FD&C adulteration and misbranding provisions. Cosmetics also are subject to specific labeling regulations, including warning statements if the safety of a cosmetic is not adequately substantiated or if the product may be hazardous, as well as ingredient statements and other packaging requirements under the Fair Packaging and Labeling Act. Cosmetics that meet the definition of a drug (i.e., that are intended to treat or prevent disease or affect the structure or function of the body), such as our sunscreens and anti-cavity dental treatment gel, are regulated as drugs. OTC drug products may be marketed if they conform to the requirements of the OTC monograph that is applicable to that drug. Drug products not conforming to monograph requirements require an approved New Drug Application (NDA) before marketing. Under these provisions, if the agency were to find that a product or ingredient of one of our OTC drug products is not generally recognized as safe and effective or does not include it in a final monograph applicable to one of our OTC drug products, we will have to reformulate or cease marketing that product until it is the subject of an approved NDA or until the time, if ever, that the monograph is amended to include the product. If the rule becomes final, we would have to stop marketing the product as currently formulated. Whether or not an OTC drug product conforms to a monograph or is subject to an approved NDA, the drug must comply with other requirements under the FD&C including GMP s, labeling, and the FD&C s misbranding and adulteration provisions.

Advertising of products is subject to regulation by the FTC under the FTC Act. Section 5 of the FTC Act prohibits unfair methods of competition and unfair or deceptive acts or practices in or affecting commerce. Section 12 of the FTC Act provides that the dissemination of or causing to be disseminated any false advertisement pertaining to drugs or foods, which would include dietary supplements, is an unfair or deceptive act or practice. Under the FTC s Substantiation Doctrine, an advertiser is required to have a reasonable basis for all objective product claims before the claims are made. Failure to adequately substantiate claims may be considered either deceptive or unfair practices. Pursuant to this FTC requirement, USANA is required to have adequate substantiation for all material advertising claims made for our products.

In recent years the FTC has initiated numerous investigations of and actions against dietary supplement, weight management, and cosmetic products and companies. The FTC has issued a guidance document to assist companies in understanding and complying with the substantiation requirement. We have organized the documentation to support our advertising and promotional practices in compliance with the guidelines.

The FTC may enforce compliance with the law in a variety of ways, both administratively and judicially, using compulsory process, cease and desist orders, and injunctions. FTC enforcement can result in orders requiring, among other things, limits on advertising, corrective advertising, consumer redress, divestiture of assets, rescission of contracts, and such other relief as the agency deems necessary to protect the public. Violation of these orders could result in substantial financial or other penalties. USANA has not been the subject of any action by the FTC, but any action in the future by the FTC could materially adversely affect USANA s ability to successfully market its products.

In markets outside the United States, prior to commencing operations or marketing products, USANA may be required to obtain approvals, licenses, or certifications from a country s ministry of health or comparable agency. Approvals or licensing may be conditioned on reformulation of USANA products for the market or may be unavailable with respect to certain products or product ingredients. USANA must also comply with local product labeling and packaging regulations that vary from country to country.

USANA cannot predict the nature of any future laws, regulations, interpretations, or applications, nor can we determine what effect additional governmental regulations or administrative orders, when and if promulgated, would have on our business in the future. They could include, however, requirements for the reformulation of certain products to meet new standards, the recall or discontinuation of certain products that cannot be reformulated, additional record keeping, expanded documentation of the properties of certain products, expanded or different labeling, and additional scientific substantiation. Any or all of these requirements could have a material adverse effect on our business, financial condition and results of operations.

Network Marketing Regulation. Other laws and regulations affecting USANA prevent the use of deceptive or fraudulent practices that have sometimes been inappropriately associated with legitimate direct selling and network marketing activities. These include anti-pyramiding, securities, lottery, referral selling, anti-fraud and business opportunity statutes, regulations and court cases. Illegal schemes, typically referred to as pyramid, chain distribution, or endless chain schemes, compensate participants primarily or solely for the introduction or enrollment of additional participants into the scheme. Often, these schemes are characterized by large up-front entry or sign-up fees, over-priced products of low value, little or no emphasis on the sale or use of products, high-pressure recruiting tactics and claims of huge and quick financial rewards requiring little or no effort. Generally these laws are directed at ensuring that product sales ultimately are made to consumers and that advancement within sales organizations is based on sales of the enterprise s products, rather than investments in the organizations or other non-retail sales related criteria or activity. Where required by law, USANA obtains regulatory approval of its network marketing system, or, where approval is not required or available, the favorable opinion of local counsel as to regulatory compliance.

USANA occasionally receives requests to supply information regarding its network marketing plan to regulatory agencies. Although we have from time to time modified our network marketing system to comply with interpretations of various regulatory authorities, we believe that the network marketing program is in compliance with laws and regulations relating to network marketing activities in our current markets. Nevertheless, we remain subject to the risk that, in one or more of our present or future markets, the marketing system or the conduct of certain Associates could be found not to be in compliance with applicable laws and regulations. Failure by USANA or an Associate to comply with these laws and regulations could have an adverse material effect on USANA in a particular market or in general. Any or all of these factors could adversely affect the way USANA does business and could affect our ability to attract potential Associates or enter new markets. In the United States, the FTC has been active in its enforcement efforts against both pyramid schemes and legitimate network marketing organizations with certain legally problematic components, having instituted several enforcement actions resulting in signed settlement agreements and payment of large fines. Although USANA has not been the target of an FTC investigation, there can be no assurance that the FTC will not investigate USANA in the future.

USANA cannot predict the nature of any future law, regulation, interpretation or application, nor can it predict what effect additional governmental legislation or regulations, judicial decisions, or administrative orders, when and if promulgated, would have on its business in the future. It is possible that future developments may require revisions to our network marketing program. Any or all of these requirements could have a material adverse effect on our business, results of operations and financial condition.

Competition

The business of developing and distributing nutritional, personal care and weight management products such as those offered by USANA is highly competitive. Numerous manufacturers, distributors and retailers compete for consumers and, in the case of other network marketing companies, for Associates. USANA competes directly with other entities that develop, manufacture, market and distribute products in each of our product lines. USANA competes with these entities by emphasizing the underlying science, value and high quality of products as well as the convenience and financial benefits afforded by the network marketing system. However, many of our competitors are substantially larger than USANA and have greater financial resources and broader name recognition. USANA s markets are highly sensitive to the introduction of new products that may rapidly capture a significant share of those markets.

The nutritional supplement market is characterized by:

Large selections of essentially similar products that are difficult to differentiate,

Retail consumer emphasis on value pricing,

Constantly changing formulations based on evolving scientific research,

Low entry barriers resulting from low brand loyalty, rapid change, widely available manufacturing, low regulatory requirements and ready access to large distribution channels, and

A lack of uniform standards regarding product ingredient sources, potency, purity, absorption rate and form.

Similar factors are also characteristic of products comprising USANA s other product lines. There can be no assurance that USANA will be able to effectively compete in this intensely competitive environment. In addition, nutritional, personal care and weight management products can be purchased in a wide variety of channels of distribution, including retail stores. USANA s product offerings in each product category are relatively few compared to the wide variety of products offered by many of its competitors and are often premium priced. As a result, our ability to remain competitive depends in part upon the successful introduction of new products and enhancements of existing products.

USANA also competes with other network marketing organizations for the time, attention and commitment of new and current Associates. Our ability to remain competitive depends, in significant part, on our success in recruiting and retaining Associates. USANA believes that it offers a rewarding Associate compensation plan and attractive Associate benefits and services. To the extent practicable, our Associate compensation plan is designed to be seamless, permitting international expansion without re-qualification or re-entry requirements. We pay Associate incentives weekly, reducing the time an Associate must wait between purchase and sale of products and payment of commissions. There can be no assurance that our programs for recruiting and retaining Associates will be successful. We also compete for the time, attention and commitment of this independent Associate force. The pool of individuals interested in the business opportunities presented by network marketing tends to be limited in each market and is reduced to the extent other network marketing companies successfully recruit these individuals into their businesses. Our Associate base has declined in each of the last three years. Although we believe that USANA offers an attractive opportunity for Associates, there can be no assurance that other network marketing companies will not be able to recruit our existing Associates or deplete the pool of potential Associates in a given market.

USANA believes that the leading network marketing company in the world, based on total sales, is Amway Corporation and its affiliates, and that Avon Products, Inc. is the leading direct seller of beauty and related products worldwide. Leading competitors in the nutritional network marketing and nutritional product markets include Herbalife International, Inc., Nature s Sunshine Products, Inc., Twinlab Corporation, Weider Nutrition, NBTY and Nu Skin International, Inc. USANA believes there are other manufacturers of competing product lines that may or will launch direct selling enterprises, which will compete with USANA in certain product lines and for Associates. There can be no assurance that we will be able to successfully meet the challenges posed by this increased competition.

Intellectual Property

Product names used in this report are, in certain cases, trademarks and are also the property of USANA.

Trademarks. USANA uses registered trademarks in its business, particularly relating to the corporate and product names. We own 12 trademarks registered with the United States Patent and Trademark Office. We also have five pending applications to register trademarks in the United States. Federal registration of a trademark enables the registered owner of the mark to bar the unauthorized use of the registered mark in connection with a similar product in the same channels of trade by any third party anywhere in the United States, regardless of whether the registered owner has ever used the trademark in the area where the unauthorized use occurs. We also have filed applications and own trademark registrations, and we intend to register additional trademarks, in foreign countries where USANA products are or may be sold in the future. Protection afforded registered trademarks in some jurisdictions may not be as extensive as the protection available in the United States.

USANA also claims certain product names, unregistered trademarks and service marks under common law. Common law trademark rights do not provide the same level of protection afforded by registration of a trademark. In addition, common law trademark rights are limited to the geographic area in which the trademark is actually used. USANA believes these trademarks, whether registered or claimed under common law, constitute valuable assets, adding to recognition of USANA and the marketing of USANA products. We therefore believe that these proprietary rights have been and will continue to be important in enabling USANA to compete.

Trade Secrets. USANA owns certain trade secrets that it seeks to protect, in part, through confidentiality agreements with employees and other parties. Certain of our employees involved in research and development activities have not entered into these agreements. Even where these agreements exist, there can be no assurance that these agreements will not be breached, that we would have adequate remedies for any breach or that our trade secrets will not otherwise become known to or independently developed by competitors.

Patents. USANA has applied for and been given official notice for the allowance of two patents in 2001. We expect that these patents will issue during early 2002, after which the patents will continue in force for 17 years from the date of issue. These patents are process patents and relate to the method of extracting an antioxidant from olives and the waste products of olive oil production. We are currently discussing licensing agreements with several vendors to make olive extract using our patented process. At this stage, it is very difficult to determine the exact future benefit of these patents to USANA. However, we believe that the patents have the potential for significant revenue in the future through new product development and royalties from licensing.

USANA intends to protect its legal rights concerning intellectual property by all appropriate legal action. USANA may become involved from time to time in litigation to determine the enforceability, scope and validity of any of the foregoing proprietary rights. Any patent litigation could result in substantial cost and divert the efforts of USANA s management and technical personnel.

Seasonality

USANA believes that the impact of seasonality on its results of operations is not material, although historically growth has been slower in the fourth quarter of each year. This could change as new markets are opened and become a more significant part of our business.

Backlog

USANA typically ships products within 72 hours after the receipt of the order. As of December 29, 2001, there was no significant backlog.

Working Capital Practices

USANA maintains significant amounts of inventory in stock in order to provide a high level of service to its Associates and Preferred Customers. Substantial inventories are required to meet the needs of USANA s dual role as a manufacturer and a distributor.

Environment

USANA is not aware of any instance in which it has contravened federal, state or local provisions enacted for or relating to protection of the environment or in which it otherwise may be subject under environmental laws to liability for environmental conditions that could materially affect operations.

Employees

As of March 20, 2002, we had 459 employees (as measured by full time equivalency), as follows: 362 in the United States, 46 in Australia-New Zealand, 18 in Canada, 18 in Hong Kong and 15 in Japan. Of these employees, 195 are involved in customer service and order entry, 90 in manufacturing and shipping, 149 in selling and administration and 25 in research and development and quality control. Our employees are not represented by a collective bargaining agreement and we have not experienced work stoppages as a result of labor disputes. USANA believes its relationship with its employees is good.

Item 2. Properties

USANA s corporate headquarters are located in Salt Lake City, Utah in a building of 184,000 square feet on a company-owned 16-acre parcel. The allocation of this space includes approximately 44,000 square feet for manufacturing, packaging and distribution; 73,000 square feet of warehouse space; and 67,000 square feet occupied by executive and administrative personnel, customer services, research and development, and three laboratories. During 2001, we completed construction on a new warehouse that added 80,000 square feet.

We believe that our facilities are suitable and adequate in relation to our needs for the foreseeable future. Total monthly lease commitments for the properties under lease average approximately $150,000. The following table summarizes our facilities as of December 29, 2001.

Location	Nature of Use	Square Feet	Held
Salt Lake City, UT USA	Corporate headquarters/manufacturing/warehouse	184,000	Owned
Tooele, UT USA	Call center	12,000	Leased
Ontario, Canada	Warehouse/distribution center/office	18,000	Leased
Sydney, Australia	Central office/call center/warehouse/distribution center	20,000	Leased
Auckland, New Zealand	Warehouse/distribution center/office	4,000	Leased
Causeway Bay, Hong Kong	Central office/call center	6,900	Leased
Tokyo, Japan	Central office/call center	12,000	Leased
Yokohama, Japan	Warehouse/distribution center	11,200	Leased
Idaho Falls, ID USA	Office	1,000	Leased
Kwai Chung, Hong Kong	Warehouse/distribution center	4,000	Leased

Item 3. Legal Proceedings

There are various lawsuits and claims against USANA that arise in the normal course of business. Management believes based upon the opinion of company counsel, that as of December 29, 2001, there are no actions that will result in a material adverse effect on USANA s consolidated financial position.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of shareholders during the quarter ended December 29, 2001.

PART II

Item 5. Market for Registrant s Common Equity and Related Stockholder Matters

Market Information

USANA s common stock trades on the Nasdaq Stock Market under the symbol USNA. The following table contains the reported high and low sale prices for our common stock as reported on the Nasdaq Stock Market for the periods indicated:

2000		**High**		**Low**
First Quarter	$	8.00	$	4.38
Second Quarter	$	5.50	$	2.38
Third Quarter	$	4.31	$	2.56
Fourth Quarter	$	3.03	$	0.88

2001		**High**		**Low**
First Quarter	$	3.06	$	1.25
Second Quarter	$	2.38	$	1.61
Third Quarter	$	2.10	$	1.40
Fourth Quarter	$	1.80	$	1.15

On March 20, 2002, the high and low sales prices of our common stock were $1.50 and $1.31, respectively.

Shareholders

As of March 20, 2002, we had approximately 645 holders of record of the common stock and an estimated 5,000 beneficial owners, including shares of common stock held in street name.

Dividends

USANA has never declared or paid cash dividends on its common stock. USANA currently intends to retain future earnings, if any, to fund the development and growth of its business and does not anticipate paying any cash dividends in the foreseeable future. Future cash dividends, if any, will be determined by the Board of Directors and will be based on earnings, capital, financial condition and other factors deemed relevant by the Board of Directors. USANA s credit facility contains restrictions on the ability to declare cash dividends on its capital stock or redeem or retire that stock without the lender s written consent.

Item 6. Selected Financial Data

The following page of selected consolidated financial data with respect to the consolidated statements of earnings and consolidated balance sheets for each of the last five fiscal years are derived from USANA s audited consolidated financial statements for the relevant periods. The data should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations, and the audited consolidated financial statements and related notes thereto included in this report.

	Fiscal Year (1)				
	1997	1998	1999	2000	2001
	(in thousands, except per share data)				
Consolidated Statements of Earnings Data:					
Net sales (2)	$ 88,543	$ 126,291	$ 134,312	$ 123,180	$ 114,280
Cost of sales (2)	21,174	30,133	30,099	36,344	32,802
Gross profit	67,369	96,158	104,213	86,836	81,478
Operating expenses:					
Associate incentives	39,536	54,408	57,044	47,032	43,912
Selling, general and administrative (2)	16,056	25,163	31,778	32,939	32,286
Restructuring and impairment (3)			4,400		
Research and development	1,245	1,362	1,377	1,410	1,080
Total operating expenses	56,837	80,933	94,599	81,381	77,278
Earnings from operations	10,532	15,225	9,614	5,455	4,200
Other income (expense), net	166	178	(48)	(677)	(692)
Earnings before income taxes	10,698	15,403	9,566	4,778	3,508
Income taxes	4,116	5,906	3,665	1,911	1,309
Net earnings	$ 6,582	$ 9,497	$ 5,901	$ 2,867	$ 2,199
Earnings per share:					
Basic	$ 0.52	$ 0.73	$ 0.49	$ 0.29	$ 0.23
Diluted	$ 0.49	$ 0.68	$ 0.47	$ 0.29	$ 0.23
Weighted average shares outstanding:					
Basic	12,741	12,937	12,158	9,787	9,678
Diluted	13,319	13,929	12,473	9,890	9,706
Dividends per share					

	As of				
	Dec. 27, 1997	Jan. 2, 1999	Jan. 1, 2000	Dec. 30, 2000	Dec. 29, 2001
	(in thousands, except other data)				
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$ 2,608	$ 2,617	$ 1,411	$ 2,900	$ 2,465
Working capital	4,569	7,899	(1,281)	2,308	350
Current assets	11,273	16,615	15,048	16,927	14,189
Total assets	26,369	39,426	36,773	35,492	35,354
Long-term debt, less current maturities			7,500	8,000	6,000
Stockholders equity	19,258	30,086	12,919	12,873	14,527
Other Data:					
Current Associates	84,000	116,000	113,000	93,000	86,000
Preferred Customers	9,000	26,000	46,000	76,000	77,000

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(1) The 1997, 1999, 2000 and 2001 fiscal years were 52-week years. Fiscal year 1998 was a 53-week year. Fiscal year 1997 covered the period December 29, 1996 to December 27, 1997. Fiscal year 1998 covered the period December 28, 1997 to January 2, 1999. Fiscal year 1999 covered the period January 3, 1999 to January 1, 2000.

Fiscal year 2000 covered the period January 2, 2000 to December 30, 2001. Fiscal year 2001 covered the period December 31, 2000 to December 29, 2001.

(2) The financial results for the years ended above are adjusted to reflect the Financial Accounting Standards Board guidelines on revenue recognition pursuant to Emerging Issues Task Force No 00-10 (EITF 00-10). For additional information on EITF 00-10, see page 16 in the Overview section and Note A of the audited consolidated financial statements included in this report.

(3) For information on the restructuring and impairment charge during 1999, see the Results of Operations section of Item 7 on page 21 as well as Note G of the audited consolidated financial statements included elsewhere in this report.

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of financial condition and results of operations should be read in conjunction with the audited consolidated financial statements and notes thereto appearing elsewhere in this report.

Overview

USANA develops and manufactures high-quality nutritional, personal care and weight management products. USANA distributes its products through a network marketing system. As of December 29, 2001, USANA had approximately 86,000 Associates in the United States, Canada, Australia, New Zealand, Hong Kong, Japan and the United Kingdom.

The financial results for any quarter and year included in this report, as reported, have been adjusted to reflect the Financial Accounting Standards Board guidelines on revenue recognition pursuant to Emerging Issues Task Force No 00-10 (EITF 00-10). Under EITF 00-10 guidelines, historical and future revenue relating to amounts billed to a customer for shipping and handling should be classified as revenue. The corresponding expenses are reported as cost of sales. Prior to 2000, we reported freight income and expense as a net amount within selling, general and administrative expense.

Net sales are primarily dependent upon the efforts of a network of independent Associates who purchase products and sales materials. USANA also sells products directly to Preferred Customers who desire to purchase products for personal use and are not permitted to resell or distribute the products. As of December 29, 2001, USANA had approximately 77,000 Preferred Customers.

USANA recognizes revenue when products are shipped and title passes to the customer. In 2001, sales in the five primary markets, the United States (which includes direct sales into Japan and the United Kingdom), Canada, Australia-New Zealand, Hong Kong and Japan, were 57.9%, 24.5%, 12.5%, 4.6% and 0.5%, respectively, of net sales. As USANA expands into additional international markets, it expects international operations to account for an increasing percentage of net sales.

Cost of sales primarily consists of expenses related to raw materials, labor, quality assurance and overhead directly associated with the procurement and production of products and sales materials as well as duties and taxes associated with product exports. In 2001, products manufactured by USANA accounted for approximately 63% of net sales. As international sales increase as a percentage of net sales, USANA expects that the overall cost of sales could increase slightly, reflecting additional duties, freight and other expenses associated with international expansion.

Associate incentives are USANA s most significant expense and were 38.4% of net sales in 2001. Associate incentives include commissions and leadership bonuses, and are paid weekly based on sales volume points. Most products are assigned a sales volume point value independent of the product s price. Associates earn commissions based on sales volume points generated in their downline. Generally, Associate kits, sales aids and logo merchandise, such as items of clothing and luggage, have no sales volume point value and commissions are not paid on the sale of these items.

USANA closely monitors the amount of Associate incentives paid as a percentage of net sales and may from time to time adjust its Associate compensation plan to prevent Associate incentives from having a significant adverse effect on earnings. This must be done while continuing to maintain an appropriate incentive for Associates.

Selling, general and administrative expenses include wages and benefits, depreciation and amortization, rents and utilities, Associate events, promotion and advertising, and professional fees along with other marketing and administrative expenses. Wages and benefits represent the largest component of selling, general and administrative expenses. Myron Wentz Ph.D. is the President, Chief Executive Officer and Chairman of the Board of Directors of USANA. Dr. Wentz does not receive a salary and USANA does not anticipate that he will take a salary for the foreseeable future. However, if Dr. Wentz were to take a salary, or if a new President or Chief Executive Officer were retained and paid a customary salary and benefits, selling, general and administrative expenses would increase as a result of the compensation paid. As a result of substantial investments in a new order-entry system, computer and telecommunications equipment and systems to support international expansion, USANA has significant depreciation and amortization expense. USANA anticipates that additional capital investments will be required in future periods to promote and support growth in sales and the increasing size of the customer base, which includes both Associates and Preferred Customers.

Research and development expenses include costs incurred in developing new products, supporting and enhancing existing products and reformulating products for introduction in international markets.

USANA operates on a 52-53 week year, ending on the Saturday closest to December 31. Fiscal year 1999 covered the period January 3, 1999 to January 1, 2000. Fiscal year 2000 covered the period January 2, 2000 to December 30, 2001. Fiscal year 2001 covered the period December 31, 2000 to December 29, 2001. Fiscal year 2002 will cover the period December 30, 2001 to December 28, 2002.

Results of Operations

The following table summarizes operating results as a percentage of net sales, respectively, for the periods indicated:

	Fiscal Year		
	1999	**2000**	**2001**
Consolidated Statements of Earnings Data:			
Net sales	100.0%	100.0%	100.0%
Cost of sales	22.4	29.5	28.7
Gross profit	77.6	70.5	71.3
Operating expenses:			
Associate incentives	42.5	38.2	38.4
Selling, general and administrative	23.7	26.8	28.3
Restructuring and impairment	3.3		
Research and development	1.0	1.1	0.9
Total operating expenses	70.5	66.1	67.6
Earnings from operations	7.1	4.4	3.7
Other income (expense), net		(0.5)	(0.6)
Earnings before income taxes	7.1	3.9	3.1
Income taxes	2.7	1.6	1.2
Net earnings	4.4%	2.3%	1.9%

Years Ended December 29, 2001 and December 30, 2000

Net Sales. Net sales decreased 7.2% to $114.3 million in 2001, a decrease of $8.9 million from $123.2 million in 2000. The decrease in net sales is a result of an overall 7.5% decline in the Associate base and weaker foreign currencies relative to the U.S. dollar, which negatively affected the translation of sales in foreign markets.

During the fourth quarter of 2001, we began serving customers directly from our operations in Japan. Sales in our Japan market have yet to reach expected levels. Despite the disappointment with the current level of sales in Japan, we are still optimistic that sales levels will continue to improve and remain committed to this market. Sales to Japan under our direct export program, which are included in the United States results, totaled $2.6 million in 2001 compared to $711,000 in 2000.

The following tables illustrate the growth (decline) in net sales and customers by market for the years ended December 30, 2000 and December 29, 2001. Sales data for the United States includes products shipped directly from the U.S. headquarters to customers in the United Kingdom and Japan:

Sales By Market
(in thousands)
Year Ended

Market		2000			2001		Change from Prior Year	Percent Change
United States	$	68,526	55.6%	$	66,140	57.9%	$ (2,386)	(3.5)%
Canada		29,204	23.7%		28,013	24.5%	(1,191)	(4.1)%
Australia-New Zealand		18,979	15.4%		14,299	12.5%	(4,680)	(24.7)%
Hong Kong		6,471	5.3%		5,208	4.6%	(1,263)	(19.5)%
Japan			0.0%		620	0.5%	620	N/A
Consolidated	$	123,180	100.0%	$	114,280	100.0%	$ (8,900)	(7.2)%

Current Associates By Market

Market	As of December 30, 2000		As of December 29, 2001		Change from Prior Year	Percent Change
United States	45,000	48.4%	39,000	45.3%	(6,000)	(13.3)%
Canada	21,000	22.6%	22,000	25.6%	1,000	4.8%
Australia-New Zealand	19,000	20.4%	15,000	17.4%	(4,000)	(21.1)%
Hong Kong	8,000	8.6%	7,000	8.1%	(1,000)	(12.5)%
Japan		0.0%	3,000	3.5%	3,000	N/A
Consolidated	93,000	100.0%	86,000	100.0%	(7,000)	(7.5)%

Preferred Customers By Market

Market	As of December 30, 2000		As of December 29, 2001		Change from Prior Year	Percent Change
United States	44,000	57.9%	46,000	59.7%	2,000	4.5%
Canada	19,000	25.0%	20,000	26.0%	1,000	5.3%
Australia-New Zealand	11,000	14.5%	10,000	13.0%	(1,000)	(9.1)%
Hong Kong	2,000	2.6%	1,000	1.3%	(1,000)	(50.0)%
Japan		0.0%		0.0%		0.0%
Consolidated	76,000	100.0%	77,000	100.0%	1,000	1.3%

Total Customers By Market

Market	As of December 30, 2000		As of December 29, 2001		Change from Prior Year	Percent Change
United States	89,000	52.7%	85,000	52.1%	(4,000)	(4.5)%
Canada	40,000	23.7%	42,000	25.8%	2,000	5.0%
Australia-New Zealand	30,000	17.7%	25,000	15.4%	(5,000)	(16.7)%
Hong Kong	10,000	5.9%	8,000	4.9%	(2,000)	(20.0)%
Japan		0.0%	3,000	1.8%	3,000	N/A
Consolidated	169,000	100.0%	163,000	100.0%	(6,000)	(3.6)%

Gross Profit. Gross profit increased to 71.3% of net sales in 2001 from 70.5% in 2000. The increase in gross profit as a percentage of net sales can be attributed to:

A change in our pricing on new products introduced during 2001, Improved procurement efficiencies and inventory management, and

A decrease in product devel0opment costs in 2001, resulting from new products introduced during 2000.

The change in pricing was intended to make it easier for Associates to build their business. New products have better gross margins and pay Associates at a higher rate. The increase in gross profit was partially offset by the compression of gross margins as a result of weaker foreign currencies relative to the U. S. dollar. USANA believes that gross profit for 2002 will continue to improve in relation to net sales as a result of the change in pricing.

Associate Incentives. Associate incentives increased to 38.4% of net sales in 2001 from 38.2% in 2000. The increase in Associate incentives relative to net sales can primarily be attributed to the change in pricing on new products introduced in 2001.

Selling, General and Administrative. Selling, general and administrative expenses increased to 28.3% of net sales in 2001 from 26.8% in 2000. This increase as a percentage of net sales is a direct result of declining sales and the expenses incurred in connection with the new operations in Japan. USANA made a company-wide effort to better manage costs and was able to reduce selling, general and administrative expenses in absolute terms during 2001 by $4.1 million, excluding the costs associated with the Japan market.

USANA will continue to search for ways to reduce selling, general and administrative expenses for 2002. However, these expenses are expected to continue at a high level due to the first full year of operations in Japan and as a result of potential costs to pursue new international opportunities.

Other Income (Expense). Interest expense decreased $397,000 in 2001 when compared to 2000. This decrease is a result of lower interest rates and reduced debt levels throughout 2001. Additional changes in other income (expense) include:

A difference of $665,000 from a foreign currency exchange gain of $417,000 in 2000 to a loss of $248,000 in 2001, and

A $151,000 one-time benefit resulting from dissolving the operating entity in the United Kingdom.

Net Earnings. Net earnings decreased to 1.9% of net sales in 2001 from 2.3% in 2000. The decrease in net earnings can primarily be attributed to:

Lower sales in 2001, and

Costs associated with establishing operations in Japan.

Diluted earnings per share were $0.23 for 2001, a decrease of $0.06 from diluted earnings of $0.29 per share in 2000.

Years Ended December 30, 2000 and January 1, 2000

Net Sales. Net sales decreased 8.3% to $123.2 million in 2000, a decrease of $11.1 million from $134.3 million in 1999. The decrease in net sales was primarily the result of:

The impact of the value initiative, introduced in February 2000, which reduced prices by an average of 24%, An overall 18% decline in the Associate base,

Weaker foreign currencies relative to the U.S. dollar, which negatively affected the translation of sales in foreign markets, and

The negative impact of the introduction of a Goods and Service Tax in Australia.

The decrease in the Associate base was partially offset by strong enrollments of Preferred Customers. The Preferred Customer base increased 65% from the 1999 levels. During 2000, USANA also had direct export sales of approximately $711,000 to customers in Japan, compared to no sales in Japan in 1999.

The following tables illustrate the growth (decline) in net sales and customers by market for the years ended January 1, 2000 and December 30, 2000:

Sales By Market
(in thousands)
Year Ended

Market		**1999**			**2000**			**Change from Prior Year**	**Percent Change**
United States	$	73,231	54.5%	$	68,526	55.6%	$	(4,705)	(6.4)%
Canada		30,910	23.0%		29,204	23.7%		(1,706)	(5.5)%
Australia-New Zealand		27,230	20.3%		18,979	15.4%		(8,251)	(30.3)%
Hong Kong		2,941	2.2%		6,471	5.3%		3,530	120.0%
Consolidated	$	134,312	100.0%	$	123,180	100.0%	$	(11,132)	(8.3)%

Current Associates By Market

Market	As of January 1, 2000		As of December 30, 2000		Change from Prior Year	Percent Change
United States	54,000	47.8%	45,000	48.4%	(9,000)	(16.7)%
Canada	26,000	23.0%	21,000	22.6%	(5,000)	(19.2)%
Australia-New Zealand	27,000	23.9%	19,000	20.4%	(8,000)	(29.6)%
Hong Kong	6,000	5.3%	8,000	8.6%	2,000	33.3%
Consolidated	113,000	100.0%	93,000	100.0%	(20,000)	(17.7)%

Preferred Customers By Market

Market	As of January 1, 2000		As of December 30, 2000		Change from Prior Year	Percent Change
United States	26,000	56.5%	44,000	57.9%	18,000	69.2%
Canada	11,000	23.9%	19,000	25.0%	8,000	72.7%
Australia-New Zealand	8,000	17.4%	11,000	14.5%	3,000	37.5%
Hong Kong	1,000	2.2%	2,000	2.6%	1,000	100.0%
Consolidated	46,000	100.0%	76,000	100.0%	30,000	65.2%

Total Customers By Market

Market	As of January 1, 2000		As of December 30, 2000		Change from Prior Year	Percent Change
United States	80,000	50.3%	89,000	52.7%	9,000	11.3%
Canada	37,000	23.3%	40,000	23.7%	3,000	8.1%
Australia-New Zealand	35,000	22.0%	30,000	17.7%	(5,000)	(14.3)%
Hong Kong	7,000	4.4%	10,000	5.9%	3,000	42.9%
Consolidated	159,000	100.0%	169,000	100.0%	10,000	6.3%

Gross Profit. Gross profit decreased to 70.5% of net sales in 2000 from 77.6% in 1999. The decrease in gross profit as a percentage of net sales can be attributed to:

The impact of the value initiative, which reduced prices by an average of 24%,

Inefficiencies in shipping approximately 25% more product as a result of the value initiative, The compressions of gross margins as a result of the weakening of foreign currencies relative to the U.S. dollar,

The operating of production at less than capacity near the end of 2000 to reduce inventory levels, which resulted in overhead and direct labor costs flowing directly through cost of sales instead of being capitalized as a component of inventory, and

Product development costs resulting from new products introduced during 2000.

Associate Incentives. Associate incentives decreased to 38.2% of net sales in 2000 from 42.5% in 1999. The decrease in Associate incentives as a percentage of net sales can be primarily attributed to the impact of the value initiative, which decreased the ratio of sales volume points to the wholesale price on customer product purchases. Associate incentives are paid on the amount of sales volume points generated.

Selling, General and Administrative. Selling, general and administrative expenses increased to 26.8% of net sales from 23.7% in 1999. The increase in selling, general and administrative expenses can be attributed to:

Sales and marketing activities to promote and support the value initiative, Inefficiencies in customer service expenses dealing with customer issues from a larger and changing customer base as a result of the value initiative,

Spending in Japan, and in potential future markets, and

Increased spending on activities related to the 2000 Annual International Convention.

Restructuring. USANA recorded a restructuring charge and reserve totaling $2.7 million ($1.7 million after tax) in the third quarter of 1999. The restructuring charge included the impact of a substantial reduction in the United Kingdom operations, liquidation of associated assets in the United Kingdom and a reduction of staff outside of the United Kingdom. USANA did not have a similar charge in 2000.

Impairment. In accordance with Financial Accounting Standards No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of , USANA wrote off the remaining book value of a custom network marketing system totaling $1.7 million ($1.0 million after tax) in the third quarter of 1999. This charge was the result of the decision to replace the system with a new custom network marketing system. This was a one-time charge in 1999 and did not affect 2000 results.

Interest Expense. Interest expense increased substantially to 1.0% of net sales from 0.2% in 1999 as a result of the debt incurred during 1999 and early 2000. The debt was incurred to effect the repurchase of 2.95 million shares of common stock from Gull Holdings, Ltd., USANA s largest shareholder, and open-market purchases of approximately 531,000 shares of common stock under a share repurchase program.

Net Earnings. Net earnings decreased to 2.3% of net sales in 2000 from 4.4% in 1999. The decrease in net earnings can primarily be attributed to:

Lower than expected sales,

Substantially higher selling, general and administrative expenses, and

Higher interest expense on debt incurred to fund the repurchase of common stock in 1999 and early 2000.

Diluted earnings per share were $0.29 for 2000, a decrease of $0.18 from diluted earnings of $0.47 per share in 1999.

Quarterly Financial Information

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

	Quarter Ended							
	April 1, 2000	July 1, 2000	Sept. 30, 2000	Dec. 30, 2000	March 31, 2001	June 30, 2001	Sept. 29, 2001	Dec. 29, 2001
	(in thousands, except per share data)							
Consolidated Statements of Earnings Data:								
Net sales	$ 31,672	$ 31,437	$ 30,362	$ 29,709	$ 27,614	$ 28,606	$ 29,341	$ 28,719
Cost of sales	7,667	9,659	9,251	9,767	7,982	8,354	8,232	8,234
Gross profit	24,005	21,778	21,111	19,942	19,632	20,252	21,109	20,485
Operating expenses:								
Associate incentives	12,763	11,947	11,275	11,047	10,503	10,958	11,187	11,264
Selling, general and administrative	8,317	8,521	8,247	7,854	7,574	8,150	8,538	8,024
Research and development	429	364	311	306	285	266	276	253
Total operating expenses	21,509	20,832	19,833	19,207	18,362	19,374	20,001	19,541
Earnings from operations	2,496	946	1,278	735	1,270	878	1,108	944
Other income (expense), net	(225)	(253)	(465)	266	(516)	(88)	(170)	82
Earnings before income taxes	2,271	693	813	1,001	754	790	938	1,026
Income taxes	909	277	325	400	283	296	352	378
Net earnings	$ 1,362	$ 416	$ 488	$ 601	$ 471	$ 494	$ 586	$ 648
Earnings per share:								
Basic	$ 0.14	$ 0.04	$ 0.05	$ 0.06	$ 0.05	$ 0.05	$ 0.06	$ 0.07
Diluted	$ 0.13	$ 0.04	$ 0.05	$ 0.06	$ 0.05	$ 0.05	$ 0.06	$ 0.07
Weighted average shares outstanding:								
Basic	10,048	9,733	9,683	9,683	9,683	9,683	9,682	9,664
Diluted	10,212	9,847	9,771	9,731	9,733	9,719	9,708	9,664

	Quarter Ended							
	April 1, 2000	July 1, 2000	Sept. 30, 2000	Dec. 30, 2000	March 31, 2001	June 30, 2001	Sept. 29, 2001	Dec. 29, 2001
Consolidated Statements of earning as a percentage of Net Sales:								
Net sales	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of sales	24.2	30.7	30.5	32.9	28.9	29.2	28.1	28.7
Gross profit	75.8	69.3	69.5	67.1	71.1	70.8	71.9	71.3
Operating expenses:								
Associate incentives	40.3	38.0	37.1	37.2	38.0	38.3	38.1	39.2
Selling, general and administrative	26.3	27.1	27.2	26.4	27.4	28.5	29.1	27.9
Research and development	1.4	1.2	1.0	1.0	1.0	0.9	0.9	0.9
Total operating expenses	67.9	66.3	65.3	64.7	66.5	67.7	68.2	68.0
Earnings from operations	7.9	3.0	4.2	2.5	4.6	3.1	3.8	3.3

Other income (expense), net	(0.7)	(0.8)	(1.5)	0.9	(1.9)	(0.3)	(0.6)	0.3
Earnings before income taxes	7.2	2.2	2.7	3.4	2.7	2.8	3.2	3.6
Income taxes	2.9	0.9	1.1	1.3	1.0	1.0	1.2	1.3
Net earnings	4.3%	1.3%	1.6%	2.0%	1.7%	1.7%	2.0%	2.3%

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

The timing of Company-sponsored Associate events,

The recruiting and retention of Associates,

Fluctuations in currency exchange rates,

The opening of new markets,

New product introductions,

The timing of holidays, especially in the fourth quarter, which may reduce the amount of time Associates spend selling products or recruiting new Associates,

The operation of the network marketing system,

The negative impact of changes in or interpretations of regulations that may limit or restrict the sale of certain products,

The adverse effect of a failure by USANA or an Associate, or allegations of a failure, to comply with applicable governmental regulations,

The integration and operation of new information technology systems,

The inability to introduce new products or the introduction of new products by competitors,

Availability of raw materials,

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

Consumer perceptions of USANA s products and operations.

Because USANA s products are ingested by consumers or applied to their bodies, USANA is highly dependent upon consumers perception of the safety, quality and efficacy of its products. As a result, substantial negative publicity, whether founded or unfounded, concerning one or more products or other products similar to the products could adversely affect our business, financial condition and results of operations.

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

Liquidity and Capital Resources

USANA has historically financed growth primarily with cash flows from operations. In 2001, operations generated net cash of $10.0 million compared to $4.1 million in 2000. Cash and cash equivalents decreased to $2.5 million at December 29, 2001 from $2.9 million at December 30, 2000.

On December 29, 2001, USANA had net working capital of $350,000 compared to $2.3 million at December 30, 2000. The change in net working capital was primarily the result of investments in property and equipment and a $2.0 million increase in current maturities of long-term debt.

USANA invested $6.6 million in property and equipment in 2001 compared to $5.3 million in 2000. Expanded warehouse space, improved technology systems, and investments related to newly opened operations in Japan comprise the majority of the investment in property and equipment in 2001. USANA plans on spending significantly less on property and equipment in 2002 in comparison to 2001.

USANA does not extend credit to its customers, but requires payment prior to shipping, which eliminates significant receivables.

During 1999, USANA entered into agreements with a financial institution to provide up to $25 million in secured credit facilities consisting of a $10 million five year term loan and a $15 million three year revolving line of credit. The credit facilities were amended in March 2001 and reduced the revolving line of credit to $12.5 million and did not require USANA to make quarterly principal payments on the term loan until March 2002. Four principal payments of $500,000 per quarter will commence on March 1, 2002, and seven principal payments of $857,000 per quarter will commence on March 1, 2003, resulting in full repayment of the term loan on September 1, 2004. The revolving line of credit expires on September 1, 2002.

The credit facilities contain restrictive covenants requiring USANA to maintain certain financial ratios. As of December 29, 2001, USANA was in compliance with these covenants. As of December 29, 2001, $8.0 million was outstanding on the 5-year term loan and $4.1

million was outstanding on the line of credit. For additional information on debt and operating lease commitments, see Notes E and I of the audited consolidated financial statements included elsewhere in this report.

USANA believes that its current cash balances, the available line of credit and cash provided by operations will be sufficient to cover its needs in the ordinary course of business for the foreseeable future. If USANA experiences an adverse operating environment or unusual capital expenditure requirements, additional financing may be required. However, no assurance can be given that additional financing, if required, would be available on favorable terms. USANA may also require or seek additional financing, including through the sale of its equity securities to finance future expansion into new markets, finance capital acquisitions associated with growth and for other reasons. Any financing which involves the sale of equity securities or instruments convertible into equity securities could result in immediate and possibly significant dilution to existing shareholders.

Inflation

USANA does not believe that inflation has had a material impact on its historical operations or profitability.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

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

Foreign Currency Risks. Sales outside the United States represented 45.5%, 44.4% and 42.1% of net sales in 1999, 2000, and 2001, respectively. Inventory purchases are transacted primarily in U.S. dollars from vendors located in the United States. The local currency of each international subsidiary is considered the functional currency with all revenue and expenses translated at weighted average exchange rates for reported periods. Consequently, USANA s 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. Given the uncertainty of exchange rate fluctuations, we cannot estimate the effect of these fluctuations on our future business, product pricing, results of operations or financial condition. Changes in currency exchange rates affect the relative prices at which USANA sells its products.

USANA seeks to reduce its exposure to fluctuations in foreign exchange rates by creating offsetting positions through the use of foreign currency exchange contracts. We do not use derivative financial instruments for trading or speculative purposes. We regularly monitor our foreign currency risks and periodically take measures to reduce the impact of foreign exchange fluctuations on USANA s operating results. As of December 29, 2001 and during the entire year of 2001, USANA had no hedging instruments in place to offset exposure to the Canadian Dollar, Australian Dollar, New Zealand Dollar, Hong Kong Dollar, Japanese Yen, British Pound or Euro, to which, in aggregate, USANA had significant exposure. In future years, when USANA has foreign currency exchange contracts in place at year-end, we will present the required information in tabular form.

As a last recourse for hedging currency risk, USANA may elect to adjust prices in non-U.S. markets to reflect changes in foreign currency exchange rates. However, there can be no assurance that these practices will be successful in eliminating all or substantially all of the risks encountered in connection with its foreign currency transactions.

Interest Rate Risks. USANA currently carries $8.0 million in long-term debt with a bank at an effective interest rate of 4.3875%. This long-term debt matures at the rate of $2.0 million in 2002, $3.4 million in 2003 and $2.6 million in 2004. USANA also has a revolving line of credit with a bank with $4.1 million outstanding at December 29, 2001 with a weighted average interest rate of 4.103%. The interest rate is computed at the bank s Prime Rate or LIBOR adjusted by features specified in the loan agreements, with fixed rate term options of up to six months. A hypothetical 100 basis point increase in interest rates on all of the above debt would result in an annual after tax increase of interest expense of approximately $76,000, or approximately $0.01 per diluted share.

Forward-Looking Statements and Certain Risks

The statements contained in this report that are not purely historical are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act. These statements regard our expectations, hopes, beliefs, 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, an others. Forward-looking statements include, but are not limited to, statements contained in Business and 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 future operations and capital spending needs. Actual results could differ materially from the anticipated results or other expectations expressed in these forward-looking statements or for the reasons discussed below. The fact that some of the risk factors may be the same or similar to past reports we have filed with the Securities and Exchange Commission means only that the risks are present in multiple periods. We believe that many of the risks detailed here are part of doing business in the industry in which we operate and compete and will likely be present in all periods reported. The fact that certain risks are endemic to 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 actual results could differ from those projected in these forward-looking statements. Among others, risks and uncertainties that may affect our business, financial condition, performance, development, and results of operations include the following:

As a network marketing company, we do not have direct control over the marketing of our products. We rely on non-employee, independent Associates to purchase, market and sell our products. Associates are independent contractors who purchase products directly for their own use or for resale. Associates typically work at the distribution of the products on a part-time basis and may and likely will engage in other business activities, some of which may compete with us. We have a large number of Associates and a relatively small corporate staff to implement our marketing programs and provide motivational support to our Associates. We undertake no effort to provide individual training to Associates. Associates may voluntarily terminate their agreements with us at any time. There is typically significant turnover in Associates from year to year. Because of this high turnover, we must continually recruit new Associates. Our net sales are directly dependent upon the efforts of these non-employee, independent Associates and future growth in sales volume will depend in large part upon our success in increasing the number of new Associates and improving productivity of the Associates.

We do not directly control the independent acts of Associates and the violation of applicable laws in the sale of our products or the promotion of our compensation plan could adversely affect our business. Associates are required to sign and adhere to a written agreement and policies and procedures. Although these policies and procedures prohibit Associates from making certain claims regarding products or income potential from the distribution of the products, Associates may from time to time create promotional materials or otherwise provide information that does not accurately describe our marketing program. They also may make statements regarding potential earnings, product claims or other matters in violation of our policies or applicable laws and regulations concerning these matters. Such violations may result in legal action by regulatory agencies. Future legal actions against Associates or others associated with us could lead to increased regulatory scrutiny of our business, including our network marketing system. We take what we believe to be commercially reasonable steps to monitor Associate activities to guard against misrepresentation and other illegal or unethical conduct by Associates and to assure that the terms of our compensation plan are observed. There can be no assurance, however, that our efforts in this regard will be sufficient to accomplish this objective. Publicity resulting from these Associate activities can also make it more difficult for us to attract and retain Associates and may have an adverse effect on our business, financial condition and results of operations.

Network marketing is subject to intense government scrutiny and regulation, which adds to the expense of doing business and the possibility that changes in the law might adversely affect our ability to market some of our products in certain markets. Network marketing systems such as ours are frequently subject to laws and regulations directed at ensuring that product sales are made to consumers of the products and that compensation, recognition and advancement within the marketing organization are based on the sale of products rather than investment in the sponsoring company. In the United States, these laws and regulations include the federal and state securities laws, the regulation of the offer and sale of franchises and business opportunities, regulations and statutes administered by the FTC and various state anti-pyramid and business opportunity laws that target direct selling businesses that promise quick rewards for little or no effort, require high entry costs, use high pressure recruiting methods or do not involve legitimate products. Similar laws govern our activities in foreign countries where it presently has operations or may have operations in the future. We are subject to the risk that, in one or more of our present or future markets, our marketing system could be found not to comply with these laws and regulations or may be prohibited. Failure to comply with these laws and regulations or such a prohibition could have a material adverse effect on our business, financial condition and results of operations. Further we may simply be prohibited from distributing products through a network-marketing channel in some foreign countries.

Our business is subject to the effects of adverse publicity and negative public perception. Our ability to attract and retain Associates and to sustain and enhance sales through our Associates can be affected by adverse publicity or negative public perception regarding our industry, our competition or our business generally. This negative public perception may include publicity regarding the legality of network marketing, the quality or efficacy of nutritional supplement products or ingredients in general or our products or ingredients specifically, and regulatory investigations of, regardless of whether those investigations involve us or our Associates or the business practices or products of our competitors or other network marketing companies. There can be no assurance that we will not be subject to adverse publicity or negative public perception in the future or that such adverse publicity will not have a material adverse effect on our business, financial condition and results of operations.

The loss of key management personnel would adversely affect our business. We depend on the services of our founder, Dr. Wentz, who serves as our President, Chief Executive Officer and Chairman of the Board. We also rely on our other executive officers. Dr. Wentz is a highly visible spokesman for our products and our business, and we believe our success depends in large part on the continued visibility and reputation of Dr. Wentz, which helps distinguish us from our competitors. Dr. Wentz is not a permanent resident of the United States and will likely spend no more than four months per year in the United States, however he devotes a majority of his time to our business and travels outside the United States to direct and promote our international expansion. The loss or limitation of Dr. Wentz s services as the lead spokesman for our business or our products, as a key developer of those products or as one of our executive officers could have a material adverse effect upon our business, financial condition and results of operations.

Our executive officers other than Dr. Wentz are primarily responsible for our day-to-day operations, and we believe our success depends in part on our ability to retain our executive officers and to continue to attract additional qualified individuals to our management team. We do not maintain a key man life insurance policy on Dr. Wentz or any of our other officers, nor do we have an employment agreement with any of our officers. The loss or limitation of the services of any of our executive officers or the inability to attract additional qualified management personnel could have a material adverse effect on our business, financial condition and results of operations.

The ownership of a significant percentage of our common stock gives Dr. Wentz effective control and limits the influence of other shareholders on important policy and management issues. Gull Holdings, Ltd., which is solely owned and controlled by Dr. Wentz, owned 49.5% of our outstanding common stock at December 29, 2001. By virtue of this stock ownership, Gull Holdings, Ltd. may be able to exert significant influence over the election of the members of our Board of Directors and to exert significant influence over our affairs. This concentration of ownership could also have the effect of delaying, deterring or preventing a change in control that might otherwise be beneficial to stockholders. In addition, Dr. Wentz and his son David Wentz currently serve on the Board of Directors. There can be no assurance that conflicts of interest will not arise with respect to these directors or that conflicts will be resolved in a manner favorable to us.

There is no assurance of future industry growth. There can be no assurance that the nutritional supplement market is as large as reported or that projected or expected growth will occur or continue. Market data and projections, such as those presented in this report, are inherently uncertain and subject to change. In addition, the underlying market conditions are subject to change based on economic conditions, consumer references and other factors that are beyond our control. Recently, various publicly traded nutritional supplement companies, as well as industry analysts, have announced that there is a slow-down in sales of nutritional supplements. There can be no assurance that an adverse change in size or growth rate of this market will not have a material adverse effect on our business, financial condition or results of operations.