

USANA HEALTH SCIENCES INC  
Form 10-K  
March 11, 2013

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

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**FORM 10-K**

(Mark One)

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

For the fiscal year ended December 29, 2012

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number: 0-21116

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**USANA HEALTH SCIENCES, INC.**

(Exact name of registrant as specified in its charter)

**Utah**  
(State or other jurisdiction of  
incorporation or organization)

**87-0500306**  
(I.R.S. Employer  
Identification No.)

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

(Address of principal executive offices, Zip Code)

**(801) 954-7100**

(Registrant's telephone number, including area code)

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

(Title of each class)

Common Stock, Par Value \$0.001 Per Share

(Name of each exchange on which registered)

New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: **None**

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes  No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) 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 or any amendment to this Form 10-K.

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

Large accelerated filer       Accelerated filer       Non-accelerated filer       Smaller reporting company   
(Do not check if a smaller reporting company)

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

The aggregate market value of common stock held by non-affiliates of the registrant as of June 29, 2012 was approximately \$262,342,000, based on a closing market price of \$41.12 per share.

There were 13,499,699 shares of the registrant's common stock outstanding as of March 1, 2013.

**Documents incorporated by reference.** The registrant incorporates information required by Part III (Items 10, 11, 12, 13, and 14) of this report by reference to the registrant's definitive proxy statement to be filed pursuant to Regulation 14A for its 2013 Annual Shareholders Meeting.

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*The statements contained in this report on Form 10-K that are not purely historical are considered to be "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These forward-looking statements include, but are not limited to, any projections of net sales, earnings, or other financial items; any statements of the strategies, plans and objectives of management for future operations; any statements concerning proposed new products or developments; any statements regarding future economic conditions or performance; any statements of belief; and any statements of assumptions underlying any of the foregoing. Forward-looking statements may include the words "may," "will," "estimate," "intend," "continue," "believe," "expect" or "anticipate" and any other similar words. These statements represent our expectations, beliefs, anticipations, commitments, intentions, and strategies regarding the future and include, but are not limited to, the risks and uncertainties outlined in Item 1A Risk Factors and Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations. Readers are cautioned that actual results could differ materially from the anticipated results or other expectations that are expressed in forward-looking statements within this report. The forward-looking statements included in this report speak only as of the date hereof and we undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise, except as required by law.*

*In this Annual Report on Form 10-K, unless otherwise expressly indicated, references to "dollars" and "\$" are to United States dollars.*

**PART I**

**Item 1. Business**

**General**

USANA Health Sciences, Inc. was founded in 1992 by Myron W. Wentz, Ph.D. We develop and manufacture high-quality, science-based nutritional and personal care products with a primary focus on promoting long-term health and reducing the risk of chronic degenerative disease. In so doing, we are committed to continuous product innovation and sound scientific research. We have operations in 18 markets worldwide where we distribute and sell our products by way of direct selling. Our net sales in fiscal year 2012 were \$648.7 million, of which 76.5% were in markets outside of the United States. As a U.S.-based multi-national company with an expanding international presence, our operating results are becoming more sensitive to currency fluctuations, as well as economic and political conditions in markets throughout the world. Additionally, we are subject to the various laws and regulations unique both to the products that we sell and to our method of distribution.

Our customer base comprises two types of customers: "Associates" and "Preferred Customers." Associates are independent distributors of our products, who also purchase our products for personal use. Preferred Customers purchase our products strictly for personal use and are not permitted to resell or to distribute the products. As of December 29, 2012, we had 247,000 active Associates and 64,000 active Preferred Customers worldwide.

**Recent Developments**

During 2012, we executed several strategies designed to grow our business. These strategies are discussed in the following categories:

*Personalization.* We officially launched our global marketing strategy, which focuses on personalizing our product and incentive offerings to our customer base around the world. Under this strategy, we expanded the availability of our flagship MyHealthPak product to all of our international markets. MyHealthPak is a fully personalized supplement pack that can include any of our Essential and Optimizer products. Under this strategy, we also introduced two proprietary

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health assessment applications for our Associates and Preferred Customers called True Health Assessment and True Health Companion. These applications are designed for use on iPads and other platforms through the web and are intended to provide our Associates with a new and personalized way to market USANA to potential customers. We launched these new applications at our 2012 International Convention and also gave every Associate in attendance a free iPad with a pre-loaded version of the True Health Assessment. Personalization will be our marketing and operating strategy over the next several years. We believe this strategy will facilitate our short-and long-term growth objectives, which include: (i) returning our North America region to growth; (ii) growing our business in Greater China, and (iii) international expansion.

*North America Growth Strategy.* In North America/Europe, we continued to execute our growth strategy, which focuses on strengthening our partnership with our Associate sales force, introducing North America-specific incentives, and innovating to develop new products and technologies. During 2012, we held an increased number of meetings and events where members of our management team worked closely with our Associate Leaders to grow our business. We also launched our new Lifetime Matching Bonus, which was well received by our Associates and provides us with the flexibility to offer other incentives specifically for North America. We also offered a new bonus for our Associates in Mexico periodically during 2012, which helped drive results in that market and North America in general. Finally, in 2012, we hired a new executive to lead our Research and Development group who shares our passion for innovation. With his leadership, we plan to launch a variety of new products and technologies under our personalization strategy over the next several years.

*China-Growth Strategy.* We continued our efforts to grow our Greater China region in 2012 and are encouraged by the results in that region. This strategy included integrating our mainland China ("China" or "PRC") operations and systems, to the extent possible, with our worldwide operations. It also included educating our Associates on the USANA products that we have introduced in China, as well as on our China business opportunity. Additionally, we opened a new branch office in Shenzhen, which is a key city for our business in southern China, and held our Annual Celebration where new products and sales tools were introduced. During 2013, we plan to continue to execute our strategy in Greater China, or more specifically China. This strategy will continue to focus on educating Associates and opening a new branch office, and will also include registering for additional provincial licenses. Notably, subsequent to December 29, 2012, we received three additional provincial direct selling licenses in China. We now have direct selling licenses in Beijing, Jiangsu, Shaanxi, and Tianjin.

*International Expansion.* We increased our international expansion efforts in 2012 by commencing operations in Thailand, France and Belgium. Each of these markets is heavily consumer focused, which means that it will take time for our Associate leaders to develop entrepreneurs to grow these markets. We continue to believe that Thailand, France and Belgium will be successful markets for USANA and we will continue to support the efforts of our Associates to grow these markets. In 2013, we will continue our international expansion efforts by opening a new market around the middle of the year.

In 2013, our primary objective will be to strengthen and grow our Active Associate counts throughout the world. To this end, we will continue to execute each of the strategies mentioned above, as well as introduce additional market-specific strategies. For example, beginning in January 2013 we implemented a pricing initiative in several of our mature markets, which includes price reductions in certain markets. This pricing initiative is intended to make our products more consistently priced for our Associates and Preferred Customers in all of our markets. Our launch of this initiative may create some short-term pressure on our net sales and earnings in these markets. We believe, however, that this strategy will create greater long-term customer growth in these markets.

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The following table summarizes our product lines.

<b>Product Line/Category</b>	<b>Description</b>	<b>Percent of Product Sales by Fiscal Year</b>		<b>Product examples</b>
<b>USANA® Nutritionals</b>				
Essentials	Includes core vitamin and mineral supplements that provide a foundation of advanced total body nutrition for every age group beginning with children 13 months of age.	2010	30%	USANA® Essentials
		2011	29%	HealthPak 100
		2012	28%	
Optimizers	Consists of targeted supplements designed to meet individual health and nutritional needs. These products support needs such as cardiovascular health, skeletal/structural health, and digestive health, and are intended to be used in conjunction with the Essentials.	2010	47%	Proflavanol
		2011	50%	CoQuinone® 30
		2012	52%	BiOmega-3
Foods	Includes low-glycemic meal replacement shakes, snack bars, and other related products that provide optimal macro-nutrition (complex carbohydrates, complete proteins, and beneficial fats) in great tasting and convenient formats. These products can be used along with Essentials and Optimizers to provide a complete and healthy diet, and sustained energy throughout the day.	2010	12%	Nutrimeal
		2011	11%	Fibergy
		2012	11%	RESET weight-management program and accompanying RESET kit
Sensé beautiful science®	Includes premium, science-based, personal care products that support healthy skin and hair by providing advanced topical nourishment, moisturization, and protection. These products are designed to complement inner nutrition for the skin provided by the USANA Nutritionals and are manufactured with our patented, self-preserving technology, which uses a unique blend of botanicals, antioxidants, and active ingredients to keep products fresh without adding traditional chemical preservatives.	2010	8%	Daytime Protective
		2011	7%	Emulsion
		2012	7%	Night Renewal Perfecting Essence
All Other	Includes materials and online tools that are designed to assist our Associates in building their businesses and in marketing our products.	2010	3%	Associate Starter Kit
		2011	3%	Product Brochures
		2012	2%	

In addition to the products described above, we offer products designed specifically for prenatal, infant, and young child age groups in China. As we continue to increase our focus on personalization and innovation, we will look for product opportunities such as our MyHealthPak product.

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The approximate percentage of total product sales represented by our top-selling products for the last three fiscal years is as follows:

Top-selling products	Year Ended		
	2010	2011	2012
USANA® Essentials	18%	18%	19%
Proflavanol®	11%	12%	12%
HealthPak 100	10%	9%	7%

**Geographic Presence**

Our products are distributed and sold in 18 markets. We have organized our markets into two geographic regions: North America/Europe and Asia Pacific, with three sub-regions under Asia Pacific.

*North America / Europe*

North America / Europe is our most mature region and includes the United States (including direct sales from the United States to the United Kingdom and the Netherlands), Canada, Mexico, France and Belgium. We commenced operations in France and Belgium during 2012. North America has been our most challenging region. Our North America growth strategy, which is discussed elsewhere in this report, is intended to improve our operating trend in this region and generate growth.

*Asia Pacific*

Asia Pacific is organized into three sub-regions: Southeast Asia Pacific, Greater China, and North Asia. Markets included in each of these sub-regions are as follows:

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

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

North Asia Japan and South Korea

Growth in our Asia Pacific region over the last several years has been led by the Philippines and Hong Kong. Our most recent market expansions in this region include our entry into Thailand in 2012 and our entry into mainland China in 2010 through our acquisition of BabyCare. Going forward, we anticipate that growth in this region will continue to be led by the Philippines and China, but we expect other markets in this region to grow as well.

*Net Sales by Region*

The following table shows net sales by geographic region for our last three fiscal years. We report net sales in a geographic region if a product shipment originates in that geographic region. Additional

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(1) Our business in China is that of BabyCare, our wholly-owned subsidiary.



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financial information relating to our geographic regions can be found in Note L to the Consolidated Financial Statements included in this report.

Region	2010		Years Ended 2011		2012	
			(in thousands)			
North America/Europe	\$ 242,147	46.8%	\$ 236,386	40.6%	\$ 244,333	37.7%
Asia Pacific						
Southeast Asia Pacific	99,311	19.2%	111,447	19.2%	139,651	21.5%
Greater China	152,280	29.4%	204,822	35.2%	235,626	36.3%
North Asia	23,906	4.6%	29,284	5.0%	29,116	4.5%
Asia Pacific Total	275,497	53.2%	345,553	59.4%	404,393	62.3%
	\$ 517,644	100.0%	\$ 581,939	100.0%	\$ 648,726	100.0%

**Research and Development**

Our research and development efforts are focused on developing and providing high-quality, science-based products that promote long-term health and reduce the risk of chronic degenerative disease. Our research and development activities include developing products that are new to USANA and new to the industry, updating existing formulas to keep them current with the latest science, and adapting existing formulas to meet ever-changing regulations in new and existing international markets. Our scientific staff includes experts on human nutrition, cellular biology, biochemistry, natural product chemistry, and clinical research. These experts continually review the latest published research on nutrition, attend scientific conferences, and work with a number of third-party research institutions and researchers to identify possible new products and opportunities to reformulate our existing products.

In 2012, we continued our relationship with the Linus Pauling Institute ("LPI") at Oregon State University. Our goal is to better determine and understand the function and role of micronutrients such as vitamins, minerals, and antioxidants in promoting optimal health and preventing disease. As part of this relationship, our in-house research team works closely with LPI on nutritional and clinical research. In 2013, we plan to continue our research efforts with LPI and maintain our ongoing nutrition research in preventing oxidative stress, glycemic stress, and chronic inflammation.

Our goal is to maintain a sharp focus on nutrition both inside and outside the body in promoting health and preventing chronic degenerative disease. Because we believe in focusing primarily on key health issues within our society rather than on fads, we typically do not introduce a new product unless we believe that it can provide health benefits to a significant number of our customers. As a result, we maintain a focused and compact line of products, which we believe simplifies the selling and buying process for our Associates and Preferred Customers.

We follow pharmaceutical standards established by the U.S. Pharmacopeia and other pharmacopeias in the development and formulation of our products. Our ingredients are selected to meet a number of criteria, including, but not limited to: safety, potency, purity, stability, bio-availability, and efficacy. We control the quality of our products beginning at the formulation stage, and we maintain our quality control through controlled sourcing of raw ingredients, manufacturing, packaging, and labeling. In fiscal years 2010, 2011, and 2012 we expended \$3.8 million, \$4.1 million, and \$4.7 million, respectively, on product research and development activities. Going forward, we intend to increase our spending and resources for research and development in connection with our personalization strategy.

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**Manufacturing and Quality Assurance**

We conduct nearly all of the manufacturing, production and quality control operations for our nutritional and personal care products in-house. We have established and maintain a manufacturing and quality control facility in Salt Lake City, Utah. BabyCare manufactures and produces nearly all of its products in-house and maintains manufacturing and quality control facilities in Beijing, China and Tianjin, China. Additional information about our U.S. manufacturing, production and quality control operations is set out below.

*Tablet Manufacturing*

Tablet manufacturing is conducted at our Salt Lake City, Utah manufacturing facility. Our tablet production process uses automatic and semi-automatic equipment and includes the following activities: identifying and evaluating suppliers of raw materials, acquiring raw materials, analyzing raw material quality, weighing or otherwise measuring raw materials, mixing raw materials into batches, forming mixtures into tablets, coating and sorting the tablets, analyzing tablet quality, packaging finished products, and analyzing finished product quality. We conduct sample testing of raw materials, in-process materials, and finished products for purity, potency, and composition to determine whether our products conform to our internal specifications, and we maintain complete documentation for each of these tests. We employ a qualified staff of professionals to develop, implement and maintain a quality system designed to assure that our products are manufactured to our internal and applicable regulatory agency specifications.

Our Salt Lake City manufacturing facility is registered with the U.S. Food and Drug Administration ("FDA"), Health Canada Natural Health Products Directorate, the Australian Therapeutic Goods Administration ("TGA"), and other governmental agencies, as required. This facility is audited regularly by various organizations and government agencies to assess, among other things, compliance with Good Manufacturing Practice regulations ("GMPs") and with labeling claims. Based on these audits, our Salt Lake City manufacturing facility has received and maintains certifications from the Islamic Foods and Nutrition Counsel of America in compliance with Halal, NSF International in compliance with product testing and GMPs, and the TGA in compliance with the Therapeutic Goods Act of 1989.

The manufacture of nutritional or dietary supplements and related products in the United States requires compliance with dietary supplement GMPs, which are based on the food-model GMPs and pharmaceutical GMPs, with additional requirements that are specific to dietary supplements. We believe our manufacturing processes comply with the GMPs for dietary supplements.

*Personal Care Manufacturing*

Historically, we have manufactured the majority of our personal care products at our Draper, Utah manufacturing facility. In 2011, we moved the manufacturing of our personal care products to our Salt Lake City facility to maximize efficiency and reduce costs on these items. The production process for personal care products includes identifying and evaluating suppliers of raw materials, acquiring raw materials, analyzing raw material quality, weighing or otherwise measuring the raw materials, mixing raw materials into batches, analyzing liquid batch quality, packaging finished products, and analyzing finished product quality. We conduct sample testing of raw materials, in-process materials, and finished products for purity, potency, and composition to determine whether our products conform to our internal specifications, and we maintain complete documentation for each of these tests.

At our Salt Lake City facility, we have standard technology for producing batches of personal care items, and we have semi-automatic packaging equipment for packaging end products. We employ qualified staff to develop, implement, and maintain a quality system. Although the FDA has not promulgated GMPs for personal care items, it has issued guidelines for manufacturing personal care products. We voluntarily maintain compliance with the guidance established by FDA and the Personal Care Products Council.

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*Third-Party Suppliers and Manufacturers*

We contract with third-party suppliers and manufacturers for the production of some of our products, which account for approximately 25% of our product sales. These third-party suppliers and manufacturers produce and, in most cases, package these products according to formulations that have been developed by, or in conjunction with, our in-house product development team. These products include most of our gelatin-capsulated supplements, Rev3 Energy Drink, Probiotic, our powdered drink mixes and nutrition bars, and certain of our personal care products. Products manufactured at these locations must also go through quality control and assurance procedures to ensure they are manufactured in conformance with our specifications.

*Quality Control/Assurance*

We conduct quality control processes in two in-house laboratories that are located in Salt Lake City, Utah. In our microbiology laboratory, scientists test for biological contamination of raw materials and finished goods. In our analytical chemistry laboratory, scientists test for chemical contamination and accurate levels of active ingredients in both raw materials and finished products. Both laboratories conduct stability tests on finished products to determine the shelf life of our products. Our laboratory staff also performs chemical assays on vitamin and mineral constituents, using United States Pharmacopoeia methods and other internally validated methods. In addition to our quality control and clinical laboratories, our headquarters facility also houses a laboratory designated for research and development. We also perform processes similar to those described above at our labs in China.

*Raw Materials*

Most of the raw ingredients that are used in the manufacture of our products are available from a number of suppliers. We have 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, and believe we will be able to do so in the future, if the need arises. Accordingly, we are not subject to a single-source supplier for our required supplies of raw ingredients. Our raw material suppliers must demonstrate stringent process and quality control before we use their products in our manufacturing process.

**Distribution and Marketing**

*General*

We distribute our products internationally through a network marketing system, which is a form of person-to-person direct selling. Under this system, distributors purchase products at wholesale prices from the manufacturer for resale to consumers and for personal consumption. The concept of network marketing is based on the strength of personal recommendations that frequently come from friends, neighbors, relatives, and close acquaintances. We believe that network marketing is an effective way to distribute our products because it allows person-to-person product education and testimonials as well as higher levels of customer service, all of which are not as readily available through other distribution channels.

*Structure of Network Marketing Program*

*Associates.* A person who wishes to sell USANA products must join our independent sales force as an Associate. A person becomes an Associate by completing an application under the sponsorship of an existing Associate. The new Associate then becomes part of the sponsoring Associate's "down-line" sales organization. New Associates sign a written contract and agree to adhere to the USANA policies and procedures. Under the policies and procedures, Associates may not, among other things: (i) use deceptive or unlawful practices to sell USANA products; (ii) make deceptive or unlawful claims or

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representations concerning our products or Compensation Plan; or (iii) sell competitive products to other USANA Associates or solicit USANA Associates to participate in other network marketing opportunities. New Associates are required to purchase a starter kit that includes a detailed manual describing our business and products as well as our policies and procedures. We sell these kits at a nominal cost averaging \$30 in each of our markets. No other investment is required to become an Associate.

Once a person becomes an Associate, he or she may purchase products directly from us at wholesale prices for personal use and resale to customers. Our Associates are also entitled to build sales organizations by attracting and enrolling new Associates and establishing a network of product users. The sponsoring of new Associates results in the creation of multiple levels within our network marketing structure. Sponsored Associates are referred to as part of the "down-line" of the sponsoring Associate. Down-line Associates may also sponsor new Associates, creating additional levels in their network, but also forming a part of the same down-line as the original sponsoring Associate. As outlined below, Associates who are interested in earning additional income must successfully sell USANA products and establish a business network/down-line in order to qualify for commissions, including bonuses. Subject to payment of a minimal annual account renewal fee, Associates may continue to distribute or consume our products as long as they adhere to our policies and procedures.

Individuals who reside in China and who are interested in being part of USANA's organization in China may do so by joining BabyCare as an Associate. The process for joining BabyCare is very similar to the process for joining USANA and requires an initial Associate application and an agreement by the Associate to adhere to the policies and procedures in China. Much like our operations in other markets, an Associate in China is provided with opportunities to build a sales organization and receive compensation for sales generated by that organization. Associates in China do not participate in USANA's Compensation Plan and, therefore, are compensated under the plan created and implemented by BabyCare specifically for China.

*Preferred Customers.* We also sell directly to customers who purchase products only for personal use. This program is our "Preferred Customer" program. Preferred Customers may not resell or distribute our products. We believe this program gives us access to a market that would otherwise be missed, by targeting customers who enjoy USANA products, but who prefer not to maintain a distribution relationship with us. Although our policies prohibit Preferred Customers from engaging in retail sales of products, they may enroll as Associates at any time, if they desire. Preferred Customers are not eligible to earn commissions or to participate in our Compensation Plan. Our China operations also utilize a Preferred Customer program, which is similar to USANA's Preferred Customer program in its other markets.

*Associate Training and Motivation*

Initial training of Associates about the products, the Compensation Plan, network marketing, and USANA is provided primarily by an Associate's sponsor and others in their sales organization. We develop and sell training materials and sales tools to assist Associates in building their businesses, as well as provide reprints from other commercial publications that feature USANA and may be used as sales tools. We also sponsor and conduct regional, national, and international Associate events, as well as intensive leadership training seminars. Attendance at these sessions is voluntary, and we undertake no generalized effort to provide individualized training to Associates, although experience shows that the most effective and successful Associates participate in training activities. Although we provide leadership training and sales tools, we ultimately rely on our Associates to: sell our products, attract new Associates and Preferred Customers to purchase our products, and educate and train new Associates regarding our products and Compensation Plan.

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*Associate Compensation*

As outlined below, our Compensation Plan provides several opportunities for Associates to earn compensation, provided they are willing to consistently work at building, training, and retaining their down-line organizations to sell USANA products to consumers. The purpose behind each form of compensation under our Compensation Plan is to reward Associates for generating product sales either directly or indirectly through their down-line sales organization and network of product consumers. We believe our Compensation Plan is distinctive for its weekly payouts to Associates.

Associates can earn compensation in four ways:

*Commissions.* The primary way an Associate is compensated is through earning commissions. Associates earn commissions through generating sales volume points, which are a measure of the product sales of their down-line sales organization. Sales volume points are assigned to each of our products and comprise a certain percent of the product price in U.S. dollars. To be eligible to earn commissions, an Associate must sell a certain amount of product each month ("Qualifying Sales"). Qualifying Sales may include product that the Associates use personally or that they resell to consumers. Associates do not earn commissions on these Qualifying Sales. Associates may earn commissions on their sale of products above the Qualifying Sales as well as the sale of products by Associates in their down-line organization and Preferred Customers. Additionally, Associates do not earn commissions for simply recruiting and enrolling others in their down-line organization. Commissions are paid only when products are sold. We pay Associate commissions on a weekly basis. As noted elsewhere in this report, our China operations maintain their own compensation plan, which has been implemented by BabyCare specifically for China.

*Bonuses.* We offer Associates several bonus opportunities, including our leadership bonus, elite bonus, and lifetime matching bonus. These bonus opportunities are based on a pay-for-performance philosophy and, therefore, are paid out when the Associate achieves the required performance measures.

*Retail Mark-Ups.* As discussed previously, our Associates purchase products from us at wholesale prices and may resell them to consumers at higher retail prices. The Associate retains the retail mark-up as another form of compensation.

*Contests and Promotions.* We periodically sponsor contests and promotions designed to incentivize Associates to generate sales and grow their down-line organization and product users. These promotions are also based on a pay-for-performance philosophy and, therefore, are only paid upon the achievement of the promotion objectives.

We endeavor to integrate our Compensation Plan seamlessly across all markets where legally permissible, allowing Associates to receive commissions for global not merely local product sales. This seamless down-line structure is designed to allow Associates to build a global network by establishing or expanding their down-line in any of the markets where we operate. We believe our Compensation Plan significantly enhances our ability to expand internationally, and we intend, where permitted, to continue to integrate new markets into our Compensation Plan. Our Associates in China do not participate in USANA's Compensation Plan. Instead, they are compensated under a plan that has been created and implemented by BabyCare specifically for China.

**Operating Strengths**

Our principal objective is to be a leading developer, manufacturer and distributor of science-based nutritional and personal care products and to create a rewarding opportunity through network marketing for our Associates who distribute our products. Our strategy is to capitalize on our operating strengths, which include: a strong research and development program; in-house manufacturing

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capability; science-based products; an attractive Associate Compensation Plan; a scalable business model; and an experienced management team.

*Emphasis on Research and Development.* We have a technical team of experienced scientists, including several holding Ph.D. degrees, quality engineers, and regulatory specialists who contribute to our research and development activities. In our research and development laboratories, our scientists and researchers:

Investigate activities of natural extracts and formulated products in laboratory and clinical settings;

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

Develop new nutritional ingredients for use in supplements;

Study the metabolic activities of existing and newly identified nutritional ingredients;

Enhance existing products, as new discoveries in nutrition and skin care are made;

Formulate products to meet diverse regulatory requirements across all of our markets; and

Investigate processes for improving the production of our formulated products.

Our scientists and researchers also conduct double-blind, placebo-controlled, clinical studies which are intended to further evaluate the efficacy of our products. In addition, we work with outside research organizations to further support various aspects of our research and development efforts. One of these organizations is the Linus Pauling Institute at Oregon State University. Our work with the Linus Pauling Institute advances the science of human nutrition and health, provides us with valuable information to formulate and upgrade our nutritional products, and allows us to better advise our customers on how to use USANA products. We have also funded clinical research programs at Boston University, the University of Colorado, the University of Utah, Sydney University in Australia, The Orthopedic Specialty Hospital ("TOSH") and Utah State University. Additionally, our Scientific Advisory Council, comprised of health care professionals and nutritional science experts worldwide, provides us with valuable insights into product applications and efficacy. It is through our internal research and development efforts and our relationships with outside research organizations and health care providers that we can provide what we believe to be some of the highest quality health products in the industry.

*In-house Manufacturing.* We manufacture products that account for approximately 75% of our product sales. We believe that our ability to manufacture our own products in-house is a significant competitive advantage for the following reasons:

We can better control the quality of raw materials and finished products;

We can more reliably monitor the manufacturing process to better guarantee potency and bioavailability and to reduce the risk of product contamination;

We can better control production schedules to increase the likelihood of maintaining an uninterrupted supply of products for our customers;

We are able to produce most of our own prototypes in the research phase of product development; and

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We are better able to manage the underlying costs associated with manufacturing our products.

*Science-based Products.* As a result of our emphasis on research and development and our in-house manufacturing capabilities, we have developed a focused line of high-quality health products that we believe provides health benefits to our customers. Our products have been developed based on

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a combination of published research, in-house laboratory and third-party clinical studies, and sponsored research.

*Attractive Associate Compensation Plan and Support.* We are committed to increasing our product sales by providing a highly competitive compensation plan to attract and retain Associates who constitute our sales force. We incent our Associates by paying incentives on a weekly basis. Additionally, our Compensation Plan is, where permissible, a global-seamless plan, meaning that Associates can be compensated each week for their business success in any market in which they have a down-line organization where we conduct business. As noted elsewhere in this report, our China operations maintain their own compensation plan, which is structured differently than USANA's plan in other markets.

To support our Associates, we sponsor meetings and events throughout the year, which offer information about our products and our network marketing system. These meetings are designed to assist Associates in business development and to provide a forum for interaction with some of our Associate leaders and with members of the USANA management team. We also provide low-cost sales tools and resources, which we believe are an integral part of building and maintaining a successful home-based business for our Associates. For example, we offer an interactive presentation tool, called Health and Freedom Solution, which was created and designed to help our Associates easily explain and share the USANA opportunity, including the benefits of our products and our Compensation Plan.

In addition to Company-sponsored meetings, sales tools and resources, we maintain a website exclusively for our Associates, where they can keep up on the latest USANA news, obtain training materials, manage their personal information, enroll new customers, shop for products, and register for Company-sponsored events. Additionally, through this website, Associates can access other online services to which they may subscribe. For example, we offer an online business management service, which includes a tool that helps Associates track and manage their business activity, a personal webpage to which prospects or retail customers can be directed, e-cards for advertising, and a tax tracking tool.

We also believe that recognition is an important factor in supporting and retaining our Associates. We understand that being a successful USANA Associate requires hard work and dedication. We frequently hold a variety of contests and promotions, rewarding our Associates for their achievements to help motivate them and recognize their efforts. We also celebrate key achievements and rank advancements of our Associates. We believe that our recognition programs and contests greatly contribute to our ability to retain our Associates.

*Business Model.* We believe that our business model provides, among others, the following advantages:

No requirement for a company-employed sales force to sell our products, with a relatively low incremental cost to add a new Associate;

Commissions paid to our Associates are tied to sales performance;

Accounts receivable are minimal because payment is required at the time an Associate or Preferred Customer purchases product;

A stream of recurring revenue from our monthly product subscription program known as "Autoship," which we utilize in all of our markets (for the year ended December 29, 2012, this program represented 31% of our sales); and

We can expand into new international markets with moderate investment because, for markets other than China, we generally maintain minimal administrative, customer support, and warehouse facilities in each of these markets.



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*Experienced Management Team.* Our management team includes individuals with expertise in various scientific and managerial disciplines, including nutrition, product research and development, international development, marketing, customer network development, information technology, finance, legal, regulatory and operations. This team is responsible for supporting growth, research and development, international expansion, strengthening our financial condition, and improving our internal controls.

**Growth Strategy**

We seek to grow our business by pursuing the following strategies:

*Personalization.* Our personalization initiative will be our marketing and operating strategy going forward. This strategy focuses on personalizing each aspect of our business to our customer base around the world. We will use our personalization initiative to facilitate growth through the other strategies set out below.

*Attract and Retain Associates.* Our Associates are the key to the growth of our business. Accordingly, we must continue to attract and retain Associates. For this reason, our management team maintains a close working relationship with our Associate leaders. One of our key initiatives in 2012 was to continue to strengthen this working relationship by holding more in-person meetings between management and Associates and by providing additional leadership training for Associates. In addition to our Annual International Convention and our Asia Pacific Convention, we hold several regional events in key growth areas to provide support and training to new Associates. We continue to increase our investment in these events and in the marketing of our Compensation Plan to aid Associates in improving the productivity of their businesses.

Over the last couple of years we have also worked closely with certain of our Associate leaders to develop new and unique training tools to assist in the personal development and growth of our new Associates. These training tools are designed to serve as a guide for someone new to USANA and network marketing who has the entrepreneurial spirit to own and operate a home-based business. In addition to these new sales tools, we have also increased our emphasis on building global awareness of the USANA brand. This includes our new sponsorship of the U.S. Ski Team, as well as our partnership with the Women's Tennis Association ("WTA"). Not only are we the official health supplement supplier to the WTA, but we now have six top players who are dedicated to promoting our products and brand. We seek to leverage this relationship to build brand credibility and increase product consumption and loyalty. In addition to our sponsorship of professional athletes, we seek to advertise and collaborate with credible, nationally recognized organizations and individuals to enhance our global brand. In 2012, we began a strategic relationship with Dr. Mehmet Oz through his charity, Healthcorps. Over the past 5 or 6 years, the world has witnessed the overwhelming rise in popularity of Dr. Oz and, now, he has become a nationally recognized part of American culture. Dr. Oz participated in a number of our Associate events during 2012 and was a key speaker at our 2012 International Convention in Salt Lake City, Utah. We plan to continue our relationship with Dr. Oz through Healthcorps in 2013 and going forward. This relationship will include Dr. Oz's participation on future Associate leadership calls and, more importantly, his continued participation at Associate events. While branding efforts such as this have a global reach, the primary objective of this initiative is to grow sales and the number of Associates in North America.

In 2013, our primary initiative will be to strengthen and grow our Active Associate counts throughout the world. To this end, we will continue to execute our growth strategies in North America and Greater China as well as introduce additional market-specific strategies. One of these new strategies is a pricing initiative that we implemented in several of our mature markets, which includes price reductions in certain markets. This pricing initiative is intended to make our products more consistently priced for our Associates and Preferred Customers in all of our markets. We believe that

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this strategy will create greater long-term customer growth in these markets and our business in general.

*Successfully Grow our Greater China Region.* In light of the strength of our Asia Pacific region and our growing Asian Associate base, we believe that Greater China currently represents the most significant and imminent growth opportunity for us. Our strategy in this region is focused on generating Associate growth in each of Taiwan, Hong Kong and China, with an emphasis on China. To capitalize on this opportunity, in August 2010, we indirectly acquired BabyCare, a direct selling company organized under the laws of China. We believe our acquisition of BabyCare accelerates our growth potential in China for several reasons, including: (i) the license granted to BabyCare from the Chinese government, which allows BabyCare to engage in direct selling in the municipality of Beijing; and (ii) BabyCare's existing management team, which continues to operate BabyCare and has extensive experience in the Chinese direct selling market as well as in Chinese government relations and regulations. BabyCare is working to obtain similar direct selling licenses in other provinces within China. Notably, subsequent to the year ended December 29, 2012, we received three additional provincial direct selling licenses in Jiangsu, Shaanxi, and Tianjin. During 2012, we continued integrating our China operations and systems, to the extent possible, with our worldwide operations in an effort to make it easier, more efficient, and more enjoyable for BabyCare's Associates to conduct business in China. We also continued educating our Associates on the USANA products that we have introduced in China, as well as on our China business opportunity. The launch of several USANA products in China has expanded our presence in China's adult supplement market and, as a result, expanded the sales opportunities for BabyCare Associates to existing and prospective Chinese customers. In 2013, we will continue to execute our Greater China growth strategy to generate Associate and sales growth in this region.

*Introduce New and Re-formulate Existing Products.* Our research and development team is continually reviewing the latest scientific findings related to nutrition, conducting in-house research and clinical trials, looking at new technologies, and attending scientific conferences. If, in the process, we see potential for a new product or ingredient that provides a measurable and important health benefit, and if we believe this benefit can be realized by our customers, we will generally pursue development of that product. Our research and development focus in 2012 and going forward will be centered on personalization and innovation. To the extent reasonably possible, we intend to personalize our product offering and product delivery systems to our customers' individual needs. An example of our personalization efforts is our MyHealthPak product, which is a fully customized, pre-packaged supplement regimen that can include any of our Essentials and Optimizers. We will also enhance our focus on innovation to develop new products and technologies. To facilitate this, we have expanded our research and development team, increased our research and development investment, and expanded our collaborations with outside scientific experts and organizations. In particular, we hired a new executive during 2012 to lead our research and development team. With his leadership, we will launch a variety of new products and technologies under our personalization strategy over the next several years.

*Enter New Markets.* We believe that significant growth opportunities continue to exist in markets where we currently conduct business and in new international markets. In 2011, we announced our intent to become more aggressive in our international expansion efforts. To this end, we commenced operations in Thailand, France and Belgium in 2012. We will also open another new market during 2013. These new markets, as well as any future markets we may consider, are selected following an assessment of several factors, including market size, anticipated demand for USANA products, receptiveness to network marketing, and the market entry process, which includes consideration of possible regulatory restrictions on our products or our network marketing system. We have also begun to register certain products with regulatory and government agencies in other countries in preparation for further international expansion. Wherever possible, we expect to seamlessly integrate the

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Compensation Plan in each market to allow Associates to receive commissions for global not merely local product sales. This seamless down-line structure is designed to allow an Associate to build a global network by creating a down-line across national borders. We believe our seamless Compensation Plan significantly enhances our ability to expand internationally, and we intend, where permitted, to integrate the future markets that we open into this plan. While we deem new market expansion as a key growth strategy, given the significant opportunity that currently exists in China, we plan to focus the majority of our time and resources on growing sales in that market.

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

**Competition**

We compete with manufacturers, distributors, and retailers of nutritional products for consumers, and with network marketing companies for distributors. On both fronts, some of our competitors are significantly larger than we are, have a longer operating history, higher visibility and name recognition, and greater financial resources than we do. We compete with these entities by emphasizing the underlying science, value, and superior quality of our products, the simplicity in our product offerings, and the convenience and financial benefits afforded by our network marketing system and global seamless Compensation Plan.

Our business is driven primarily by our distributors, whom we refer to as Associates. Our ability to compete with other network marketing companies depends, in significant part, on our success in attracting and retaining Associates. There can be no assurance that our programs for attracting and retaining Associates will be successful. The pool of individuals interested in network marketing is limited in each market and is reduced to the extent other network marketing companies successfully attract these individuals into their businesses. Although we believe that we offer an attractive opportunity for our 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.

We believe 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 industry include Herbalife Ltd., Inc.; Nu Skin Enterprises, Inc.; and NBTY, Inc. Based on information that is publicly available, 2011 net sales of the aforementioned companies ranged from \$1.7 billion to \$11.1 billion. There are other manufacturers of competing product lines that have or may launch direct selling enterprises that compete with us in certain product lines and in the recruiting of Associates. There can be no assurance that we will be able to successfully meet the challenges posed by increased competition.

**Product Returns**

Product returns have not been a material factor in our business, totaling approximately 1.1% of net sales in both 2010 and 2011 and 0.8% in 2012. Because our emphasis on customer satisfaction is a hallmark of our business model, our standard policy allows Associates to return any unused product from their first purchase within the first 30 days following their purchase for a 100% refund of the sales price. Thereafter, any 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. According to the terms of the Associate agreement, return of product where the purchase amount exceeds \$100 and was not damaged at the time of receipt by the Associate may result in cancellation of the Associate's

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distributorship. Depending upon the conditions under which product was returned Associates and Preferred Customers may either receive a refund based on their original form of payment, or credit on account for a product exchange. This standard policy differs slightly in a few of our international markets due to the regulatory environment in those markets.

**Major Customers**

Sales are made to independent Associates and Preferred Customers. No single customer accounted for 10% or more of net sales. Notwithstanding the foregoing, the nature of our business model results in a significant amount of sales to several different Associate leaders and their downline sales organizations. Although no single Associate accounted for 10% or more of our net sales, the loss of a key Associate leader or that Associate's downline sales organization could adversely affect our net sales and our overall operating results.

**Compliance by Associates**

We continually monitor and review our Associates' compliance with our policies and procedures as well as the laws and regulations applicable to our business around the world. Part of this review entails an assessment of our Associates' sales activities to ensure that Associates are actually selling products to consumers. Our policies and procedures require Associates to present our products and the USANA opportunity ethically and honestly. Associates are not permitted to make claims about our products or Compensation Plan that are not consistent with our policies and procedures and applicable laws and regulations. The majority of our Associates must use marketing and promotional materials provided by USANA. Associates who have achieved a certain leadership threshold are permitted, however, to produce their own marketing and promotional materials, but only if such materials are approved by USANA prior to use.

From time to time, some Associates fail to adhere to our policies and procedures. We systematically review reports of alleged Associate misbehavior. Infractions of the policies and procedures are reported to our compliance group, who determine what disciplinary action is warranted in each case. More serious infractions are reported to our Compliance Committee, which includes USANA executives. If we determine that an Associate has violated any of our policies and procedures, we may take a number of disciplinary actions, 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 in our discretion, including termination of the Associate's purchase and distribution rights.

We believe that Associate compliance is critical to the integrity of our business, and, therefore, we are aggressive in ensuring that our Associates comply with our policies and procedures. As explained above, when an Associate fails to comply with our policies and procedures, we may terminate their purchase and distribution rights. From time to time, we become involved in litigation with Associates whose purchase and distribution rights have been terminated. We consider such litigation to be routine and incidental to our business and will continue to be aggressive in ensuring that our Associates comply with our policies and procedures.

**Information Technology**

We believe that the ability to efficiently manage distribution, compensation, manufacturing, inventory, and communication functions through the use of sophisticated and dependable information processing systems is critical to our success. Our information technology resources are maintained primarily by our in-house staff to optimally support our customer base and core business processes.

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Our IT staff manages an array of systems and processes which support our global operations 24 hours a day and 365 days a year. Three of our most critical applications include:

A web-based application that provides online services to Associates, such as training sessions and presentations, online shopping, enrollment, real-time reporting engine, Company and product information, web-hosting, email, and other tools to help Associates effectively manage their business and down-line organizations.

A web-based order-entry system that handles order entry, customer information, compensation, the hierarchy of Associates, returns, invoices, and other transactional-based processes.

A fully integrated world-wide Enterprise Resource Planning ("ERP") system that handles accounting, human resources, inventory management, production processes, quality assurance, and reporting requirements in a multinational environment.

Our web applications are supported by a clustered environment and a redundant system outside of our home office, which serves as a disaster recovery site.

**Regulatory Matters**

*Product Regulation.* Numerous governmental agencies in the United States and other countries regulate the manufacturing, packaging, labeling, advertising, promoting, distributing, and the selling of nutrition, health, beauty, and weight-management products. In the United States, advertisement of our products is regulated by the Federal Trade Commission ("FTC") under the FTC Act and, where such advertising is considered to be product labeling by the FDA, under the Food, Drug, and Cosmetic Act ("FDCA") and the regulations thereunder. USANA products in the U.S. are also subject to regulation by, among others, the Consumer Product Safety Commission, the U.S. Department of Agriculture, and the Environmental Protection Agency. The manufacturing, labeling, and advertising of our products are also regulated by various governmental agencies in each country in which they are distributed. For example, in Australia, product registration, labeling and manufacturing is regulated by the TGA and, in Japan, the Ministry of Health, Labor and Welfare. In China, the State Food and Drug Administration ("SFDA") regulates product registration, labeling and manufacturing.

Our largest selling product group includes products that are regulated as dietary supplements under the FDCA. Dietary supplements are also regulated in the United States under the Dietary Supplement Health and Education Act of 1994 ("DSHEA"), which we believe is generally favorable to the dietary supplement industry. Some of our powdered drink, food bar, and other nutrition products are regulated as foods under the Nutrition Labeling and Education Act of 1990 ("NLEA"). The NLEA establishes requirements for ingredient and nutritional labeling including product labeling claims.

The manufacture of nutritional or dietary supplements and related products in the United States requires compliance with dietary supplement GMPs, which are based on the food-model GMPs and Pharmaceutical GMP's, with additional requirements that are specific to dietary supplements. We believe our manufacturing processes comply with these GMPs for dietary supplements.

In general, our personal care products, which are regulated as cosmetic products by the FDA, are not subject to pre-market approval by that agency. Cosmetics, however, are subject to regulation by the FDA under the FDCA 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 sunscreens, are regulated as drugs. Over-the-counter ("OTC") drug products, including cosmetics, 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

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Application ("NDA") before marketing may begin. 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 is not included in a final monograph that is applicable to one of our OTC drug products, we would be required 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 such product.

Advertising of our products in the U.S. is subject to regulation by the FTC under the FTC Act. 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, we are required to have adequate substantiation for all material advertising claims that we make for our products in the U.S.

In recent years, the FTC has initiated numerous investigations of and actions against companies that sell dietary supplement, weight-management, and cosmetic products. The FTC has issued guidance to assist companies in understanding and complying with its substantiation requirement. We believe that we have adequate substantiation for all material advertising claims that we make for our products in the U.S., and we believe that we have organized the documentation to support our advertising and promotional practices in compliance with these guidelines. However, no assurance can be given that the FTC would reach the same conclusion if it were to review or question our substantiation for our advertising claims in the U.S.

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. Although, to our knowledge, we have not been the subject of any action by the FTC, no assurance can be given that the FTC will not question our advertising or other operations in the U.S. in the future. Any action in the future by the FTC could materially and adversely affect our ability to successfully market our products in the U.S.

The Dietary Supplement & Nonprescription Drug Consumer Protection Act requires manufacturers of dietary supplement and over-the-counter products to notify the FDA when they receive reports of serious adverse events occurring within the United States. We have an internal adverse event reporting system that has been in place for several years and believe that we are in compliance with this law.

In markets outside the United States, prior to commencing operations or marketing products, we may be required to obtain approvals, licenses, or certifications from a country's Food Administration, 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. We must also comply with local product labeling and packaging regulations that vary from country to country. For example, China extensively regulates the registration, labeling and marketing of our products. In China, our nutritional products are typically classified as "health foods" and our personal care products are typically classified as "non-special use cosmetics". The registration process for health foods is complex and generally requires extensive analysis and approval by the SFDA. As a result, it may take several years to register a product as a health food in China. We continue to work through the registration process for other health food products, which we also hope to begin selling through BabyCare in the future.

We 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. Future changes could include requirements for the

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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 operating results.

*Network Marketing Regulation.* Laws and regulations in each country in which we operate prevent the use of deceptive or fraudulent practices that have sometimes been inappropriately associated with legitimate direct selling and network marketing activities. 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 on investments in the organizations or on other criteria or activity that are not related to retail sales. Where required by law, we obtain regulatory approval of our network marketing system, or, where approval is not required or available, the favorable opinion of local counsel as to regulatory compliance.

In addition to the FTC, each state has enacted its own "Little FTC Act" to regulate sales and advertising. Occasionally, we receive requests to supply information regarding our 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 our network marketing program is compliant with the 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 compliant with applicable laws and regulations. Failure by an Associate or by us to comply with these laws and regulations could have a material adverse effect on our business in a particular market or in general.

The direct selling laws and regulations in China require us to operate under a business model, which is different from our global business model. In China, we operate through BabyCare's business model, which has been designed specifically for China. China's direct selling regulations contain both financial and operational restrictions for direct selling companies. Additionally, BabyCare is required to obtain various licenses and approvals to conduct its direct selling business in China. BabyCare has been granted a license to engage in direct selling activities in the municipalities of Beijing, Jiangsu, Shaanxi, and Tianjin and continues working to obtain similar licenses in other cities and provinces. These licenses allow BabyCare to operate under its direct selling business model in the approved provinces by utilizing non-employee sales representatives to sell products away from fixed retail locations. In cities and provinces where BabyCare has not been issued a direct selling license, it must operate under a retail and wholesale sales model. Under this model, BabyCare utilizes non-employee sales representatives to sell its products through retail stores in the applicable city or province. BabyCare has also engaged independent service providers that meet both the requirements to operate their own business under Chinese law as well as the conditions set forth by BabyCare to sell products and provide services to BabyCare customers. If, and when, BabyCare receives a direct selling license in additional cities and provinces, it will continue to transition away from this retail model and integrate its direct selling business model in these cities and provinces.

We cannot predict the nature of any future law, regulation, interpretation, or application, nor can we predict what effect additional governmental legislation or regulations, judicial decisions, or administrative orders, when and if promulgated, would have on our business. It is possible that future legal requirements may require that we revise our network marketing program. Such new requirements could have a material adverse effect on our business, financial condition, and operating results.

*Transfer Pricing Regulation.* In the U.S. and many other countries, we are subject to transfer pricing and other tax regulations that are designed to ensure that appropriate levels of income are reported by our U.S. or international entities and are taxed accordingly. We have adopted transfer

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prices, which are supported by a formal transfer pricing study for the sale of products to our subsidiaries in accordance with applicable transfer pricing laws. In addition, we have entered into agreements with our subsidiaries for services and other contractual obligations, such as the payment of Associate incentives that are also supported by the same formal transfer pricing study. If the U.S. Internal Revenue Service or the taxing authorities of any other jurisdiction were to successfully challenge these agreements or require changes in our standard transfer pricing practices for products, we could become subject to higher taxes and our earnings may be adversely affected. The tax treaties between the U.S. and most countries provide competent authority for relief to avoid any double taxation. We believe that we operate in compliance with all applicable transfer pricing regulations. There can be no assurance, however, that we will continue to be found to be operating in compliance with transfer pricing regulations or that those laws will not be modified, which may require that we change our operating procedures.

**Intellectual Property**

*Trademarks.* We have developed and we use registered trademarks in our business, particularly relating to our corporate and product names. We own 17 trademarks that are registered with the United States Patent and Trademark Office. 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 have filed applications and own trademark registrations, and we intend to register additional trademarks in countries where USANA products are or may be sold in the future. Protection of registered trademarks in some jurisdictions may not be as extensive as the protection in the United States.

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

*Trade Secrets.* We own certain intellectual property, including trade secrets that we seek to protect, in part, through confidentiality agreements with employees and other parties. 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. Our proprietary product formulations are generally considered trade secrets, but are not otherwise protected under intellectual property laws.

*Patents.* We have three U.S. patents. Two of our patents relate to the method of extracting an antioxidant from olives and the byproducts of olive oil production. These patents were issued in 2002 and will continue in force until December 20, 2019. In 2003, we entered into a licensing agreement with a supplier to make olive extract using our patented process. Our third patent relates to a method of self-preserving our Sensé line of personal care products. This patent was issued in May 2007 and will continue in force until August 5, 2024.

We intend to protect our legal rights concerning intellectual property by all appropriate legal action. Consequently, we 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 management and technical personnel.



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**Seasonality**

Although we are not significantly affected by seasonality, we do experience slight variations in the activity of our Associates in many of our markets in the first and fourth quarters around major cultural events such as Chinese New Year and Christmas.

**Backlog**

Our products are typically shipped within 72 hours after receipt of an order. As of March 1, 2013 we had no significant backlog of orders.

**Working Capital Practices**

We maintain sufficient amounts of inventory in stock in order to provide a high level of service to our Associates and Preferred Customers. Substantial inventories are required to meet the needs of our dual role as manufacturer and distributor. We also watch seasonal commodity markets and may buy ahead of normal demand to hedge against cost increases and supply risks.

**Environment**

We are not aware of any instance in which we have contravened federal, state, or local laws relating to protection of the environment or in which we otherwise may be subject to liability for environmental conditions that could materially affect operations.

**Employees**

As of March 1, 2013 we had approximately 1,330 employees worldwide, as measured by full-time equivalency. Our employees are not currently represented by a collective bargaining agreement, and we have not experienced work stoppages as a result of labor disputes. We believe that we have a good relationship with our employees.

**Additional Available Information**

We maintain executive offices and principal facilities at 3838 West Parkway Boulevard, Salt Lake City, Utah 84120. Our telephone number is (801) 954-7100. We maintain a World Wide Web site at [www.usanahealthsciences.com](http://www.usanahealthsciences.com). The information on our web site should not be considered part of this report on Form 10-K.

We make available, free of charge at our corporate web site, copies of our annual reports on United States Securities and Exchange Commission ("SEC") Form 10-K, quarterly reports on SEC Form 10-Q, current reports on SEC Form 8-K, proxy statements, and all amendments to these reports, as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC pursuant to Section 13(a) or 15(d) of the Exchange Act. This information may also be obtained from the SEC's on-line database, which is located at [www.sec.gov](http://www.sec.gov).

**Item 1A. Risk Factors**

**Forward-Looking Statements and Certain Risks**

*We encounter substantial risks in our business, any one of which may adversely affect our business, results of operations or financial condition. The fact that some of these risk factors may be the same or similar to those that we have filed with the Securities and Exchange Commission in past reports, means only that the risks are present in multiple periods. We believe that many of the risks that are described here are part of doing business in the industry in which we operate and will likely be present in all periods. The fact that certain risks are endemic to the industry does not lessen their significance. These risk factors should be*

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*read together with the other items in this report, including Item 1, "Business," and Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations." 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 are dependent upon an independent sales force and we do not have direct control over the marketing of our products.** We rely on non-employee, independent Associates to market and sell our products and to generate our sales. Associates typically market and sell our products on a part-time basis 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 to provide motivational support to our Associates. We rely primarily upon our Associates to attract, train and motivate new Associates. Our sales are directly dependent upon the efforts of our Associates. Our ability to maintain and increase sales in the future will depend in large part upon our success in increasing the number of new Associates, retaining and motivating our existing Associates, and in improving the productivity of our Associates. Moreover, our ability to continue to attract and retain Associates can be affected by a number of factors, some of which are beyond our control, including:

General business and economic conditions;

Adverse publicity or negative misinformation about us or our products;

Public perceptions about network marketing programs;

High-visibility investigations or legal proceedings against network marketing companies by federal or state authorities or private citizens;

Public perceptions about the value and efficacy of nutritional, personal care, or weight management products generally;

Other competing network marketing organizations entering into the marketplace that may recruit our existing Associates or reduce the potential pool of new Associates; and

Changes to the Compensation Plan required by law or implemented for business reasons that make attracting and retaining Associates more difficult.

We can provide no assurance that the number of Associates will increase or remain constant or that their productivity will increase. Our Associates may terminate their services at any time, and, like most direct selling companies, we experience a high turnover among new Associates from year to year. In previous fiscal years, we have experienced both increases and declines in our overall number of active Associates. A few of our mature markets, however, including the United States, have experienced a decline in the number of active Associates for several years. If our initiatives for 2013 do not drive growth in our Associate numbers, particularly in the United States and other markets where our Associate numbers have declined, our operating results could be harmed. We cannot accurately predict any fluctuation in the number and productivity of Associates because we primarily rely upon existing Associates to sponsor and train new Associates and to motivate new and existing Associates. Our operating results in other markets could also be adversely affected if we and our existing Associates do not generate sufficient interest in our business to successfully retain existing Associates and attract new Associates.

**Our Hong Kong market accounts for a significant part of our business. Any decline in sales or customers in this market, without a corresponding increase in sales and customers in our China market through BabyCare, would harm our business, financial condition and results of operations.** Over the past few years, the majority of our sales and Associate growth has occurred in our Hong Kong market, which represented 27.9% of our net sales in 2012. Following our acquisition of BabyCare in China, we announced that we would shift our international attention to growing our business in

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China. As a result of this strategy, we will likely experience a decline in sales and/or customers in our Hong Kong market. Any decline in the performance of our Hong Kong market without a corresponding increase in the performance in China would harm our business, financial condition and results of operations. We must comply with significant legal and regulatory requirements to engage in direct selling in China and use a separate compensation plan for our Associates in China. Although we believe that, in light of our successful Asian Associate base, we will be successful in growing our business in China, it is difficult to assess the extent to which our Chinese business model and Associate compensation plan will be accepted or successful in that market. Although we are required to conduct our operations in China through BabyCare, we believe that our long-term success in China will depend on our ability to successfully integrate, to the extent possible, our operations with BabyCare's operations. This includes, among other things, continuing to register current and future USANA products, in a timely manner, for sale in China and educating our Associates on our Compensation Plan in China. In light of the factors listed above, and the other risks to our business, there can be no assurance that we will not experience a decline in sales and/or customers in our Hong Kong market or that we will be successful in growing sales and customers in China.

**Difficult economic conditions may adversely affect our business.** Over the past few years, economic conditions in many of the markets where we sell our products have resulted in challenges to our business. This is particularly true in our North America region, where, although we have seen a recent improvement, we continue to experience difficulty generating meaningful growth. We cannot predict whether world or market specific economies will improve or deteriorate in the future. If difficult economic conditions continue or worsen, we could experience declines in net sales, profitability and cash flow due to lower demand for our products or other factors caused by economic challenges faced by our customers, potential customers or suppliers. Additionally, these conditions may result in a material adverse effect on our liquidity and capital resources or otherwise negatively impact our operations or overall financial condition.

**The loss of a significant USANA Associate or downline sales organization could adversely affect our business.** We rely on the successful efforts of our Associates that become leaders within our Compensation Plan. Our Compensation Plan is designed to permit Associates to sponsor new Associates, creating multiple "business centers," or levels in the downline organization. Sponsored Associates are referred to as "downline" Associates within the sponsoring Associate's "downline network." If these downline Associates in turn sponsor new Associates, additional business centers are created, with the new downline Associates becoming part of the original sponsoring Associate's downline network. As a result of this network marketing system, Associates develop business relationships with other Associates. The loss of a key Associate or group of Associates, large turnover or decreases in the size of the key Associate force, seasonal or other decreases in purchase volume, sales volume reduction, the costs associated with training new Associates, and other related expenses may adversely affect our business, financial condition, or results of operations.

**Our Associate Compensation Plan, or changes we make to it, may be viewed negatively by some Associates, could fail to achieve our desired objectives, and could have a negative impact on our business.** Our line of business is highly competitive and sensitive to the introduction of new competitors, new products and/or new distributor compensation plans. Network marketing companies commonly attempt to attract new distributors by offering generous distributor compensation plans. From time to time, we modify components of our Compensation Plan in an effort to (i) keep it competitive and attractive to existing and potential Associates, (ii) cause or address a change in Associate behavior, (iii) incent Associates to grow our business, (iv) conform to legal and regulatory requirements, and (v) address other business needs. In light of the size and diversity of our Associate force and the complexity of our Compensation Plan, it is difficult to predict how any changes to the plan will be viewed by Associates and whether such changes will achieve their desired results. For example, in 2012, we made changes to the matching bonus component of our Compensation Plan in an

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effort to make it a more long-term focused incentive and to make it successful in all of our regions. Our old matching bonus program was successful in certain of our Asia Pacific markets, but was unsuccessful in North America. In 2010, we also made changes to our Compensation Plan to encourage more entrepreneurial Associates to join the Company and build a sales organization at an accelerated pace. While these changes successfully caused us to enroll more entrepreneurial Associates, they have made it more challenging for us to enroll Associates in general, including those who simply consume our products and are less entrepreneurial. As a result, our Associate counts have decreased in many of our markets, including North America. There can be no assurance that our Associate Compensation Plan will allow us to successfully attract new Associates or retain existing Associates, nor can we assure that any changes we make to our Compensation Plan will achieve our desired results.

**The violation of marketing or advertising laws by Associates in connection with the sale of our products or the improper promotion of our Compensation Plan could adversely affect our business.** All Associates sign a written contract and agree to adhere to our policies and procedures. Although these policies and procedures prohibit Associates from making false, misleading and other improper claims regarding products or income potential from the distribution of the products, Associates may, from time to time, without our knowledge and in violation of our policies, 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. These violations may result in legal action against us by regulatory agencies, state attorneys general, or private parties. Legal actions against our Associates or others who are 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 the activities of our Associates to guard against misrepresentation and other illegal or unethical conduct by Associates and to assure that the terms of our policies and procedures and Compensation Plan are observed. There can be no assurance, however, that our efforts in this regard will be sufficient to accomplish this objective, particularly in times/regions where we may experience rapid growth. Adverse publicity resulting from such activities could 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.

**Legal action by former Associates or third parties against us could harm our business.** We continually monitor and review our Associates' compliance with our policies and procedures as well the laws and regulations applicable to our business. From time to time, some Associates fail to adhere to our policies and procedures. If this happens, we may take disciplinary action against the particular Associate. This disciplinary action is based on the facts and circumstances of the particular case and may include anything from warnings for minor violations to termination of an Associate's purchase and distribution rights for more serious violations. From time to time, we become involved in litigation with an Associate whose purchase and distribution rights have been terminated. We consider this type of litigation to be routine and incidental to our business. While neither the existence nor the outcome of this type of litigation is typically material to our business, in the past we have been involved in litigation of this nature that resulted in a large cash award against the Company. Our competitors have also been involved in this type of litigation, and in some cases class actions, where the result has been a large cash award against the competitor or a large cash settlement by the competitor. These types of challenges, awards or settlements could provide incentives for similar actions by other former Associates against us in the future. Any such challenge involving us or others in our industry could harm our business by resulting in fines or damages against us, creating adverse publicity about us or our industry, or hurting our ability to attract and retain customers. We believe that Associate compliance is critical to the integrity of our business, and, therefore, we will continue to be aggressive in ensuring that our Associates comply with our policies and procedures. As such, there can be no assurance that this type of litigation will not occur again in the future or result in an award or settlement that has a materially adverse effect on our business.

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**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 sell some of our products in certain markets.** Network marketing systems, such as ours, are frequently subject to laws and regulations, both in the U.S. and internationally, that are 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 on investment in the sponsoring company. Regulatory authorities, in one or more of our present or future markets, could determine that our network marketing system does not comply with these laws and regulations or that it is prohibited. Failure to comply with these laws and regulations or such a prohibition could have a material adverse effect on our business, financial condition, or results of operations. Further, we may simply be prohibited from distributing products through a network-marketing channel in some countries, or we may be forced to alter our Compensation Plan.

We are also subject to the risk that new laws or regulations might be implemented or that current laws or regulations might change, which could require us to change or modify the way we conduct our business in certain markets. This could be particularly detrimental to us if we had to change or modify the way we conduct business in markets that represent a significant percentage of our net sales. For example, the FTC released a proposed New Business Opportunity Rule in April 2006. As initially drafted, the proposed rule would have required pre-sale disclosures for all business opportunities, which may have included network marketing compensation plans such as ours. However, in March 2008 the FTC issued a revised notice of proposed rulemaking, and, in December 2011, the FTC issued its final rule. This final rule does not attempt to cover multi-level marketing companies.

**We may have or incur obligations relating to the activities of our Associates.** Our Associates are subject to taxation, and, in some instances, legislation or governmental agencies impose an obligation on us to collect taxes, such as sales taxes or value added taxes, and to maintain appropriate records of such transactions. In addition, we are subject to the risk in some jurisdictions of being responsible for social security and similar taxes with respect to our Associates. In the event that local laws and regulations or the interpretation of local laws and regulations change to require us to treat our independent Associates as employees, or if our Associates are deemed by local regulatory authorities in one or more of the jurisdictions in which we operate to be our employees rather than independent contractors, under existing laws and interpretations, we may be held responsible for a variety of obligations that are imposed upon employers relating to their employees, including social security and related taxes in those jurisdictions, plus any related assessments and penalties, which could harm our financial condition and operating results.

**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, regardless of whether those investigations involve us or our Associates or the business practices or products of our competitors or other network marketing companies. In 2007, we were the victim of false statements made to the press and regulatory agencies, causing us to incur significant expense in defending and dispelling the allegations during 2007 and 2008. More recently, in November 2012, we were again the target of false and misleading statements concerning our business practices, particularly in China and Hong Kong. This adverse publicity also adversely impacted the market price of our stock and caused insecurity among our Associates. 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, or results of operations.

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**The loss of key management personnel could adversely affect our business.** Our Founder, Dr. Myron Wentz, is a highly visible spokesman for our products and our business, and our message is based in large part on his vision and reputation, which helps distinguish us from our competitors. Any loss or limitation on Dr. Wentz as a lead spokesman for our mission, business, and products could have a material adverse effect upon our business, financial condition, or results of operations. In addition, our executive officers 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, to compensate our executive officers at attractive levels, and to continue to attract additional qualified individuals to our management team. We cannot guarantee continued service by our key executive officers. We do not maintain key man life insurance on any of our executive officers, nor do we have an employment agreement with any of our executive 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, or results of operations.

**The beneficial ownership of a significant percentage of our common stock gives our founder and parties related to or affiliated with him effective control, and limits the influence of other shareholders on important policy and management issues.** Gull Holdings, Ltd., an entity that is solely owned and controlled by Dr. Wentz, owned 48% of our outstanding common stock at December 29, 2012. By virtue of this stock ownership, Dr. Wentz is able to exert significant influence over the election of the members of our Board of Directors and our business 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 shareholders. In addition, Dr. Wentz also currently serves as Chairman of our Board of Directors and his son, David Wentz, is our Chief Executive Officer. There can be no assurance that conflicts of interest will not arise with respect to these relationships or that conflicts will be resolved in a manner favorable to other shareholders of the Company.

**Sales by our shareholders of a substantial number of shares of our common stock in the public market could adversely affect the market price of our common stock.** A large number of outstanding shares of our common stock are held by several of our principal shareholders. If any of these principal shareholders were to decide to sell large amounts of stock over a short period of time such sales could cause the market price of our common stock to decline.

**Our stock price has been volatile and subject to various market conditions.** There can be no assurance that an active market in our stock will be sustained. The trading price of our common stock has been subject to wide fluctuations. We have a relatively small public float compared to the number of our shares outstanding. Accordingly, we cannot predict the extent to which investors' interest in our common stock will provide an active and liquid trading market. Due to our limited public float, we are vulnerable to investors taking a "short position" in our common stock, which is likely to have a depressing effect on the price of our common stock and add increased volatility to our trading market. The price of our common stock also may fluctuate in the future in response to quarter-to-quarter variations in operating results, material announcements by us or our competitors, governmental regulatory action, conditions in the nutritional supplement industry, negative publicity, or other events or factors, many of which are beyond our control. In addition, the stock market has historically experienced significant price and volume fluctuations, which have particularly affected the market prices of many dietary and nutritional supplement companies and which have, in certain cases, not had a strong correlation to the operating performance of these companies. Our operating results in future quarters may be below the expectations of securities analysts and investors. If that were to occur, the price of our common stock would likely decline, perhaps substantially.

**Our products and manufacturing activities are subject to extensive government regulation, which could limit or prevent the sale of our products in some markets.** The manufacture, packaging, labeling, advertising, promotion, distribution, and sale of our products are subject to regulation by

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numerous national and local governmental agencies in the United States and other countries, including the U.S. Food and Drug Administration ("FDA") and the U.S. Federal Trade Commission ("FTC"). For example, failure to comply with FDA regulatory requirements may result in, among other things, injunctions, product withdrawals, recalls, product seizures, fines, and criminal prosecutions. Any action of this type by the FDA could materially adversely affect our ability to successfully market our products. With respect to FTC matters, if the FTC has reason to believe the law is being violated (e.g., failure to possess adequate substantiation for product claims), it can initiate an enforcement action. The FTC has a variety of processes and remedies available to it for enforcement, both administratively and judicially, including compulsory process authority, cease and desist orders, and injunctions. FTC enforcement could result in orders requiring, among other things, limits on advertising, consumer redress, divestiture of assets, rescission of contracts, or such other relief as may be deemed necessary. Violation of these orders could result in substantial financial or other penalties. Any action against us by the FTC could materially and adversely affect our ability to successfully market our products.

The manufacture of nutritional or dietary supplements and related products in the United States requires compliance with dietary supplement GMPs, which are based on the food-model GMPs, with additional requirements that are specific to dietary supplements. We believe our manufacturing processes comply with these GMPs for dietary supplements. Nevertheless, any action by the FDA which determined that our processes were non-compliant with dietary supplement GMPs, could materially adversely affect our ability to manufacture and market our products. Additionally, the Dietary Supplement & Nonprescription Drug Consumer Protection Act requires manufacturers of dietary supplement and over-the-counter products to notify the FDA when they receive reports of serious adverse events occurring within the United States. Potential FDA responses to any such report could include injunctions, product withdrawals, recalls, product seizures, fines, or criminal prosecutions. We have an internal adverse event reporting system that has been in place for several years and believe that we are in compliance with this new law. Nevertheless, any action by the FDA in response to a serious adverse event report that may be filed by us could materially and adversely affect our ability to successfully market our products.

In markets outside the United States, prior to commencing operations or marketing our products, we may be required to obtain approvals, licenses, or certifications from a country's ministry of health or a comparable agency. For example, our manufacturing facility has been registered with the FDA and Health Canada and is certified by Australia's TGA. Approvals or licensing may be conditioned on reformulation of products or may be unavailable with respect to certain products or product ingredients. We must also comply with product labeling and packaging regulations that vary from country to country. These activities are also subject to regulation by various agencies of the countries in which our products are sold.

We 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, could have on our business. These potential effects could include, however, requirements for the reformulation of certain products to meet new standards, the recall or discontinuance of certain products, additional record keeping and reporting requirements, expanded documentation of the properties of certain products, expanded or different labeling, or additional scientific substantiation. Any or all of these requirements could have a material adverse effect on our business, financial condition, or results of operations.

**Risks associated with operating in international markets could restrict our ability to expand globally and harm our business and prospects, and we could be adversely affected by our failure to comply with the laws applicable to our foreign activities, including the U.S. Foreign Corrupt Practices Act and other similar worldwide anti-bribery laws.** Our international operations are presently conducted in various foreign countries, and we expect that the number of countries in which we

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operate could expand over the next few years. Economic conditions, including those resulting from wars, civil unrest, acts of terrorism and other conflicts or volatility in the global markets, may adversely affect our customers, their demand for our products and their ability to pay for our products. In addition, there are numerous risks inherent in conducting our business internationally, including, but not limited to, potential instability in international markets, changes in regulatory requirements applicable to international operations, currency fluctuations in foreign countries, political, economic and social conditions in foreign countries and complex U.S. and foreign laws and treaties, including tax laws and the U.S. Foreign Corrupt Practices Act (FCPA). These risks could restrict our ability to sell products to or to obtain international customers or to operate our international business profitably, and our overall business and results of operations could be negatively impacted by our foreign activities.

The FCPA and similar anti-bribery laws in other jurisdictions prohibit U.S.-based companies and their intermediaries from making improper payments to government officials for the purpose of obtaining or retaining business. We pursue opportunities in certain parts of the world that experience government corruption, and in certain circumstances, compliance with anti-bribery laws may conflict with local customs and practices. Our policies mandate compliance with all applicable anti-bribery laws. Further, we require our partners, subcontractors, agents and others who work for us or on our behalf to comply with the FCPA and other anti-bribery laws. Although we have policies and procedures designed to ensure that we, our employees, our agents and others who work with us in foreign countries comply with the FCPA and other anti-bribery laws, there is no assurance that such policies or procedures will protect us against liability under the FCPA or other laws for actions taken by our agents, employees and intermediaries. If we are found to be liable for FCPA violations (either due to our own acts or our inadvertence, or due to the acts or inadvertence of others), we could incur severe criminal or civil penalties or other sanctions, which could have a material adverse effect on our reputation, business, results of operations or cash flows. In addition, detecting, investigating and resolving actual or alleged FCPA violations is expensive and could consume significant time and attention of our senior management.

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

In many market areas, other network marketing companies already have significant market penetration, the effect of which could be to desensitize the local Associate population to a new opportunity, such as USANA, or to make it more difficult for us to attract qualified Associates. Even if



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we are able to commence operations in new markets, there may not be a sufficient population of persons who are interested in our network marketing system. We believe our future success will depend in part on our ability to seamlessly integrate our Compensation Plan across all markets where legally permissible. There can be no assurance, however, that we will be able to utilize our Compensation Plan seamlessly in all existing or future markets. For example, in August 2010, we indirectly acquired BabyCare, a nutritional supplement company that is now licensed by the government of China to engage in direct selling in the Municipalities of Beijing, Jiangsu, Shaanxi, and Tianjin. In accordance with Chinese law, we utilize a compensation plan that has been designed specifically for China and implemented by BabyCare separately from our Compensation Plan in our other markets.

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

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

**Chinese regulations prevent persons who are not Chinese nationals from engaging in direct selling in China.** We cannot guarantee that any of our Associates living outside of China or any of our sales representatives or independent Associates in China have not engaged or will not engage in activities that violate our policies in this market, or that violate Chinese law or other applicable law, and therefore result in regulatory action and adverse publicity, which would harm our business in China.

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

Chinese authorities deem our corporate activities as violating applicable Chinese laws and regulations (including restrictions on foreign investments);

Chinese regulatory authorities change applicable laws and regulations or impose additional requirements and conditions with which we are unable to comply; or

We are found to violate any existing or future Chinese laws or regulations;

the relevant Chinese authorities would have broad discretion to deal with such a violation by levying fines, revoking business licenses, requiring us to restructure our China ownership or operations, and/or

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require us to discontinue some or all of our business in China. Any of these actions would adversely affect our business.

**Our ability to expand our direct selling operations in China is dependent upon the Chinese government granting us additional direct selling licenses.** We will be required to obtain licenses from municipalities and provinces within China where we currently do not hold direct selling licenses. We currently hold four such licenses and we are in the process of applying for licenses in additional jurisdictions within China. If we are unable to obtain additional necessary national and local government approvals in China as quickly as we would like, our ability to expand and grow our business could be negatively impacted. The process for obtaining the necessary government approvals to conduct direct selling continues to evolve. The process is time-consuming and expensive. The complexity of the approval process, as well as the government's continued cautious approach as direct selling develops in China, makes it difficult to predict the timeline for obtaining additional approvals. If the results of the government's evaluation of our direct selling activities result in further delays in obtaining licenses elsewhere, or if the current processes for obtaining approvals are delayed for any reason or are changed or are interpreted differently than currently understood, our ability to expand direct selling in China and our growth prospects in this market, could be negatively impacted. We currently are only allowed by the PRC to sell through direct selling the limited number of products that we manufacture in China. If we wish to sell additional products (other than those already approved) through the direct-selling channel, we must successfully complete a product approval process similar to the process described above. We cannot assure that we will be successful in obtaining such additional product approvals on a timely basis or at all.

**If our operations in China are successful, we may experience rapid growth in China, and there can be no assurances that we will be able to successfully manage rapid expansion of our direct selling activities under license in China or the related manufacturing and retail operations required to support this expansion.** If we are unable to effectively manage such growth and expansion, including expansion of our retail stores, warehouses, and manufacturing operations, our government relations may be compromised and our operations in China may be harmed.

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

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

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

**An increase in the amount of incentives paid to Associates reduces our profitability.** The payment of Associate incentives is our most significant expense. These incentives include commissions, bonuses, and certain awards and prizes. From time to time, we adjust our Compensation Plan to better manage these incentives as a percentage of net sales. We closely monitor the amount of Associate incentives that are paid as a percentage of net sales, and may periodically adjust our Compensation Plan to prevent Associate incentives from having a significant adverse effect on our earnings. There can be no assurance that changes to the Compensation Plan or product pricing will be successful in achieving target levels of Associate incentives as a percentage of net sales. Furthermore, such changes may make it difficult to attract and retain qualified and motivated Associates or cause us to lose some of our longer-standing Associates.

**Our business is subject to the risks associated with intense competition from larger, wealthier, and more established competitors.** We face intense competition in the business of distributing and marketing nutritional supplements, vitamins and minerals, personal care products, and other nutritional products, as described in greater detail in "Business Competition." Numerous manufacturers, Associates, and retailers compete actively for consumers and, in the case of other network marketing companies, for Associates. There can be no assurance that we will be able to compete in this intensely competitive environment. In addition, nutrition and personal care products can be purchased in a wide variety of channels of distribution, including retail stores. Our product offerings in each product category are also relatively small, compared to the wide variety of products offered by many of our competitors.

We are also subject to significant competition from other network marketing organizations for the time, attention, and commitment of new and existing Associates. Our ability to remain competitive depends, in significant part, on our success in recruiting and retaining Associates. There can be no assurance that our programs for recruiting and retaining Associates will be successful. The pool of individuals who may be interested in network marketing is limited in each market, and it is reduced to the extent other network marketing companies successfully recruit these individuals into their businesses. Although we believe we offer 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.

**Taxation and transfer pricing considerations affect our operations.** In many countries, including the United States, we are subject to transfer pricing and other tax regulations that are designed to ensure that appropriate levels of income are reported by our U.S. and foreign entities and are taxed appropriately. Although we believe that we are in compliance with all material regulations and restrictions in this regard, we are subject to the risk that taxing authorities could audit our transfer pricing and related practices and assert that additional taxes are owed. We are also subject to the risk that taxing authorities in any of our markets could change the laws in a manner that may increase our effective tax rate and/or duties on our products. Under tax treaties, we are eligible to receive foreign tax credits in the United States for foreign taxes paid abroad. In the event any audits or assessments are concluded adversely to us, we may or may not be able to offset the consolidated effect of foreign income tax assessments through the use of U.S. foreign tax credits. Currently, we are utilizing all

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foreign tax credits in the year in which they arise. Because the laws and regulations governing U.S. foreign tax credits are complex and subject to periodic legislative amendment, we cannot be sure that we would in fact be able to take advantage of any foreign tax credits in the future. As a result, adverse outcomes in these matters could have a material impact on our financial condition or operating results.

**Fluctuation in the value of currency exchange rates with the U.S. dollar affects our operations and our net sales and earnings.** Over the past several years, a majority of our net sales have been generated outside the United States. Such sales for the year ended December 29, 2012 represented 76.5% of our total net sales. We will likely continue to expand our operations into new markets, exposing us to expanding risks of changes in social, political, and economic conditions, including changes in the laws and policies that govern investment or exchange in these markets. Because a significant portion of our sales are generated outside the United States, exchange rate fluctuations will have a significant effect on our sales and earnings. Further, if exchange rates fluctuate dramatically, it may become uneconomical for us to establish or to continue activities in certain countries. For instance, changes in currency exchange rates may affect the relative prices at which we and our competitors sell similar products in the same market. As our business expands outside the United States, an increasing share of our net sales and operating costs will be transacted in currencies other than the U.S. dollar. Accounting practices require that our non-U.S. financial results be converted to U.S. dollars for reporting purposes. Consequently, our reported net earnings may be significantly affected by fluctuations in currency exchange rates, with earnings generally increasing with a weaker U.S. dollar and decreasing with a strengthening U.S. dollar. Product purchases by our subsidiaries are transacted in U.S. dollars. As our operations expand in countries where transactions may be made in currencies other than the U.S. dollar, our operating results will be increasingly subject to the risks of exchange rate fluctuations and we may not be able to accurately estimate the impact that these changes might have on our future business, product pricing, results of operations, or financial condition. In addition, the value of the U.S. dollar in relation to other currencies may also adversely affect our sales to customers outside the United States. Currently our strategy for reducing our exposure to currency fluctuation includes the timely and efficient repatriation of earnings from international markets and settlement of intercompany transactions. At times in the past we have sought to reduce exposure to fluctuations in currency exchange rates by creating offsetting positions through the use of currency exchange contracts on cash that we repatriate. We did not enter into any such contracts during 2012, but we may look to something like this in the coming year. We do not use derivative instruments for speculative purposes. There can be no assurance that we will be successful in protecting our operating results or cash flows from potentially adverse effects of currency exchange fluctuations. Any such adverse effects could also adversely affect our business, financial condition, or results of operations.

**Disruptions to shipping channels that we use to distribute our products to international warehouses may adversely affect our margins and profitability in those markets.** In the past, we have felt the impact of disruptions to the shipping channels used to distribute our products; these disruptions have included increased port congestion, a lack of capacity on the railroads, and a shortage of manpower. Although we have not recently experienced significant shipping disruptions, we continue to watch for signs of upcoming congestion. Congestion to ports can affect previously negotiated contracts with shipping companies, resulting in unexpected increases in shipping costs and reduction in our net sales.

**The inability to obtain adequate supplies of raw materials for products at favorable prices, or at all, or the inability to obtain certain products from third-party suppliers, could have a material adverse effect on our business, financial condition, or results of operations.** We acquire all of our raw materials for the manufacture of our products from third-party suppliers. Materials used in manufacturing our products are purchased through purchase order, often invoking pre-negotiated annual supply agreements. We have very few long-term agreements for the supply of these materials. We also contract with third-party manufacturers and suppliers for the production of some of our

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products, including most of our gelatin-capsuled supplements, Probiotic, Rev3 Energy Drink, our powdered drink mixes and nutrition bars, and certain of our personal care products. These third-party suppliers and manufacturers produce and, in most cases, package these products according to formulations that have been developed by, or in conjunction with, our in-house product development team. There is a risk that any of our suppliers or manufacturers could discontinue manufacturing our products or selling their products to us. Although we believe that we could establish alternate sources for most of our products, any delay in locating and establishing relationships with other sources could result in product shortages or back orders for products, with a resulting loss of net sales. In certain situations, we may be required to alter our products or to substitute different products from another source. We have, in the past, discontinued or temporarily stopped sales of certain products that were manufactured by third parties while those products were on back order. There can be no assurance that suppliers will provide the raw materials or manufactured products that are needed by us in the quantities that we request or at the prices that we are willing to pay. Because we do not control the actual production of certain raw materials and products, we are also subject to delays caused by any interruption in the production of these materials, based on conditions not within our control, including weather, crop conditions, transportation interruptions, strikes by supplier employees, and natural disasters or other catastrophic events.

**Shortages of raw materials may temporarily adversely affect our margins or our profitability related to the sale of those products.** In the past, we have experienced temporary shortages of the raw materials used in certain of our nutritional products. Although we had identified multiple sources to supply such raw material ingredients, quantities of the materials we purchased during these shortages were at higher prices, which negatively impacted our gross margins for those products. While we periodically experience price increases due