USANA HEALTH SCIENCES INC
Form 10-K
March 13, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 29, 2007

OR

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

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

USANA HEALTH SCIENCES, INC.

(Exact name of registrant as specified in its charter)

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

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

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

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

(Title of each class)	**(Name of each exchange on which registered)**
Common Stock, Par Value $0.001 Per Share	The Nasdaq Stock Market LLC

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

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

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

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

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

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

Large accelerated filer o Accelerated filer ý Non-accelerated filer o Smaller reporting company o

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

There were 16,392,384 shares of the registrant's common stock outstanding as of March 3, 2008. The aggregate market value of common stock held by non-affiliates of the registrant as of June 29, 2007 was approximately $342,758,000.

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 the 2008 Annual Shareholders Meeting.

USANA HEALTH SCIENCES, INC.

FORM 10-K

For the Fiscal Year Ended December 29, 2007

INDEX

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 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 Operation. 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.

PART I

Item 1. Business

General

USANA Health Sciences, Inc. ("We," "USANA" or the "Company") is a Utah corporation, founded in 1992 by Myron W. Wentz, Ph.D., that develops and manufactures high-quality, science-based nutritional and personal care products, with a commitment to continuous product innovation and sound scientific research. We distribute and sell our products internationally through a network marketing system, which is a form of direct selling. Our international markets include Canada, Mexico, Australia, New Zealand, Singapore, Malaysia, Hong Kong, Taiwan, Japan, and South Korea, and direct sales from the United States to the United Kingdom and the Netherlands. 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 their personal use and are not permitted to resell or to distribute the products. As of December 29, 2007, we had 176,000 active Associates and 78,000 active Preferred Customers worldwide. For purposes of this report, we only count as "active" those Associates and Preferred Customers who have purchased product from USANA at any time during the most recent three-month period. Our net sales in fiscal year 2007 were $423.1 million, of which 87% was generated by Associates, and 13% by Preferred Customers.

Associates are encouraged to build and manage their own sales force by recruiting, managing, and training others to sell our products, and they are compensated on sales generated by their business group. Associates can also receive compensation by purchasing products at wholesale prices and selling them at retail prices. We believe that network marketing is an effective way to distribute our products because it allows person-to-person product education, which is not readily available through traditional distribution channels. This personal touch may enhance consumers' awareness of the health benefits of our products, as well as motivate them to live and support a healthier lifestyle. Additionally, we feel that network marketing appeals to a broad cross-section of people, particularly those seeking to supplement their income, start a home-based business, or pursue entrepreneurial opportunities other than conventional full-time employment. We consider our high-quality products, compact product lines, the rewarding USANA Associate compensation plan (the "Compensation Plan"), distributor support and recognition, and weekly Associate incentive payments to be attractive components of the USANA network marketing system.

We sell products from two primary product lines: USANA® Nutritionals, which includes high-quality supplements and functional foods, and Sensé beautiful science® (Sensé), a unique line of skin and personal care products. We also offer sales and marketing tools that are designed to assist our Associates in building their businesses and in selling our products, as well as combination packs, which include a variety of products from each product line. In 2007, the USANA Nutritionals and Sensé product lines represented approximately 87% and 10%, respectively, of our total product sales. Sales from other items, the majority of which include marketing and sales tools, accounted for the remaining 3% of total product sales. We limit our product lines to include only science-based products that we believe can provide health benefits to a significant percentage of our customers. Additionally, while not required, our products are designed, manufactured, packaged, and labeled at levels that we believe are consistent with the more rigorous pharmaceutical standards.

From July 2003 through August 2007, we also operated a third-party contract manufacturing business at a facility located in Draper, Utah, which we historically disclosed as a separate reportable business segment. We acquired the contract manufacturing business as part of a vertical integration strategy to manufacture and package our Sensé line of skin and beauty care products. On August 10, 2007, we sold our third-party contract manufacturing business in order to focus on our direct selling business. We retained the assets that are associated with manufacturing and packaging our Sensé

products. We currently lease space from the Draper facility, where we continue to manufacture and package our Sensé products. As a result of the sale of the third-party contract manufacturing business, we now consider our operations to be a single reportable segment: Direct Selling.

Products

Our primary product lines consist of USANA® Nutritionals and Sensé . The USANA® Nutritionals product line is further categorized into three separate classifications: Essentials, Optimizers, and Macro-Optimizers.

USANA® Nutritionals

The Essentials include core vitamin and mineral supplements that provide a foundation of advanced nutrition for every age group. To help meet the "essential" nutrient needs of children and teens during the years of development, when good nutrition is especially important, USANA offers: Usanimals , a formulation of vitamins, minerals, and antioxidants, in an easy-to-take, chewable tablet for children who are 13 months to 12 years old; and Body Rox , a nutritional supplement containing 31 essential vitamins, minerals, antioxidants, and cofactors for adolescents who are 12 to 18 years old. USANA® Essentials for adults consists of two products: Mega Antioxidant, a balanced, high-potency blend of 30 vitamins, antioxidants, and other important nutrients to support cellular metabolism and to counteract free-radical damage; and Chelated Mineral, a complete spectrum of essential minerals, in balanced, highly absorbable forms. The USANA® Essentials are also a part of the HealthPak 100 , a convenient pillow pack that also includes some key Optimizers. During the third quarter of 2007, we introduced a new product concept for our customers called MyHealthPak . This concept offers a fully customizable packaging system for our supplement products that allows customers to create their own personalized selection of our full line of nutritional supplements in a pillow pack that is similar to our HealthPak 100 product.

Optimizers are more targeted supplements that are designed to meet individual health and nutritional needs. Products in this category include Proflavanol®, Poly C®, Procosa® II, CoQuinone® 30, BiOmega-3 , E-Prime , BodyRox Active Calcium Chewable, Active Calcium , PhytoEstrin , Palmetto Plus , Ginkgo-PS , Garlic EC , Visionex®, OptOmega®, Hepasil DTX , and TenX Antioxidant Blast.

The Macro Optimizers include healthy, low-glycemic functional foods and other related products: Nutrimeal , Fibergy®, and SoyaMax drink mixes, as well as Nutrition and Fibergy Bars . Our RESET weight management program and the accompanying RESET kit are also part of the Macro-Optimizers. The RESET kit is conveniently packaged in a self-contained box with all of the USANA products that are needed to complete a five-day regimen, which is designed to assist adults in losing weight and in beginning a positive, long-term change in their diet.

Sensé beautiful science®

The Sensé product line includes premium, science-based, personal care products that support healthy skin and hair by providing advanced topical nourishment, moisturization, and protection. These products 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. Products in this line include Perfecting Essence, Gentle Daily Cleanser, Hydrating Toner, Daytime Protective Emulsion, Eye Nourisher, Night Renewal, Serum Intensive, Rice Bran Polisher, Crème Masque, Revitalizing Shampoo, Nourishing Conditioner, Firming Body Nourisher, Energizing Shower Gel, and Intensive Hand Therapy.

All Other

In addition to these principal product lines, we develop and sell materials and online tools that are designed to assist our Associates in building their businesses and in marketing our products. These resource materials and sales tools include product brochures and business forms that are designed by us and are printed by outside publishers. In addition, we occasionally provide reprints of other commercial publications that feature USANA and may be used as a sales tool. We also periodically contract with authors and publishers to produce or provide books, tapes, and other items that deal with health topics and personal motivation, which we then sell to our Associates. New Associates are required to purchase a starter kit, which contains USANA training materials that help them to build their businesses. Associates do not earn commissions on the sale of starter kits or sales tools.

The following table summarizes the approximate percentages of total product sales that were contributed by our major product lines for the last three fiscal years:

	Year Ended		
	2005	2006	2007
USANA® Nutritionals			
Essentials*	38%	37%	36%
Optimizers	34%	34%	38%
Macro Optimizers	10%	13%	13%
Sensé beautiful science®	15%	11%	10%
All Other	3%	5%	3%

* The Essentials category (under the USANA® Nutritionals) includes USANA Essentials , HealthPak 100 , Body Rox , and Usanimals .

Key Products

The following table highlights sales data for our top-selling products as a percentage of total product sales for the last three fiscal years.

	Year Ended		
	2005	2006	2007
USANA® Essentials	22%	21%	20%
HealthPak 100	13%	14%	13%
Proflavanol®	10%	9%	10%

Geographic Presence

Our products are distributed and sold in 13 countries throughout the world. We have historically presented information for these countries in two geographic regions: North America and Asia Pacific. North America included the United States, Canada, Mexico, and direct sales to the United Kingdom and the Netherlands; and Asia Pacific included Australia-New Zealand, Hong Kong, Japan, Taiwan, South Korea, Singapore, and Malaysia. As our international presence has continued to grow, we now present this information in four geographic regions:

North America United States, Canada, Mexico, and direct sales from the United States to the United Kingdom and the Netherlands

Southeast Asia/Pacific Australia-New Zealand, Singapore, and Malaysia*

* We commenced operations in Malaysia in January 2007.

East Asia Hong Kong and Taiwan

North Asia Japan and South Korea

Currently, a significant portion of our net sales are concentrated in the North America region, which represented 63.1% of net sales in 2007. The United States continues to be our largest market, representing 40.1% of net sales during 2007. As we continue to expand internationally, our operating results will likely become more sensitive to economic and political conditions in foreign markets, as well as to foreign currency fluctuations. Net sales reported for each geographic region are determined by the location from which the product shipment originates and are reported for the last three fiscal years below. Additional financial information relating to our geographic regions can be found in Note M to the Consolidated Financial Statements.

	Year Ended					
Region	**2005**		**2006**		**2007**	
North America	$ 209,445	66.5%	$ 246,489	67.5%	$ 267,235	63.1%
Southeast Asia/Pacific	58,300	18.5%	65,104	17.8%	90,690	21.4%
East Asia	32,349	10.3%	37,478	10.3%	49,314	11.7%
North Asia	14,923	4.7%	16,095	4.4%	15,910	3.8%
	$ 315,017	100.0%	$ 365,166	100.0%	$ 423,149	100.0%

Research and Development

We focus our research and development efforts on developing and providing the highest quality, science-based products that reduce the risk of chronic degenerative disease and promote long-term health. 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 scientists are continually reviewing the latest published research on nutrition, attending scientific conferences, and working in collaboration with a number of outside research institutions and researchers to identify possible new products and opportunities to reformulate existing products.

In 2007, we expanded our existing relationship with the Linus Pauling Institute ("LPI") at Oregon State University in an effort to better determine 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 will collaborate with LPI on nutritional and clinical research. Additionally, we plan to contribute $500,000 annually to LPI to help fund research on the role of nutrition in preventing oxidative stress, glycemic stress, and chronic inflammation, as well as the development of physiological markers of these conditions.

Our goal is to maintain a sharp focus on nutrition both inside and outside the body in the prevention of chronic degenerative diseases, and on healthy weight management. Because we believe in focusing on key health issues within our society rather than on fads, we do not introduce a new product unless we believe that it can provide health benefits to a significant percentage 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 Associates and Preferred Customers.

We follow pharmaceutical standards established by the U.S. Pharmacopeia in the development and reformulation of our products. Our ingredients are selected to meet a number of criteria, including, but not limited to: safety, potency, purity, stability, bio-availability, natural versus synthetic, and whether the ingredients are readily available. 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 2005, 2006, and 2007, we expended $2.2 million,

$3.0 million, and $3.4 million, respectively, on research and development activities. We intend to continue dedicating resources at similar levels for the research and development of new products and the reformulation of existing products.

Manufacturing and Quality Assurance

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: 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.

Our Salt Lake City manufacturing facility is registered with the U.S. Food and Drug Administration ("FDA"), Health Canada, 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 GMP, and the TGA in compliance with the Therapeutic Goods Act of 1989.

For the last several years, the manufacture of nutritional or dietary supplements and related products in the United States has required compliance with food-model GMPs. On June 22, 2007, however, the FDA published GMPs for dietary supplements, which will become effective June 1, 2008. The dietary supplement GMPs are based on the food-model GMPs, with additional requirements that are specific to dietary supplements. We believe that our processes comply with the FDA's more demanding drug-model GMPs and, therefore, do not anticipate making any significant changes to our current processes to comply with these stricter requirements.

Personal Care Manufacturing

In addition to tablet manufacturing, we manufacture our personal care products at the Draper, Utah manufacturing facility. 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 the Draper facility, we have standard technology for producing batches of personal care items, and we have semi-automatic packaging equipment for packaging the end product. We employ qualified staff to develop, implement, and maintain a quality system. Although the FDA has not promulgated GMP requirements for manufacturing personal care products, we voluntarily maintain compliance with the product development and GMP guidance of the Cosmetic, Toiletry and Fragrance Association.

Third-Party Suppliers and Manufacturers

We contract with third-party suppliers and manufacturers for the production of some of our 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. These products include gelatin-capsuled supplements, Garlic EC , OptOmega®, certain powdered drink mixes, and nutrition bars.

Quality Control

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.

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, as needed, and believe we will be able to do so in the future, if the need arises. Our raw material suppliers must demonstrate stringent process and product 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 through a network of vertically organized independent distributors. These distributors purchase products at wholesale prices from the manufacturer and then make retail sales to consumers. 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, which is not as readily available through other distribution channels.

Structure of Network Marketing Program

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 downline sales organization. New Associates sign a written contract and agree to adhere to the USANA policies and procedures. New Associates are also required to purchase a starter kit that includes a detailed manual, including our policies and procedures. We sell starter kits at our cost for a price of approximately U.S. $49. We also offer starter kits in an electronic format at a lower price, which we also sell at our cost. Subject to payment of a minimal annual renewal fee, Associates may continue to distribute products until they voluntarily withdraw or are terminated for failing to adhere to our policies and procedures.

We also sell directly to customers who purchase products only for personal consumption. 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 selling, distribution, or other business 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, nor to participate in our Compensation Plan.

Associate Training and Motivation

Initial training of Associates about the products, the Compensation Plan, network marketing, and about 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.

Associate Compensation

The Compensation Plan provides several opportunities for Associates to earn compensation, provided they are willing to consistently work at building, training, and retaining their downline organizations to sell USANA products to consumers. We believe this Compensation Plan is distinctive for its weekly payouts, which are designed to create appropriate incentives for the sale of USANA products. Associates cannot simply recruit others for the purpose of developing a downline and earn income passively, depending solely on the efforts of their downline. The primary way in which an Associate can earn compensation is by generating sales volume points through our base Compensation Plan. Sales volume points are assigned to each of our products and are generally targeted to represent a certain percent of the price in U.S. dollars. Each Associate is required to purchase a certain amount of product each month ("Qualifying Purchases"), which they must either resell to consumers or use personally in order to qualifiy to earn commissions or bonuses under USANA's Compensation Plan. Associates do not earn commissions on these Qualifying Purchases. The purpose of our Compensation Plan is to reward Associates for actively selling our products and for recruiting and retaining others to sell our products.

Associates can earn compensation in four ways:

Generating sales volume points, which are based on product sales of their downline sales organization;

Participating in a leadership bonus pool, which is based on certain performance requirements;

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

Earning prizes or bonuses through Company-sponsored promotions and contests.

Most Associates sell our products on a part-time basis and consume them personally. The sponsoring of new Associates results in the creation of multiple levels within our network marketing structure. Sponsored Associates are referred to as the "downline" of the sponsoring Associate. Downline Associates may also sponsor new Associates, creating additional levels in their network, but also forming a part of the same downline as the original sponsoring Associate. Associates who are interested in earning additional income and who successfully expand their business network or downline can qualify for higher levels of compensation, as well as leadership bonuses, by attaining certain sales volume levels and by demonstrating leadership abilities. We do not pay commissions based on recruiting or sponsorship activity. Associates may not sell competitive products to other USANA

Associates or solicit USANA Associates to participate in other network marketing opportunities. Our policies and procedures also restrict Associates' advertising and representations or claims concerning USANA products or our Compensation Plan.

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

Industry Overview

As both a manufacturer and a direct seller of nutritional and personal care products, we compete within two industries: nutrition and direct selling. The nutrition industry includes many small- and medium-sized companies that manufacture and distribute products that are generally intended to maintain the body's health and general well being, including the following:

Nutritional Supplements products such as vitamins and minerals, specialty supplements, herbs and botanicals, meal replacements, dietary supplements, and derivative compounds;

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

Functional Foods products with added ingredients or fortification that are designed specifically for health or performance purposes; and

Natural Personal Care products combining nutrition with skin care.

We believe that the following factors drive growth in the nutrition industry:

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

The aging population in most of our markets, particularly the baby-boomer generation in the U.S., who tend to use more nutritional supplementation as they age;

Rising health care costs and the worldwide trend toward preventative health care; and

Product introductions in response to new scientific findings.

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

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

Natural health food retailers;

Network marketing;

Mail order;

Healthcare professionals and practitioners; and

The Internet.

We distribute our products through a network marketing system, which is a common form of direct selling. According to the World Federation of Direct Selling Associations ("WFDSA"), the direct selling industry currently generates approximately $110 billion annually in worldwide retail sales, through approximately 60 million independent distributors.

According to statistics compiled by the Direct Selling Association (the U.S. member of the WFDSA), the United States remains the largest market for direct selling, with $32 billion in annual retail sales and 15 million independent distributors in 2006. According to the Direct Selling Association, wellness products, which include nutritional supplements and functional foods, accounted for 20.3% of the U.S. direct retail sales in 2006, and personal care products accounted for 33.7% of such sales.

We believe that we are well positioned to capitalize on growth trends in direct sales, as both a developer and manufacturer of nutritional supplements and personal care products.

Operating Strengths

Our principal objective is to be a leading developer and manufacturer of science-based nutritional and personal care products and to create a rewarding opportunity through network marketing for our Associates to distribute our products. Our strategy is to capitalize on our operating strengths, which include: a strong research and development program; in-house manufacturing capability; science-based products; an attractive Associate Compensation Plan with strong support; a scalable business model; and an experienced management team.

Emphasis on Research and Development. We have a technical team of approximately 20 individuals who contribute to our research and development activities. This team includes experienced scientists, including several scientists holding Ph.D. degrees, quality engineers, and regulatory specialists. In our research and development laboratories, our scientists and researchers:

Investigate *in vitro* and *in vivo* activity of new natural extracts and formulated products;

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

Develop new nutritional ingredients for use in supplements;

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

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

Formulate products to meet the regulatory requirements in all of our markets.

Our scientists and researchers also perform double-blind, placebo-controlled, clinical studies which are intended to further evaluate the efficacy of our products. We also collaborate with outside research organizations to further support various aspects of our research and development efforts. For example, in 2007 we expanded our existing relationship with LPI at Oregon State University. Additionally, we fund clinical research programs at Boston University and the University of Colorado. It is through our research and development efforts and our partnerships with outside research organizations 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 74% of product sales. We believe that our ability to manufacture our own products is a significant competitive advantage for the following reasons:

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

We can more reliably monitor the manufacturing process 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

We believe we can better 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 and compact line of high-quality health products that we believe provide health benefits to a significant percentage of our customers. Our products have been developed based on a combination of published research, *in vitro* and *in vivo* testing, in-house and third-party clinical studies, and sponsored research. Additionally, we design, manufacture, package, and label our products in a manner that we believe is consistent with pharmaceutical standards.

Attractive Associate Compensation Plan and Support. We are committed to providing a highly competitive compensation plan to attract and retain Associates who constitute our sales force. We believe that our Compensation Plan is one of the most financially rewarding in the network marketing industry. Associate incentives totaled $170.4 million, or 40.3% of net sales in 2007. We pay Associate incentives weekly and our Compensation Plan is a global-seamless plan, meaning that Associates can be compensated each week for their business success in any market in which we conduct business.

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 successful Associates and with the USANA management team. We also provide low-cost sales tools, which we believe are an integral part of building and maintaining a successful home-based business for our Associates.

In addition to Company-sponsored meetings and sales tools, we maintain a website exclusively for our Associates, where they can keep up on the latest USANA news, obtain training material, 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. 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 management tool.

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

Our business model does not require a company-employed sales force to sell our products, and we experience a minimal incremental cost to add a new Associate;

Commissions paid to our Associates are tied to sales performance;

Because payment is required at the time an Associate or Preferred Customer purchases product, we have virtually no accounts receivable;

We have a monthly product subscription program known as "Autoship," which provides a stream of recurring revenue, (for the year ended December 29, 2007, this program represented 51% of our net sales); and

We can readily expand into new international markets with only moderate investment, because we generally maintain only one administrative and customer support office and one or two warehouses in each of these markets.

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, and operations. The current executive management team has been in place for several years and 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:

Attract and Retain Associates and Preferred Customers. We recognize the need to continue to attract and retain Associates. We maintain emphasis on the partnership between the USANA management team and our Associate leaders. Through this partnership, our Associate leaders continue to host "Health & Freedom" meetings and online presentations, both aimed at presenting the business opportunity to potential Associates and providing additional training and resources for existing 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 in these areas. We intend to continue growing our business by maintaining a focus on our two core values, "True Health" and "True Wealth." We plan to accomplish this by increasing the number of active Associates and teaching them how to build a strong customer base. By leveraging the growth we have in our Associate field, we believe we can continue to attract individuals that are interested in joining a winning team and starting a home-based business with USANA.

We will continue to make it easier for our customers to order product from USANA and to learn about the many products that we offer. This will be accomplished with an improved online shopping cart and website, a product catalog dedicated to Preferred Customers, product sampling, and target marketing. We are also working on a Preferred Customer referral system, which will include awards and incentives for bringing in new customers. We believe we offer the finest web-based business tools in the industry. We will continue to make improvements and enhancements to these tools, which offer a convenient and simple way for our Associates to manage their business and be more productive.

Enter New Markets. We believe that significant growth opportunities continue to exist in markets where we currently conduct business and in new international markets. New markets 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 begun to register certain products with regulatory and government agencies in preparation for further international expansion. Wherever possible, we expect to seamlessly integrate the Compensation Plan in each market to allow Associates to receive commissions for global not merely local product sales. The seamless downline structure is designed to allow an Associate to build a global network by creating downlines across national borders. Associates are not required to establish new downlines or to re-qualify for higher levels of compensation in newly opened markets. We believe this seamless Compensation Plan can significantly enhance our ability to expand internationally, and we intend, where permitted, to integrate future markets into this plan.

Introduce New and Re-formulate Existing Products. Our research and development team is continually researching the latest scientific findings related to nutrition, looking at new technology and attending scientific conferences. If, in the process, we see potential for a new product that provides a true health benefit addressing a particular health issue, and if we believe its benefits can be realized by a significant percentage of our customers, we will generally pursue development of that product. At our International Convention in August, 2007, we introduced a new product and technology, called

MyHealthPak. This technology allows customers to create their own personalized selection of our line of nutritional supplements in daily AM and PM pillow packs.

If in the process of our research activities mentioned above, our research and development team identifies a new or existing ingredient that could possibly be used to enhance one of our existing products, we will generally pursue a product upgrade. Our intention is to ensure that all of our products, new and existing, incorporate the latest science in nutrition. We typically upgrade at least one of our products each year.

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.

Capital Investment. During 2007 and continuing in 2008, we have significantly added to our capital and human resources in order to support the growth of our business. In Salt Lake City, we have largely completed an expansion and upgrade of our corporate campus. In addition to the expansion of the corporate headquarters and manufacturing facilities, in 2007 we purchased a facility in Sydney, Australia and are working on the remodel and fit-out of this facility, to where our Australian operations will be moved. We also added to our human resources during 2007, increasing "bench strength" in key functions at our corporate and regional offices. Another significant investment during 2007 was the addition of a new automated packaging system, which should be fully functioning by the second quarter of 2008.

Product Returns

Product returns have not been a material factor in our business, totaling approximately 1.6% of net sales during each of the fiscal years 2005 and 2006, and 1.5% of net sales during fiscal year 2007. Because our emphasis on satisfaction is a hallmark of our business model, we permit 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 that was not damaged at the time of receipt by the Associate, where the purchase amount exceeds $100, may result in cancellation of the Associate's distributorship. Depending upon the conditions under which product was returned, Associates and Preferred Customers may receive their refunded amount either based on their original form of payment or with product or credit on account.

Major Customers

Sales are made to independent Associates and Preferred Customers. No single customer accounted for 10% or more of net sales in any of the last three fiscal years. Associates may sell products only in countries where we have approved the sale of our products.

Compliance by Associates

From time to time some Associates will fail to adhere to the USANA policies and procedures, including those governing the marketing of our products or the permissible representations regarding the Compensation Plan. We systematically review reports of alleged Associate misbehavior. Infractions of the policies and procedures are reported to a compliance committee that determines what disciplinary action may be warranted in each case. If we determine that an Associate has violated any of the USANA policies and procedures, we may take a number of disciplinary actions. For example, we may impose sanctions, such as warnings, fines or probation. We also may withdraw or deny awards, suspend privileges, withhold commissions until specific conditions are satisfied, or take other

appropriate actions in our discretion. More serious infractions may result in termination of the Associate's purchase and distribution rights completely.

Information Technology

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

A web-based application that provides online services to Associates, such as training sessions and presentations, online shopping, enrollment, company and product information, and other tools to help Associates effectively manage their downline organizations. 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.

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

A fully integrated worldwide Enterprise Resource Planning ("ERP") system that handles accounting, inventory management, production processes, quality assurance, and reporting requirements in a multinational environment. This ERP system supports global data integrity and multinational corporate governance and compliance.

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 ("FD&C") and the regulations thereunder. USANA products are also subject to regulation by, among others, the Consumer Product Safety Commission, the US Department of Agriculture, and the Environmental Protection Agency. The manufacturing, labeling, and advertising of products are also regulated by various governmental agencies in each foreign country in which they are distributed. For example, in Australia, we are subject to the Therapeutic Goods Administration and, in Japan, to the Ministry of Health, Labor and Welfare.

Our largest selling product group includes products that are regulated as dietary supplements under the FD&C. Dietary supplements are also regulated in the United States under the Dietary Supplement Health and Education Act of 1994 ("DSHEA"). We believe that the DSHEA provides a favorable regulatory climate 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 labeling claims. Although we believe our product claims comply with the law, we may need to revise some product labeling at a future date, if these labeling requirements change.

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

For the last several years, the manufacture of dietary supplements and related products in the United States has required compliance with food-model GMPs. However, on June 22, 2007, the FDA published GMPs for dietary supplements, which will be effective June 1, 2008. The dietary supplement GMPs are based on the food-model GMPs, with additional requirements that are specific to dietary supplements. We believe that our processes comply with the FDA's more demanding drug-model GMPs and, therefore, do not anticipate making any significant changes to our current processes to comply with these more strict requirements.

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 FD&C adulteration and misbranding provisions. Cosmetics also are subject to specific labeling regulations, including warning statements, if the safety of a cosmetic is not adequately substantiated or if the product may be hazardous, as well as ingredient statements and other packaging requirements under the Fair Packaging and Labeling Act. Cosmetics that meet the definition of a drug (i.e., that are intended to treat or prevent disease or affect the structure or function of the body), such as sunscreens, are regulated as drugs. OTC drug products may be marketed if they conform to the requirements of the OTC monograph that is applicable to that drug. Drug products not conforming to monograph requirements require an approved New Drug Application ("NDA") before marketing 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 will have to reformulate or cease marketing that product until it is the subject of an approved NDA or until the time, if ever, that the monograph is amended to include such product. If such an agency ruling were to become final, we would be required to stop marketing the product as currently formulated. Whether or not an OTC drug product conforms to a monograph or is subject to an approved NDA, the drug must comply with other requirements under the FDCA, including GMP's, labeling, and the FDCA's regulations regarding misbranding and adulteration.

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

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, and we believe that we have organized the documentation to support our advertising and promotional practices in compliance with these guidelines.

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

The Public Health Security and Bioterrorism Preparedness and Response Act of 2002 ("Bioterrorism Act") includes several provisions that have resulted in additional regulatory compliance issues for us. For example, one provision in the Bioterrorism Act requires the Secretary of Health and Human Services to develop regulations that mandate that domestic and foreign facilities, which manufacture, process, pack, or hold food for human or animal consumption in the United States, register with the FDA. On November 24, 2003, we fulfilled this requirement by registering with the FDA. Another provision of the Bioterrorism Act mandates that the FDA receive prior notification of all food importation. Our TenX Antioxidant Blast is purchased from a manufacturer located in Canada, and therefore, we are required to comply with this notification requirement upon importation of this product. Although some of our raw materials and other certain manufactured product may originate outside of the United States, we procure these items from entities in the United States. From time to time, we may bring consumable products that we have sent from our Salt Lake facility to our international locations back into the United States from one or more of these locations. When bringing these products back into the United States from any international location, we are also required to comply with this notification requirement.

On December 9, 2006, President Bush signed the Dietary Supplement & Nonprescription Drug Consumer Protection Act into law. The legislation requires manufacturers of dietary supplement and over-the-counter products to notify the FDA when they receive reports of serious adverse events. USANA already has an internal adverse event reporting system that has been in place for several years. Based on our understanding of the new law's requirements, we made some changes to our existing reporting system, and believe that we now comply with these new regulations.

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 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. Foreign regulatory requirements have not placed a significant burden on our ability to operate in current foreign countries.

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 reformulation of certain products to meet new standards, the recall or discontinuation of certain products that cannot be reformulated, additional record keeping, expanded documentation of the properties of certain products, expanded or different labeling, and additional scientific substantiation. Any or all of these requirements could have a material adverse effect on our business, financial condition, and results of operations.

Network Marketing Regulation. 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. These laws include anti-pyramiding, securities, lottery, referral selling, anti-fraud and business opportunity statutes, regulations, and court cases. Illegal schemes, typically referred to as "pyramid," "chain distribution," or "endless chain" schemes, compensate participants primarily or solely for the introduction or enrollment of additional participants into the scheme. Often these schemes are characterized by large up-front entry or sign-up fees, over-priced products of low value, little or no emphasis on the sale or use of products, high-pressure recruiting tactics, and claims of huge and quick financial rewards requiring little or no effort. Generally these laws are directed at ensuring that product sales ultimately are made to consumers and that advancement within sales organizations is based on sales of the enterprise's products, rather than 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 federal regulation in the United States, 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 in compliance 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 in compliance 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. Any or all of these factors could adversely affect the way we do business and could affect our ability to attract potential Associates or enter into new markets. In the United States, the FTC has been active in its enforcement efforts against both pyramid schemes and legitimate network marketing organizations with certain legally problematic components, having instituted several enforcement actions resulting in signed settlement agreements and the payment of large fines. Although, to our knowledge, we have not been the target of an FTC investigation, there can be no assurance that the FTC will not investigate us in the future.

On April 5, 2006, the FTC released a proposed New Business Opportunity Rule. This proposed rule would require pre-sale disclosures for all business opportunities, which might include network marketing compensation plans. The New Business Opportunity Rule is currently only a proposed rule. If implemented at all, the rule ultimately may not be implemented in a form that applies to network marketing compensation plans, or it may change significantly before it is implemented. If this proposed rule were adopted as it is currently proposed, it would require us to change some of our current practices regarding pre-sale disclosures.

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, results of operations, and financial condition.

Transfer Pricing Regulation. We have adopted transfer 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, agreements between our subsidiaries and us have been entered into for services and contractual obligations, such as the payment of Associate incentives that are also supported by the same formal transfer pricing study. If the United States 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 United States and most foreign countries provide for competent authority 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.

Competition

We compete with other network marketing companies for distributors. We also compete with manufacturers, distributors, and