

NU SKIN ENTERPRISES INC  
Form 10-Q  
May 10, 2007

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549**

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**FORM 10-Q**

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2007

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: **001-12421**

**NU SKIN ENTERPRISES, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**87-0565309**

(IRS Employer Identification Number)

**75 West Center Street**

**Provo, UT 84601**

(Address of principal executive offices and zip code)

**(801) 345-1000**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of April 30, 2007, 64,489,483 shares of the registrant's Class A common stock, \$.001 par value per share, were outstanding.

NU SKIN ENTERPRISES, INC.

2007 FORM 10-Q QUARTERLY REPORT FIRST QUARTER

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Nu Skin, Pharmanex and Big Planet are trademarks of Nu Skin Enterprises, Inc. or its subsidiaries.  
The italicized product names used in this Quarterly Report on Form 10-Q are product names, and also, in certain cases, our trademarks.

**PART I. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS****NU SKIN ENTERPRISES, INC.****Consolidated Balance Sheets (Unaudited)**

(U.S. dollars in thousands)

	<b>March 31, 2007</b>	<b>December 31, 2006</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 100,806	\$ 121,353
Current investments	12,200	
Accounts receivable	20,509	19,421
Inventories, net	93,544	92,092
Prepaid expenses and other	44,062	44,093
	271,121	276,959
Property and equipment, net	86,818	85,883
Goodwill	112,446	112,446
Other intangible assets, net	90,182	91,349
Other assets	128,060	98,212
Total assets	\$ 688,627	\$ 664,849
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 28,485	\$ 20,815
Accrued expenses	105,128	120,074
Current portion of long-term debt	26,767	26,652
	160,380	167,541
Long-term debt	176,778	136,173
Other liabilities	73,576	42,155
Total liabilities	410,734	345,869
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Class A common stock - 500 million shares authorized, \$.001 par value, 90.6 million shares issued	91	91
Additional paid-in capital	201,824	199,322
Treasury stock, at cost - 26.1 million and 23.6 million shares	(392,839)	(346,889)
Retained earnings	533,696	531,563
Accumulated other comprehensive loss	(64,879)	(65,107)
	277,893	318,980
Total liabilities and stockholders' equity	\$ 688,627	\$ 664,849

The accompanying notes are an integral part of these consolidated financial statements.

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**NU SKIN ENTERPRISES, INC.****Consolidated Statements of Income (Unaudited)**

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

<b>Three Months Ended March 31,</b>	
<b>2007</b>	<b>2006</b>

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	<b>Three Months Ended March 31,</b>	
Revenue	\$ 273,640	\$ 265,780
Cost of sales	50,679	46,994
Gross profit	222,961	218,786
Operating expenses:		
Selling expenses	116,438	112,298
General and administrative expenses	88,972	90,003
Impairment of assets and other		20,840
Restructuring and other charges		11,115
Total operating expenses	205,410	234,256
Operating income (loss)	17,551	(15,470)
Other income (expense), net	(794)	(1,054)
Income (loss) before (provision) benefit for income taxes	16,757	(16,524)
(Provision) benefit for income taxes	(6,257)	6,196
Net income (loss)	\$ 10,500	\$ (10,328)
Net income (loss) per share (Note 2):		
Basic	\$ 0.16	\$ (0.15)
Diluted	\$ 0.16	\$ (0.15)
Weighted-average common shares outstanding:		
Basic	65,939	70,131
Diluted	66,811	70,131

The accompanying notes are an integral part of these consolidated financial statements.

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**NU SKIN ENTERPRISES, INC.**

**Consolidated Statements of Cash Flows (Unaudited)**

(U.S. dollars in thousands)

	<b>Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
Cash flows from operating activities:		
Net income (loss)	\$ 10,500	\$ (10,328)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	7,817	7,585
Stock-based compensation	2,382	2,146
Impairment of Scanner asset		18,984
Changes in operating assets and liabilities:		
Accounts receivable	(794)	172
Inventories, net	(4,145)	(347)
Prepaid expenses and other	397	(873)

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	<b>Three Months Ended March 31,</b>	
Other assets	(29,800)	428
Accounts payable	8,186	7,125
Accrued expenses	(14,919)	(13,397)
Other liabilities	28,570	118
Net cash provided by operating activities	8,194	11,613
Cash flows from investing activities:		
Purchases of property and equipment	(5,292)	(13,625)
Proceeds on investment sales	77,250	54,555
Purchases of investments	(89,450)	(70,380)
Purchase of long-term asset		(1,981)
Net cash used in investing activities	(17,492)	(31,431)
Cash flows from financing activities:		
Exercise of employee stock options	1,128	651
Proceeds from long-term debt	40,000	
Payment of cash dividends	(6,909)	(7,019)
Income tax benefit of options exercised	187	186
Repurchases of shares of common stock	(46,023)	(175)
Net cash used in financing activities	(11,617)	(6,357)
Effect of exchange rate changes on cash	368	539
Net decrease in cash and cash equivalents	(20,547)	(25,636)
Cash and cash equivalents, beginning of period	121,353	155,409
Cash and cash equivalents, end of period	\$ 100,806	\$ 129,773

The accompanying notes are an integral part of these consolidated financial statements.

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**NU SKIN ENTERPRISES, INC.**  
**Notes to Consolidated Financial Statements**

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**1. THE COMPANY**

Nu Skin Enterprises, Inc. (the Company) is a leading, global direct selling company that develops and distributes premium-quality, innovative personal care products and nutritional supplements that are sold worldwide under the Nu Skin and Pharmanex brands. The Company also markets technology-related products and services under the Big Planet brand. The Company reports revenue from five geographic regions: North Asia, which consists of Japan and South Korea; Greater China, which consists of Mainland China, Hong Kong, Macau and Taiwan; Americas, which consists of the United States, Canada and Latin America; South Asia/Pacific, which consists of Australia, Brunei, Indonesia, Malaysia, New Zealand, the Philippines, Singapore and Thailand; and Europe, which includes several markets in Europe as well as Israel and Russia (the Company's subsidiaries operating in these countries are collectively referred to as the Subsidiaries).

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. The unaudited consolidated financial statements include the accounts of the Company and its Subsidiaries. All significant intercompany accounts and transactions are eliminated in consolidation. In the opinion of management, the accompanying unaudited consolidated financial

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statements contain all adjustments, consisting of normal recurring adjustments, considered necessary for a fair statement of the Company's financial information as of March 31, 2007, and for the three-month periods ended March 31, 2007 and 2006. The results of operations of any interim period are not necessarily indicative of the results of operations to be expected for the fiscal year. For further information, refer to the consolidated financial statements and accompanying footnotes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

### 2. NET INCOME (LOSS) PER SHARE

Net income (loss) per share is computed based on the weighted-average number of common shares outstanding during the periods presented. Additionally, diluted earnings per share data gives effect to all potentially dilutive common shares that were outstanding during the periods presented. For the three-month periods ended March 31, 2007 and 2006, other stock options totaling 2.8 million and 6.3 million, respectively, were excluded from the calculation of diluted earnings per share because they were anti-dilutive.

### 3. DIVIDENDS PER SHARE

In February 2007, our board of directors declared a quarterly cash dividend of \$0.105 per share for all shares of Class A common stock. This quarterly cash dividend of \$6.9 million was paid on March 21, 2007 to stockholders of record on March 2, 2007.

### 4. DERIVATIVE FINANCIAL INSTRUMENTS

At March 31, 2007 and December 31, 2006, the Company held forward contracts designated as foreign currency cash flow hedges with notional amounts totaling approximately \$5.9 million and \$10.1 million, respectively, to hedge foreign-currency-denominated intercompany transactions. All such contracts were denominated in Japanese yen. As of March 31, 2007 and December 31, 2006, \$(0.1) million and \$0.2 million of net unrealized gains/(losses), net of related taxes, respectively, were recorded in accumulated other comprehensive loss. The contracts held at March 31, 2007 have maturities through March 2008 and accordingly, all unrealized gains and losses on foreign currency cash flow hedges included in accumulated other comprehensive loss will be recognized in current earnings over the next 12 months. The Company recognized pre-tax gains on foreign currency cash flow hedges of \$0.2 million for the three-month period ended March 31, 2007 and recognized pre-tax gains of \$2.2 million on foreign currency cash flow hedges for the three-month period ended March 31, 2006. These gains and losses were recorded as increases to revenue in Japan in the respective periods.

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## NU SKIN ENTERPRISES, INC.

### Notes to Consolidated Financial Statements

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### 5. REPURCHASES OF COMMON STOCK

During the three-month period ended March 31, 2007, the Company repurchased approximately 2,659,000 shares of its Class A common stock under its open market repurchase plan for approximately \$46.0 million. During the three-month period ended March 31, 2006, the Company repurchased approximately 10,000 shares of its Class A common stock under its open market repurchase plan for approximately \$0.2 million.

### 6. COMPREHENSIVE INCOME (LOSS)

The components of comprehensive income (loss), net of related tax, for the three-month periods ended March 31, 2007 and 2006, were as follows (in thousands):

	Three Months Ended March 31,	
	2007	2006
Net income (loss)	\$ 10,500	\$ (10,328)
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustment	457	816

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	<b>Three Months Ended March 31,</b>	
Net unrealized gains (losses) on foreign currency cash flow hedges	(98)	291
Less: Reclassification adjustment for realized (gains) losses in current earnings	(132)	(1,361)
Comprehensive income (loss)	\$ 10,727	\$ (10,582)

**7. SEGMENT INFORMATION**

The Company operates in a single operating segment by selling products to a global network of independent distributors that operates in a seamless manner from market to market, except for its operations in Mainland China. In Mainland China the Company utilizes an employed sales force to sell its products through fixed retail locations. Selling expenses are the Company's largest expense, comprised of the commissions to its worldwide independent distributors as well as remuneration to its Mainland China sales employees paid on product sales. The Company manages its business primarily by managing its global sales force. The Company does not use profitability reports on a regional or divisional basis for making business decisions. However, the Company does recognize revenue in five geographic regions: North Asia, Greater China, Americas, South Asia/Pacific and Europe.

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**NU SKIN ENTERPRISES, INC.  
Notes to Consolidated Financial Statements**

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Revenue generated in each of these regions is set forth below (in thousands):

	<b>Three Months Ended March 31,</b>	
<b>Revenue:</b>	<b>2007</b>	<b>2006</b>
North Asia	\$ 140,259	\$ 140,614
Greater China	48,953	51,952
Americas	42,319	40,080
South Asia/Pacific	23,586	20,647
Europe	18,523	12,487
Total	\$ 273,640	\$ 265,780

Revenue generated by each of the Company's three product lines is set forth below (in thousands):

	<b>Three Months Ended March 31,</b>	
<b>Revenue:</b>	<b>2007</b>	<b>2006</b>
Pharmanex	\$ 153,162	\$ 148,904
Nu Skin	114,100	110,501
Big Planet	6,378	6,375
Total	\$ 273,640	\$ 265,780

Additional information as to the Company's operations in its most significant geographic areas is set forth below (in thousands):

	<b>Three Months Ended March 31,</b>	
<b>Revenue:</b>	<b>2007</b>	<b>2006</b>
Japan	\$ 107,027	\$ 115,216
United States	37,728	35,705
Korea	33,232	25,398

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	<b>Three Months Ended March 31,</b>	
Taiwan	20,944	22,084
Mainland China	17,536	19,722
<b>Long-lived assets:</b>	<b>March 31, 2007</b>	<b>December 31, 2006</b>
Japan	\$ 13,464	\$ 11,902
United States	43,523	43,520
Korea	1,550	1,274
Taiwan	2,880	2,686
Mainland China	13,411	13,724

### 8. DEFERRED TAX ASSETS AND LIABILITIES

The Company accounts for income taxes in accordance with SFAS 109. This statement establishes financial accounting and reporting standards for the effects of income taxes that result from an enterprise's activities during the current and preceding years. It requires an asset and liability approach for financial accounting and reporting of income taxes. The Company pays income taxes in many foreign jurisdictions based on the profits realized in those jurisdictions, which can be significantly impacted by terms of intercompany transactions between the Company and its foreign affiliates. Deferred tax assets and liabilities are created in this process. As of March 31, 2007, the Company has net deferred tax assets of \$51.8 million. The Company has netted these deferred tax assets and deferred tax liabilities by jurisdiction.

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## NU SKIN ENTERPRISES, INC.

### Notes to Consolidated Financial Statements

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### 9. UNCERTAIN TAX POSITIONS

In June 2006, the FASB issued FASB Interpretation Number 48 Accounting for Uncertainty in Income Taxes an Interpretation of SFAS 109 (FIN 48). The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized a \$2.6 million increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to the January 1, 2007 balances of retained earnings and additional paid-in capital.

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. With a few exceptions, the Company is no longer subject to U.S. federal, state and local income tax examination by tax authorities for years before 2001. In major foreign jurisdictions, the Company is no longer subject to income tax examinations for years before 2000. The company is currently under examination in a few foreign jurisdictions; however, the final outcomes of these reviews are not yet determinable.

At January 1, 2007, the Company had \$13.8 million in unrecognized tax benefits of which \$12.7 million, if recognized, would affect the effective tax rate. At the date of adoption, the Company had approximately \$2.2 million of accrued interest and penalties related to uncertain tax positions. Interest and penalties related to uncertain tax positions are recognized as a component of income tax expense. The amount of unrecognized tax benefits did not change significantly during the three months ended March 31, 2007.

### 10. COMMITMENTS AND CONTINGENCIES

The Company is subject to governmental regulations pertaining to product formulation, labeling and packaging, product claims and advertising and to the Company's direct selling system. The Company is also subject to the jurisdiction of numerous foreign tax and customs authorities. Any assertions or determination that either the Company or the Company's distributors is not in compliance with existing statutes, laws, rules or regulations could potentially have a material adverse effect on the Company's operations. In addition, in any country or jurisdiction, the adoption of new statutes, laws, rules or regulations or changes in the interpretation of existing statutes, laws, rules or regulations could have a material adverse effect on the Company and its operations. Although management believes that the Company is in compliance, in all material respects, with the statutes, laws, rules and regulations of every jurisdiction in which it operates, no assurance can be given that the Company's compliance with applicable statutes, laws, rules and regulations will not be challenged by foreign authorities or that such challenges will not have a material adverse effect on the Company's financial position or results of operations or cash flows. The Company and its



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Subsidiaries are defendants in litigation and proceedings involving various matters. In the opinion of the Company's management, based upon advice of its counsel handling such litigation and proceedings, adverse outcomes, if any, will not likely result in a material effect on the Company's consolidated financial condition, results of operations or cash flows.

The Company is subject to regular audits by federal, state and foreign tax authorities. These audits may result in additional tax liabilities. The Company accounts for such contingent liabilities in accordance with FIN 48 and believes it has appropriately provided for income taxes for all years. Several factors drive the calculation of our tax reserves. Some of these factors include: (i) the expiration of various statutes of limitations; (ii) changes in tax law and regulations; (iii) issuance of tax rulings; and (iv) settlements with tax authorities. Changes in any of these factors may result in adjustments to the Company's reserves, which would impact its reported financial results.

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### NU SKIN ENTERPRISES, INC. Notes to Consolidated Financial Statements

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Due to the international nature of the Company's business, the Company is subject from time to time to reviews and audits by the foreign taxing authorities of the various jurisdictions in which it conducts business throughout the world. In 1999, the Company implemented a duty valuation methodology with respect to the importation of certain products into Japan. For purposes of the import transactions at issue, the Company had taken the position that, under applicable customs law, there was a sale between the manufacturer and the Company's Japanese subsidiary, and that customs duties should be assessed on the manufacturer's invoice. The Valuation Department of the Yokohama customs authorities reviewed and approved this methodology at that time, and it had been reviewed on several occasions by the audit division of the Japan customs authorities since then. In connection with subsequent audits in 2004, the Yokohama customs authorities assessed the Company additional duties and penalties on these products imported into Japan from October 2002 to October 2004, based on a different valuation methodology than what was previously approved. With respect to the periods under audit, the customs authorities took the position that the relevant import transaction involved a sale between the Company's U.S. affiliate and its Japan subsidiary and that duties should be assessed on the value of that transaction. The Company disputed this assessment. The Company also disputed the amount of duties it was required to pay on products imported from November of 2004 to June of 2005 for similar reasons. The total amount assessed or in dispute is approximately \$25.0 million, net of any recovery of consumption taxes. Effective July 1, 2005, the Company implemented some modifications to the Company's business structure in Japan and in the United States that the Company believes will eliminate any further customs valuation disputes with respect to product imports in Japan after that time.

Because the Company believes the documentation and legal analysis supports its position and the valuation methodology it used with respect to the products in dispute had been reviewed and approved by the customs authorities in Japan, the Company believes the assessments are improper and it filed letters of protest with Yokohama customs with respect to this entire amount. Yokohama customs rejected the Company's letters of protest, and to follow proper administrative procedures the Company filed appeals with the Japan Ministry of Finance. On June 26, 2006, the Company was advised that the Ministry of Finance had rejected the appeals filed with their office relating to the imports from October 2002 to October 2004. The Company decided to appeal this issue through the judicial court system in Japan, and on December 22, 2006 it filed a complaint with the Tokyo District Court Civil Action Section with respect to this period. In January 2007, the Company was advised that the Ministry of Finance also rejected its appeal with them for the imports from November 2004 to June 2005. The Company currently plans to appeal this decision with the court system in Japan as well. One of the findings cited by the Ministry of Finance in its decisions was that the Company had treated the transactions as sales between its U.S. affiliate and its Japan subsidiary on its corporate income tax return under applicable income tax and transfer pricing laws. The Company has paid the \$25.0 million in customs duties and assessments, the amount of which it recorded in "Other Assets" in its Consolidated Balance Sheet. To the extent that the Company is unsuccessful in recovering the amounts assessed and paid, it will be required to take a corresponding charge to its earnings.

In Taiwan, the Company is currently subject to an audit by tax authorities with respect to the deductibility of distributor commission expenses in that market. In order to avoid the running of the statute of limitations with respect to the 1999 and 2000 tax years, the Taiwan tax authorities have disallowed the Company's commission expense deductions for those years and assessed the Company a total of approximately \$18.7 million. At this stage of the discussions, the Company is not required to pay the amount of tax under dispute. The Company is contesting this assessment and is in discussions with the tax authorities in an effort to resolve this matter. Based on its understanding of this matter, management does not believe that it is probable that the Company will incur a loss relating to this matter and accordingly has not provided any related reserves.

**NU SKIN ENTERPRISES, INC.**  
**Notes to Consolidated Financial Statements**

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**11. LONG-TERM DEBT**

The Company maintains a \$25.0 million revolving credit facility that expires in May 2007. Drawings on this revolving credit facility may be used for working capital, capital expenditures and other purposes including repurchases of the Company's outstanding shares of Class A common stock. As of March 31, 2007, there were no outstanding balances under this revolving credit facility.

The Company also has a \$205.0 million multi-currency private shelf facility with Prudential Investment Management, Inc. As of March 31, 2007, the Company had \$156.5 million outstanding under its shelf facility, \$15.0 million of which is included in the current portion of long-term debt. \$130.0 million of this long-term debt is U.S. dollar denominated, bears interest of approximately 5.2% per annum and is amortized in four tranches between five and ten years. The remaining \$26.5 million as of March 31, 2007, is Japanese yen-denominated senior promissory notes in the aggregate principal amount of 3.1 billion Japanese yen, which were issued on February 7, 2005. The notes bear interest of 1.7% per annum, with interest payable semi-annually. The interest payments on the notes began April 30, 2005. The final maturity date of the notes is April 20, 2014 and principal payments are required annually beginning on April 30, 2008 in equal installments of 445.7 million Japanese yen.

The Company's long-term debt also includes the long-term portion of Japanese yen denominated ten-year senior notes issued to the Prudential Insurance Company of America in 2000. The notes bear interest at an effective rate of 3.0% per annum and are due October 2010, with annual principal payments that began in October 2004. As of March 31, 2007, the outstanding balance on the notes was 5.5 billion Japanese yen, or \$47.1 million, \$11.8 million of which is included in the current portion of long-term debt. The Japanese notes and the revolving and shelf credit facilities are secured by guarantees issued by our material subsidiaries or by pledges of 65% to 100% of the outstanding stock of our material foreign subsidiaries.

The following table summarizes the Company's long-term debt arrangements as of March 31, 2007:

<b>Facility or Arrangement</b>	<b>Original Principal Amount</b>	<b>Balance as of March 31, 2007</b>	<b>Interest Rate</b>	<b>Repayment terms</b>
<b>2000 Japanese yen denominated notes</b>	9.7 billion yen	5.5 billion yen (\$47.1 million as of March 31, 2007)	3.0%	Notes due October 2010, with annual principal payments that began in October 2004.
<b>2003 \$205.0 million multi-currency uncommitted shelf facility:</b>				
U.S. dollar denominated:	\$50.0 million	\$40.0 million	4.5%	Notes due April 2010 with annual principal payments that began in April 2006.

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<b>Facility or Arrangement</b>	<b>Original Principal Amount</b>	<b>Balance as of March 31, 2007</b>	<b>Interest Rate</b>	<b>Repayment terms</b>
	\$25.0 million	\$10.0 million	4.0%	Notes due April 2008 with annual principal payments that began in October 2004.
	\$40.0 million	\$40.0 million	6.2%	Notes due July 2016 with annual principal payments that begin in July 2010.
	\$40.0 million	\$40.0 million	6.2%	Notes due January 2017 with annual principal payments that begin in January 2011.
Japanese yen denominated:	3.1 billion yen	3.1 billion yen (\$26.5 million as of March 31, 2007)	1.7%	Notes due April 2014, with annual principal payments beginning April 2008.
<b>2004 \$25.0 million revolving credit facility</b>	N/A	\$0	N/A	Credit facility expires May 2007.

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**NU SKIN ENTERPRISES, INC.**  
**Notes to Consolidated Financial Statements**

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**12. IMPAIRMENT OF ASSETS AND OTHER**

During the first quarter of 2006, the Company recorded impairment and other charges of \$20.8 million, primarily relating to its first generation BioPhotonic Scanners. In February 2006, as a result of the Company's launch of and transition to its second generation BioPhotonic Scanner, the Company determined it was necessary to write down the book value of the existing inventory of the prior model of the Scanner. The impairment charges relating to the Scanner recorded during the quarter ended March 31, 2006 totaled \$19.0 million. In addition, during the quarter ended March 31, 2006, the Company completed a settlement agreement with Razorstream, a service provider of video content for our digital product category, to terminate its purchase commitments for video technology for approximately \$1.8 million.

**13. RESTRUCTURING AND OTHER CHARGES**

During the first quarter of 2006, the Company recorded restructuring and other charges of \$11.1 million, primarily relating to its restructuring initiative designed to (i) eliminate organizational redundancies, (ii) revamp administrative support functions, (iii) prioritize investments to favor profitable initiatives and markets, and (iv) increase efficiencies in the supply chain process. As a result, the Company's overall headcount was reduced by approximately 225 employees, the majority of which related to the elimination of positions at the Company's U.S. headquarters. These expenses consisted primarily of severance and other charges and had all been paid as of December 31, 2006.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**ITEM 1. FINANCIAL STATEMENTS**

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The following Management's Discussion and Analysis should be read in conjunction with Management's Discussion and Analysis included in our Annual Report on Form 10-K for the year ended December 31, 2006 filed with the Securities and Exchange Commission (SEC) on March 1, 2007, and our other filings, including Current Reports on Form 8-K, filed with the SEC through the date of this report.

### Overview

Our revenue for the three-month period ended March 31, 2007 increased 3% to \$273.6 million compared to the same period in 2006. Foreign currency exchange rate fluctuations positively impacted revenue by less than 1%. The increase in revenue was primarily a result of year-over-year growth in South Korea, Europe, the United States, and our South Asia/Pacific region. In addition, results in Japan continued to improve, and China posted modest sequential growth. During the first quarter, our continued brand-building initiatives, the promotion of our sales tools such as the second-generation Pharmanex® BioPhotonic Scanner (the S2 Scanner) and the Nu Skin® ProDerm Skin Analyzer (the ProDerm Skin Analyzer), and the strength of key products also contributed to our revenue growth.

Earnings per share for the first quarter of 2007 were \$0.16, compared to a loss per share of \$0.15 for the same period in 2006, which included restructuring and impairment charges of \$0.28 per share (net of tax impact). We are beginning to see a positive impact on earnings from our business transformation initiative that was implemented last year as our general and administrative expenses as a percent of revenue improved from 33.9% to 32.5% in the first quarter of 2007 compared to the first quarter of last year. Earnings per share were also positively impacted approximately 5% as a result of our repurchases of stock during the past 12 months under our stock repurchase program.

### Revenue

North Asia. The following table sets forth revenue for the three-month periods ended March 31, 2007 and 2006 for the North Asia region and its principal markets (in millions):

		2007		2006	Change
Japan	\$	107.0	\$	115.2	(7%)
South Korea		33.3		25.4	31%
North Asia total	\$	140.3	\$	140.6	*

\* Less than 1%.

Foreign currency exchange rate fluctuations negatively impacted revenue in North Asia by less than 1%. Revenue in the region remained relatively flat as a 26% local currency revenue increase in South Korea was offset by a 3% local currency decline in Japan in the first quarter of 2007 compared to the same prior-year period.

Our year-over-year revenue trends in Japan have improved over the past three quarters, resulting in a much smaller year-over-year decline in the first quarter compared to previous quarters. We believe that the initiatives that we have implemented in Japan during this past year, including the introduction of the S2 Scanner and g3 nutrition drink, corporate image and brand building campaigns, and changes to our compensation plan are having a positive impact on this market. Revenue was also positively impacted by the launch of a new, advanced anti-aging skin care product called *Beauty Essence Duo* and a distributor convention in March. In the first quarter, however, we continued to experience some softness in our distributor numbers, with the executive distributor count decreasing 8% compared to the prior-year period and active distributors decreasing 4%.

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South Korea continues to post solid growth as our initiatives and product introductions have contributed to a strong sponsoring environment for our distributors. The number of active and executive distributors increased 24% and 23%, respectively, in the first quarter of 2007 compared to the same prior-year period. We held a successful distributor convention in March where we introduced *TriPhasic White*, one of our best selling personal care products around the world, as well as the S2 Scanner.

Greater China. The following table sets forth revenue for the three-month periods ended March 31, 2007 and 2006 for the Greater China region and its principal markets (in millions):

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		<b>2007</b>		<b>2006</b>	<b>Change</b>
Taiwan	\$	20.9	\$	22.1	(5%)
Mainland China		17.6		19.7	(11%)
Hong Kong		10.5		10.2	3%
Greater China total	\$	49.0	\$	52.0	(6%)

Foreign currency exchange rate fluctuations did not significantly impact reported revenue in the Greater China region in the first quarter of 2007. China revenue decreased by 14% on a local currency basis in the first quarter of 2007 compared to the same period in 2006, and our executive and active distributor counts decreased 12% and 21%, respectively. Although our year-over-year comparisons have been down during the past year, we have seen stabilization and modest sequential growth in our China business since we received approval from the national government in September of last year to commence direct selling activities in Shanghai. Revenue grew 3% sequentially on a local currency basis in the first quarter of 2007. Our executive and active distributor counts began to show some stabilization in the first quarter of 2007 as well. Our business in China has been negatively impacted over the last year by delays in the direct selling licensing process and related consumer uncertainty and government scrutiny of the direct selling industry. We commenced direct selling activities in Shanghai in January 2007, and we continue to focus our efforts on expanding our direct selling model into other provinces and municipalities throughout China. Given the complexity of the approval processes as well as the Chinese government's continued cautious approach to the development of direct selling in China, however, it remains difficult to predict the timeline for obtaining these approvals and further expanding our direct selling business in this market. Because we are currently approved for direct selling in only eight districts in Shanghai, a majority of our revenue will continue to come through our existing fixed locations that are composed of retail outlets with sales employees. This may also remain the case following further license approvals in other areas because of the greater income opportunity associated with our sales employee business model.

Local currency revenue in Taiwan was down 3% and Hong Kong local currency revenue was up 4% on a year-over-year basis in the first quarter of 2007 compared to the same prior-year period. Taiwan is a mature direct selling market with a large number of well-established competitors, and we experienced some softness in the sponsoring environment this past quarter as compared to the prior year period. Executive distributors decreased 4%, and active distributors decreased 1%. We believe, however, that our business there is stable and we are implementing sponsoring initiatives that we believe will help maintain stability in our business in Taiwan going forward.

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Americas. The following table sets forth revenue for the three-month periods ended March 31, 2007 and 2006 for the Americas region and its principal markets (in millions):

		<b>2007</b>		<b>2006</b>	<b>Change</b>
United States	\$	37.7	\$	35.7	6%
Canada		2.4		2.4	
Latin America		2.2		2.0	10%
Americas total	\$	42.3	\$	40.1	6%

Revenue in the United States continued to be positively impacted by several key initiatives implemented in each of our product categories during the past year, including the S2 Scanner, the ProDerm Skin Analyzer, and our Photomax digital imaging service. The ProDerm Skin Analyzer has helped generate increased sales activity in our personal care product line and Photomax has helped attract a significant number of new distributors to our business. The ProDerm Skin Analyzer has been introduced in the United States and Europe only, and we plan to introduce an improved second-generation model of this tool at our upcoming global distributor convention in September 2007. In addition, we are in the process of developing a new weight management system that we currently plan to introduce into the U.S. market later this year, with a global rollout beginning in 2008.

South Asia/Pacific. The following table sets forth revenue for the three-month periods ended March 31, 2007 and 2006 for the South Asia/Pacific region and its principal markets (in millions):

		<b>2007</b>		<b>2006</b>	<b>Change</b>
Singapore/Malaysia/Brunei	\$	9.0	\$	7.4	22%
Thailand		7.4		5.9	25%
Australia/New Zealand		4.1		3.3	24%
Indonesia		2.0		2.5	(20%)
Philippines		1.1		1.5	(27%)
South Asia/Pacific total	\$	23.6	\$	20.6	15%

Foreign currency exchange rate fluctuations positively impacted revenue in South Asia/Pacific by 9% in the first quarter of 2007 compared to the same prior-year period. After several quarters of year-over-year declines in Singapore/Malaysia/Brunei, these markets grew 22% on a

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combined basis in the first quarter of 2007 compared to the same prior-year period. Successful product launches and initiatives have helped boost revenue in this market over the last few quarters. Thailand and Australia/New Zealand also posted year-over-year growth in the first quarter. Active distributors in the region decreased 10% and executive distributors increased 8% in the first quarter compared to the same prior-year period.

Europe. The following table sets forth revenue for the three-month periods ended March 31, 2007 and 2006 for Europe (in millions):

	2007	2006	Change
Europe	\$ 18.5	\$ 12.5	48%

We experienced growth over a broad range of European markets in the first quarter. Recently opened markets of Russia and Israel continued to positively impact revenue in Europe. We believe that our success in Europe is attributable to enthusiasm and strong alignment of our distributor leaders behind key initiatives, including the S2 Scanner, the Galvanic Spa II and the ProDerm Skin Analyzer.

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### Gross profit

Gross profit as a percentage of revenue decreased to 81.5% for the first quarter of 2007 from 82.3% for the same period in 2006, due in part to increased costs for sales aid materials that we sold at or near cost at our distributor conventions held during the first quarter. In addition, we incurred increased air freight and other costs in the first quarter related to a regulatory issue in Japan, which required us to modify some of the ingredients in our *LifePak* product. We chose to air freight a portion of the updated product in order to avoid any stock outages of this leading product. We anticipate gross margins will increase towards previous levels going forward.

### Selling expenses

Selling expenses as a percentage of revenue increased slightly to 42.6% for the first quarter of 2007 from 42.3% for the same period in 2006.

### General and administrative expenses

General and administrative expenses decreased to \$89.0 million for the first quarter of 2007 from \$90.0 million for the same period in 2006. This decrease is attributable to our transformation initiative implemented in early 2006 and the progress we are making in our efforts to streamline our business and reduce overhead. These factors, coupled with higher overall revenue, resulted in a decrease in general and administrative expenses as a percentage of revenue to 32.5% for the first quarter of 2007 from 33.9% for the same period in 2006.

### Other income (expense), net

Other income (expense), net for the first quarter of 2007 was approximately \$0.8 million of expense compared to \$1.1 million of expense for the same period in 2006. Fluctuations in other income (expense), net are impacted by interest expense and foreign exchange fluctuations to the U.S. dollar on the translation of yen-based bank debt and other foreign denominated intercompany balances into U.S. dollars for financial reporting purposes.

### Provision for income taxes

Provision for income taxes for the first quarter of 2007 was \$6.3 million of expense compared to a \$6.2 million benefit for the same period in 2006. The effective tax rate was 37.3% of pre-tax income during the first quarter of 2007, compared to a rate of 37.5% in the same prior-year period.

### Net income

As a result of the foregoing factors, net income (loss) for the first quarter of 2007 increased to \$10.5 million of income from a (\$10.3) million loss for the same period in 2006.

**Liquidity and Capital Resources**

Historically, our principal uses of cash have included operating expenses, particularly selling expenses, and working capital (principally inventory purchases), as well as capital expenditures, stock repurchases, dividends, debt repayment and the development of operations in new markets. We have generally relied on cash flow from operations to fund operating activities, and we have at times incurred long-term debt in order to fund strategic transactions and stock repurchases.

We typically generate positive cash flow from operations due to favorable gross margins and the variable nature of selling expenses, which constitute a significant percentage of operating expenses. We generated \$8.2 million in cash from operations during the three-month period ended March 31, 2007, compared to \$11.6 million during the same period in 2006. This decrease in cash generated from operations is due primarily to purchases of inventory during the first quarter of 2007 as well as the increase in payment for taxes in 2007.

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As of March 31, 2007, working capital was \$110.7 million, compared to \$109.4 million as of December 31, 2006. Cash and cash equivalents at March 31, 2007 and December 31, 2006 were \$100.8 million and \$121.4 million, respectively. The decrease in cash balances was primarily due to repurchases of stock in the first quarter of approximately \$46.0 million, offset by \$40.0 million in proceeds from debt in the first quarter.

Capital expenditures in the first three months of 2007 totaled \$5.3 million, and we anticipate capital expenditures of approximately \$30 million to \$35 million for 2007. These capital expenditures are primarily related to:

purchases of Scanners;

purchases of computer systems and software, including equipment and development costs for Photomax; and

the build-out of manufacturing and additional retail stores in China, as well as other leasehold improvements in our various markets.

We currently have long-term debt pursuant to various credit facilities and other borrowings. The following table summarizes these long-term debt arrangements as of March 31, 2007:

<b>Facility or Arrangement<sup>(1)</sup></b>	<b>Original Principal Amount</b>	<b>Balance as of March 31, 2007<sup>(2)</sup></b>	<b>Interest Rate</b>	<b>Repayment terms</b>
<b>2000 Japanese yen denominated notes</b>	9.7 billion yen	5.5 billion yen (\$47.1 million as of March 31, 2007)	3.0%	Notes due October 2010, with annual principal payments that began in October 2004.
<b>2003 \$205.0 million multi-currency uncommitted shelf facility:</b>				
U.S. dollar denominated:	\$50.0 million	\$40.0 million	4.5%	Notes due April 2010 with annual principal payments that began in April 2006.
	\$25.0 million	\$10.0 million	4.0%	Notes due April 2008 with annual principal payments that began in October 2004.
	\$40.0 million	\$40.0 million	6.2%	

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Facility or Arrangement <sup>(1)</sup>	Original Principal Amount	Balance as of March 31, 2007 <sup>(2)</sup>	Interest Rate	Repayment terms
	\$40.0 million	\$40.0 million	6.2%	Notes due July 2016 with annual principal payments that begin in July 2010.
				Notes due January 2017 with annual principal payments that begin in January 2011.

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Facility or Arrangement <sup>(1)</sup>	Original Principal Amount	Balance as of March 31, 2007 <sup>(2)</sup>	Interest Rate	Repayment terms
Japanese yen denominated:	3.1 billion yen	3.1 billion yen (\$26.5 million as of March 31, 2007)	1.7%	Notes due April 2014, with annual principal payments beginning April 2008.
<b>2004 \$25.0 million revolving credit facility</b>	N/A	\$0	N/A	Credit facility expires May 2007.

<sup>(1)</sup> Each of the credit facilities and arrangements listed in the table are secured by guarantees issued by our material domestic subsidiaries and by pledges of 65% to 100% of the outstanding stock of our material foreign subsidiaries.

<sup>(2)</sup> The current portion of our long-term debt (i.e. becoming due in the next 12 months) includes \$11.8 million of the balance on our 2000 Japanese yen denominated notes and \$15.0 million of the balance on our U.S. dollar denominated debt under the 2003 multi-currency uncommitted shelf facility.

Our board of directors has approved a stock repurchase program authorizing us to repurchase our outstanding shares of Class A common stock on the open market or in private transactions. The repurchases are used primarily for our equity incentive plans and strategic initiatives. During the first quarter of 2007, we repurchased approximately 2,659,000 shares of Class A common stock under this program for an aggregate amount of approximately \$46.0 million. At March 31, 2007, approximately \$14.6 million was available for repurchases under the stock repurchase program.

In February 2007, our board of directors declared a quarterly cash dividend of \$0.105 per share for all shares of Class A common stock. This quarterly cash dividend of \$6.9 million was paid on March 21, 2007 to stockholders of record on March 2, 2007. Currently, we anticipate that our board of directors will continue to declare quarterly cash dividends and that the cash flows from operations will be sufficient to fund our future dividend payments. However, the declaration of dividends is subject to the discretion of our board of directors and will depend upon various factors, including our net earnings, financial condition, cash requirements, future prospects and other factors deemed relevant by our board of directors.

We believe we have sufficient liquidity to be able to meet our obligations on both a short- and long-term basis. We currently believe that existing cash balances, future cash flows from operations and existing lines of credit will be adequate to fund our cash needs on both a short- and long-term basis. The majority of our historical expenses have been variable in nature and as such, a potential reduction in the level of revenue would reduce our cash flow needs. In the event that our current cash balances, future cash flow from operations and current lines of credit are not sufficient to meet our obligations or strategic needs, we would consider raising additional funds in the debt or equity markets or restructuring our current debt obligations. Additionally, we would consider realigning our strategic plans, including a reduction in capital spending, stock



repurchases or dividend payments.

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Due to the international nature of our business, we are subject from time to time to reviews and audits by the foreign taxing authorities of the various jurisdictions in which we conduct business throughout the world. In 1999, we implemented a duty valuation methodology with respect to the importation of certain products into Japan. For purposes of the import transactions at issue, we had taken the position that, under applicable customs law, there was a sale between the manufacturer and our Japan subsidiary, and that customs duties should be assessed on the manufacturer's invoice. The Valuation Department of the Yokohama customs authorities reviewed and approved this methodology at that time, and it had been reviewed on several occasions by the audit division of the Japan customs authorities since then. In connection with subsequent audits in 2004, the Yokohama customs authorities assessed us additional duties and penalties on these products imported into Japan from October 2002 to October 2004, based on a different valuation methodology than what was previously approved. With respect to the periods under audit, the customs authorities took the position that the relevant import transaction involved a sale between our U.S. affiliate and our Japan subsidiary and that duties should be assessed on the value of that transaction. We disputed this assessment. We also disputed the amount of duties we were required to pay on products imported from November of 2004 to June of 2005 for similar reasons. The total amount assessed or in dispute is approximately \$25.0 million, net of any recovery of consumption taxes. Effective July 1, 2005, we implemented some modifications to our business structure in Japan and in the United States that we believe will eliminate any further customs valuation disputes with respect to product imports in Japan after that time.

Because we believe the documentation and legal analysis supports our position and the valuation methodology we used with respect to the products in dispute had been reviewed and approved by the customs authorities in Japan, we believe the assessments are improper and we filed letters of protest with Yokohama customs with respect to this entire amount. Yokohama customs rejected our letters of protest, and to follow proper administrative procedures we filed appeals with the Japan Ministry of Finance. On June 26, 2006, we were advised that the Ministry of Finance had rejected the appeals filed with their office relating to the imports from October 2002 to October 2004. We decided to appeal this issue through the judicial court system in Japan, and on December 22, 2006 we filed a complaint with the Tokyo District Court Civil Action Section with respect to this period. In January 2007, we were advised that the Ministry of Finance also rejected our appeal with them for the imports from November 2004 to June 2005. We currently plan to appeal this decision with the court system in Japan as well. One of the findings cited by the Ministry of Finance in its decisions was that we had treated the transactions as sales between our U.S. affiliate and our Japan subsidiary on our corporate income tax return under applicable income tax and transfer pricing laws. We have paid the \$25.0 million in customs duties and assessments, the amount of which we recorded in Other Assets in our Consolidated Balance Sheet. To the extent that we are unsuccessful in recovering the amounts assessed and paid, we will be required to take a corresponding charge to our earnings.

In Taiwan, we are currently subject to an audit by tax authorities with respect to the deductibility of distributor commission expenses in that market. In order to avoid the running of the statute of limitations with respect to the 1999 and 2000 tax years, the Taiwan tax authorities have disallowed our commission expense deductions for those years and assessed us a total of approximately \$18.7 million. At this stage of the discussions, we are not required to pay the amount of tax under dispute. We are contesting this assessment and are in discussions with the tax authorities in an effort to resolve this matter. Based on our understanding of this matter, we do not believe that it is probable that we will incur a loss relating to this matter and accordingly have not provided any related reserves.

### **Critical Accounting Policies**

The following critical accounting policies and estimates should be read in conjunction with our audited consolidated financial statements and related notes thereto, and our interim unaudited consolidated financial statements and related notes thereto. Management considers the most critical accounting policies to be the recognition of revenue, accounting for income taxes, accounting for intangible assets and accounting for stock-based compensation. In each of these areas, management makes estimates based on historical results, current trends and future projections.

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**Revenue.** We recognize revenue when products are shipped, which is when title and risk of loss pass to our independent distributors. With some exceptions in various countries, we offer a return policy whereby distributors can return unopened and unused product for up to 12 months subject to a 10% restocking fee. Reported revenue is net of returns, which have historically been less than 5% of gross sales. A reserve for product returns is accrued based on historical experience. We classify selling discounts as a reduction of revenue. Our selling expenses are computed pursuant to our global compensation plan for our distributors which is focused on remunerating distributors based upon the selling

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efforts of the distributors and their downlines, and not their personal purchases.

**Income Taxes.** We account for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes*. This statement establishes financial accounting and reporting standards for the effects of income taxes that result from an enterprise's activities during the current and preceding years. It requires an asset and liability approach for financial accounting and reporting of income taxes. We pay income taxes in many foreign jurisdictions based on the profits realized in those jurisdictions, which can be significantly impacted by terms of intercompany transactions among our affiliates around the world. Deferred tax assets and liabilities are created in this process. As of March 31, 2007, we had net deferred tax assets of \$51.8 million. These net deferred tax assets assume sufficient future earnings will exist for their realization, as well as the continued application of current tax rates. We have considered projected future taxable income and ongoing tax planning strategies in determining that no valuation allowance is required. In the event we were to determine that we would not be able to realize all or part of our net deferred tax assets in the future, an adjustment to the deferred tax assets would be charged to earnings in the period such determination was made.

Our foreign taxes paid are high relative to foreign operating income and our U.S. taxes paid are low relative to U.S. operating income due largely to the flow of funds among our Subsidiaries around the world. As payments for services, management fees, license arrangements and royalties are made from our foreign affiliates to our U.S. corporate headquarters, these payments often incur withholding and other forms of tax that are generally creditable for U.S. tax purposes. Therefore, these payments lead to increased foreign effective tax rates and lower U.S. effective tax rates. Variations (or shifts) occur in our foreign and U.S. effective tax rates from year to year depending on several factors, including the impact of global transfer prices and the timing and level of remittances from foreign affiliates.

In June 2006, the FASB issued FASB Interpretation Number 48, *Accounting for Uncertainty in Income Taxes - an Interpretation of SFAS 109*, ( FIN 48 ). The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized a \$2.6 million increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to the January 1, 2007 balances of retained earnings and additional paid in capital.

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. With a few exceptions, the Company is no longer subject to U.S. federal, state and local income tax examination by tax authorities for years before 2001. In major foreign jurisdictions, the Company is no longer subject to income tax examinations for years before 2000. The Company is currently under examination in a few foreign jurisdictions; however, the final outcomes of these reviews are not yet determinable.

At January 1, 2007, the Company had \$13.8 million in unrecognized tax benefits of which \$12.7 million, if recognized, would affect the effective tax rate. At the date of adoption, the Company had approximately \$2.2 million of accrued interest and penalties related to uncertain tax positions. Interest and penalties related to uncertain tax positions are recognized as a component of income tax expense. The amount of unrecognized tax benefits did not change significantly during the three months ended March 31, 2007.

We are subject to regular audits by federal, state and foreign tax authorities. These audits may result in additional tax liabilities. We account for such contingent liabilities in accordance with FIN 48, and believe we have appropriately provided for income taxes for all years. Several factors drive the calculation of our tax reserves. Some of these factors include: (i) the expiration of various statutes of limitations; (ii) changes in tax law and regulations; (iii) issuance of tax rulings; and (iv) settlements with tax authorities. Changes in any of these factors may result in adjustments to our reserves, which would impact our reported financial results.

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**Intangible Assets.** Under the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets* ( SFAS 142 ), our goodwill and intangible assets with indefinite useful lives are not amortized. Our intangible assets with finite lives are recorded at cost and amortized over their respective estimated useful lives and are reviewed for impairment in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. We are required to make judgments regarding the useful lives of our intangible assets. With the implementation of SFAS 142, we determined certain intangible assets to have indefinite lives based upon our analysis of the requirements of SFAS No. 141, *Business Combinations* ( SFAS 141 ) and SFAS 142. Under the provisions of SFAS 142, we are required to test these assets for impairment at least annually. No impairment charges related to intangible assets were recognized during the three-month periods ended March 31, 2007 or 2006. To the extent an impairment is identified in the future, we will record the amount of the impairment as an operating expense in the period in which it is identified.

**Stock-Based Compensation Expense.** Effective January 1, 2006, we adopted the fair value recognition provisions of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* ( SFAS 123R ), using the modified prospective transition method. Under this method we recognize compensation expense for all share-based payments granted after January 1, 2006 and prior to but not yet vested as of January 1, 2006,

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in accordance with SFAS 123R. Under the fair value recognition provisions of SFAS 123R, we recognize stock-based compensation net of any estimated forfeiture rate and only recognize compensation cost for those shares expected to vest on a straight-line basis over the requisite service period of the award. The fair value of our stock-based compensation expense is based on estimates using the Black-Scholes option pricing model. This option-pricing model requires the input of highly subjective assumptions including the option's expected life, risk-free interest rate, expected dividends and price volatility of the underlying stock. The stock price volatility assumption was determined using the historical volatility of the Company's common stock.

### Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ( SFAS 157 ), which defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 is effective January 1, 2008. We are currently evaluating the impact of SFAS 157 on our consolidated financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities including an amendment to FASB Statement No. 115*, ( SFAS 159 ), which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS 159 is effective January 1, 2008. We are currently evaluating the impact of SFAS 159 on our consolidated financial statements.

### Seasonality and Cyclicity

In addition to general economic factors, we are impacted by seasonal factors and trends such as major cultural events and vacation patterns. For example, most Asian markets celebrate their respective local New Year in the first quarter, which generally has a negative impact on that quarter. We believe that direct selling in Japan, the United States and Europe is also generally negatively impacted during the third quarter, when many individuals, including our distributors, traditionally take vacations.

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We have experienced rapid revenue growth in certain new markets following commencement of operations. This initial rapid growth has often been followed by a short period of stable or declining revenue, then followed by renewed growth fueled by product introductions, an increase in the number of active distributors and increased distributor productivity. The contraction following initial rapid growth has been more pronounced in certain new markets, due to other factors such as business or economic conditions or distributor distractions outside the market.

### Distributor Information

The following table provides information concerning the number of active and executive distributors as of the dates indicated. Active distributors are those distributors and preferred customers who were resident in the countries in which we operated and purchased products for resale or personal consumption directly from us during the three months ended as of the date indicated. Executive distributors are active distributors who have achieved required monthly personal and group sales volumes as well as employed full-time sales representatives in China who have completed a qualification process and receive a salary, labor benefits and bonuses based on their personal sales efforts.

Region:	As of March 31, 2007		As of March 31, 2006	
	Active	Executive	Active	Executive
North Asia	322,000	15,299	321,000	15,851
Greater China	154,000	6,432	177,000	6,900
Americas	149,000	4,317	149,000	4,225
South Asia/Pacific	69,000	2,112	77,000	1,951
Europe	53,000	1,820	45,000	1,266
Total	747,000	29,980	769,000	30,193

### Currency Risk and Exchange Rate Information

A majority of our revenue and many of our expenses are recognized outside of the United States, except for inventory purchases, which are primarily transacted in U.S. dollars from vendors in the United States. The local currency of each of our Subsidiaries' primary markets is considered the functional currency. All revenue and expenses are translated at weighted-average exchange rates for the periods reported. Therefore, our reported revenue and earnings will be positively impacted by a weakening of the U.S. dollar and will be negatively impacted by a strengthening of the U.S. dollar. The Chinese government is beginning to allow the yuan to float more freely against the U.S. dollar and other major currencies. A strengthening of the yuan would benefit our reported revenue and profits and a weakening of the yuan would negatively impact reported revenue and profits. Given the large portion of our business derived from Japan, any weakening of the yen would negatively impact reported revenue and profits. Given the uncertainty of exchange rate fluctuations, we cannot estimate the effect of these fluctuations on our future business, product pricing and results of operations or financial condition.

We seek to reduce our exposure to fluctuations in foreign currency exchange rates through the use of foreign currency exchange contracts, through intercompany loans of foreign currency and through our Japanese yen-denominated debt. We do not use derivative financial instruments for trading or speculative purposes. We regularly monitor our foreign currency risks and periodically take measures to reduce the impact of foreign exchange fluctuations on our operating results.

Our foreign currency derivatives are comprised of over-the-counter forward contracts with major international financial institutions. As of March 31, 2007, we had \$5.9 million of these contracts with expiration dates through March 2008. All of these contracts were denominated in Japanese yen. For the three-month period ended March 31, 2007, we recorded pre-tax gains of \$0.2 million, which was included in our revenue in Japan, and a loss of \$(0.1) million as of March 31, 2007, net of tax, in other comprehensive income related to the fair market valuation of our outstanding forward contracts. Based on our foreign exchange contracts at March 31, 2007, the impact of a 10% appreciation or 10% depreciation of the U.S. dollar against the Japanese yen would not represent a material potential loss in fair value, earnings or cash flows against these contracts. This potential loss does not consider the underlying foreign currency transaction or translation exposures to which we are subject.

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### Note Regarding Forward-Looking Statements

With the exception of historical facts, the statements contained in Management's Discussion and Analysis of Financial Condition and Results of Operations are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that reflect our current expectations and beliefs regarding our future results of operations, performance and achievements. These statements are subject to risks and uncertainties and are based upon assumptions and beliefs that may not materialize. These forward-looking statements include, but are not limited to, statements concerning:

our plans to launch or to continue to roll out certain products, tools and other initiatives in our various markets, and our belief that these initiatives and other recent product launches and initiatives will positively impact our business going forward;

our plans regarding the implementation of direct selling in China and its anticipated impact on our business;

our belief that our Taiwan business will remain stable going forward;

our expectations that gross margins will increase towards previous levels going forward;

our expectation that we will spend approximately \$30 million to \$35 million for capital expenditures during 2007;

our anticipation that our board of directors will continue to declare quarterly cash dividends and that the cash flows from operations will be sufficient to fund our future dividend payments;

our belief that we have sufficient liquidity to be able to meet our obligations on both a short- and long-term basis and that existing cash balances together with future cash flows from operations and existing lines of credit will be adequate to fund our cash needs;

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our plans to appeal duty assessments by the Yokohama customs through the judicial court system in Japan, and our expectation that the \$25 million payment will be recoverable;

our belief that recent modifications to our business structure in Japan and in the United States should eliminate any further customs valuation disputes with respect to product imports in Japan; and

our belief that it is not probable that we will incur a loss relating to the Taiwan audit.

In addition, when used in this report, the words or phrases will likely result, expect, anticipate, will continue, intend, plan, believe similar expressions are intended to help identify forward-looking statements.

We wish to caution readers that our operating results are subject to various risks and uncertainties that could cause our actual results and outcomes to differ materially from those discussed or anticipated. Reference is made to the risks and uncertainties described below and in our Annual Report on Form 10-K and amendments thereto (which contains a more detailed discussion of the risks and uncertainties related to our business). We also wish to advise readers not to place any undue reliance on the forward-looking statements contained in this report, which reflect our beliefs and expectations only as of the date of this report. We assume no obligation to update or revise these forward-looking statements to reflect new events or circumstances or any changes in our beliefs or expectations, except as required by law. Some of the risks and uncertainties that might cause actual results to differ from those anticipated include, but are not limited to, the following:

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(a) Because a substantial majority of our sales are generated in Asia, particularly Japan, significant variations in operating results including revenue, gross margin and earnings from those expected could be caused by:

continued weakening of the Japanese yen;

regulatory constraints with respect to the claims we can make regarding the efficacy of our products and tools;

increasing competitive pressures;

renewed or sustained weakness of Asian economies or consumer confidence;

political unrest or uncertainty; or

natural disasters or epidemics.

(b) Our operations in China are subject to significant regulatory scrutiny, and we have experienced challenges in the past, including interruption of sales activities at certain stores and minor fines being paid in some cases. Because of the government's significant concerns about direct selling activities, government regulators in China scrutinize very closely activities of direct selling companies or activities that resemble direct selling. Even though we have now obtained a direct selling license, we anticipate that government regulators will continue to scrutinize our activities and the activities of our distributors and sales employees to monitor our compliance with the new regulations and other applicable regulations as we integrate direct selling into our business model. We continue to be subject to current governmental reviews and investigations. Any determination that our operations or activities, or the activities of our employed sales representatives or distributors, are not in compliance with applicable regulations, could result in the imposition of 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 or obtain approvals for service centers or expand into new locations, all of which could harm our business.

(c) Towards the end of 2005, Chinese regulators adopted anti-pyramiding and new direct selling regulations that will allow direct selling but contain significant restrictions and limitations, including a restriction on multi-level compensation. These new regulations are not yet well understood, and there continues to be some confusion and uncertainty as to the meaning of the new regulations and the specific types of restrictions and requirements imposed under them. It is also difficult to predict how regulators will interpret and enforce these new regulations and the impact of these new regulations on pending regulatory reviews and investigations. Our business and our growth prospects may be harmed if Chinese regulators interpret the anti-pyramiding regulations or direct selling regulations in such a manner that our current method of

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conducting business through the use of employed sales representatives violates these regulations. In particular, our business would be harmed by any determination that our current method of compensating our sales employees, including our use of the sales productivity of a sales employee and the group of sales employees whom he or she trains and supervises as one of the factors in establishing such sales employee's salary and compensation, violates the restriction on multi-level compensation under the new rules. Our business could also be harmed if regulators inhibit our ability to concurrently operate our retail store/employed sales representative business model and our direct selling business. Although we have obtained a direct selling license in China, our current license only allows us to conduct direct selling in a limited area in Shanghai. If we are unable to establish required service centers or obtain additional necessary national and local licensing as quickly as we would like, or if we are not able to offer a direct selling opportunity that is attractive to distributors as a result of the limitations under the direct selling regulations, our ability to grow our business there could be negatively impacted.

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(d) Our ability to retain key and executive level distributors or to sponsor new executive distributors is critical to our success. Like most direct selling companies, we experience high turnover among distributors from year to year. Because our products are distributed exclusively through our distributors and we compete with other direct selling companies in attracting distributors, our operating results could be adversely affected if our existing and new business opportunities and incentives, products, business tools and other initiatives do not generate sufficient enthusiasm and economic incentive to retain our existing distributors or to sponsor new distributors on a sustained basis. In addition, in our more mature markets, one of the challenges we face is keeping distributor leaders with established businesses and high income levels motivated and actively engaged in business building activities and in developing new distributor leaders. There can be no assurance that our initiatives such as the Scanner and others will continue to generate excitement among our distributors in the long-term or that planned initiatives will be successful in maintaining distributor activity and productivity or in motivating distributor leaders to remain engaged in business building and developing new distributor leaders. In addition, some initiatives may have unanticipated negative impacts on our markets. For example, modifications made to compensation incentives, at times, have not been well received and contributed to declines in distributor numbers and revenue results. In China, we are in the process of making some additional modifications to our employed sales representative compensation model to simplify it and to make it more consistent with the compensation model we are implementing for the independent distributor sales force. There can be no assurance, however, that these measures will be successful in generating distributor excitement in these markets.

(e) Our use of the Scanner is subject to regulatory risks and uncertainties in our various markets. For example, in March 2003 the United States Food and Drug Administration (the "FDA") questioned its status as a non-medical device and we subsequently filed an application with the FDA to have the Scanner classified as a non-medical device. The FDA has not yet acted on our application. There are various factors that could determine whether the Scanner is a medical device, including the claims that we or our distributors make about it. We face similar regulatory issues in other markets with respect to the status of the Scanner as a non-medical device and the claims that can be made in using it. For example, during the past year we faced regulatory inquiries in Singapore, Korea and Japan regarding distributor claims with respect to the Scanner. Although these matters have not resulted in any adverse action against us, our revenue in any market going forward could be negatively impacted if we face similar issues in the future or if such inquiries weaken distributor enthusiasm surrounding the Scanner. A determination in any market that the Scanner is a medical device or that distributors are using it to make medical claims could negatively impact our ability to use the Scanner in such market. In addition, if distributors make claims regarding the Scanner outside of claims approved by us, or use it in a manner not authorized by us, this could result in regulatory actions against our business.

(f) Our current and planned initiatives surrounding the S2 Scanner and the Nu Skin® ProDerm skin analysis tool in our various markets are subject to technical and regulatory risks and uncertainties. The S2 Scanner is a newly developed tool and we cannot be certain that it will consistently meet performance expectations. In addition, we have experienced delays and challenges in completion of a ProDerm unit that meets our specifications and objectives. We have introduced an initial version in the United States that has fewer features while we continue to develop an enhanced version. If we continue to experience difficulties or delays in completing this process that prevent us from meeting our launch schedules or developing a tool that performs the desired functions, our business may be harmed. Our plans are also subject to regulatory risks, particularly in Japan, where there is a risk that regulatory authorities in Japan may impose limitations on the use of this tool and on claims that may be made in connection with its use. Such limitations in Japan or any other markets could weaken the ability of our distributors to utilize this tool in building their businesses, and could dampen distributor enthusiasm surrounding it.

(g) As we work to grow operations in developing markets, work through the approval processes for expansion of direct selling in China and look to develop other new markets, we anticipate that some distributor leaders in other markets will shift their focus away from their home markets and towards business prospects in these markets. This shift of focus of distributor leaders can negatively impact distributor leadership and growth in these other markets and consequently negatively impact revenue. In addition, if China or other new markets are not as successful as the distributor leaders from these other markets anticipate, this can also dampen distributor enthusiasm.

(h) As we continue to implement our business transformation initiative, there could be unintended negative consequences, including business disruptions and/or a loss of employees. Further, we may not realize the cost improvements and greater efficiencies as we hope for as a result of this realignment. In addition, as we continually evaluate strategic reinvestment of any savings generated as a result of our transformation initiative, we may not ultimately achieve the amount of savings that we currently anticipate.

(i) The network marketing and nutritional supplement industries are subject to various laws and regulations throughout our markets, many of which involve a high level of subjectivity and are inherently fact-based and subject to interpretation. Negative publicity concerning supplements with controversial ingredients has spurred efforts to change existing regulations or adopt new regulations in order to impose further restrictions and regulatory control over the nutritional supplement industry. The FTC in the United States is also proposing new regulations that would impose new requirements that could be burdensome. If our existing business practices or products, or any new initiatives or products, are challenged or found to contravene any of these laws by any governmental agency or other third party, or if there are any new regulations applicable to our business that limit our ability to market such products or impose additional requirements on us, our revenue and profitability may be harmed.

(j) Due to the international nature of our business, we are subject from time to time to reviews and audits by the foreign taxing authorities of the various jurisdictions in which we conduct business throughout the world. These audits sometimes result in challenges by such taxing authorities as to our methodologies used in determining our income tax, duties, customs, and other amounts owed in connection with the importation and distribution of our products. For example, we have been assessed by the Japan customs authorities for additional duties on products imported into Japan, and we are currently contesting this assessment. Audits are also often focused on whether or not certain expenses are deductible for tax purposes in a given country. Currently, audits are underway with respect to this issue in a number of our markets, including Taiwan. To the extent we are unable to successfully defend ourselves against such audits and reviews, we may be required to pay assessments and penalties and increased duties, which may, individually or in the aggregate, negatively impact our gross margins and operating results.

(k) Production difficulties and quality control problems could harm our business, in particular our reliance on third party suppliers to deliver quality products in a timely manner. Occasionally, we have experienced production difficulties with respect to our products, including the delivery of products that do not meet our quality control standards. These quality problems have resulted in the past, and could result in the future, in stock outages or shortages in our markets with respect to such products, harming our sales and creating inventory write-offs for unusable products.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The information required by Item 3 of Part I of Form 10-Q is incorporated herein by reference from the section entitled "Currency Risk and Exchange Rate Information" in "Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations" of Part I and also in Note 6 to the Financial Statements contained in Item 1 of Part I.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### **Evaluation of disclosure controls and procedures.**

As of the end of the period covered by this report, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, our disclosure controls and procedures were effective as of March 31, 2007.

**Changes in internal controls over financial reporting.**

There have been no changes in our internal control over financial reporting (as defined in Rule 13a-15 (f) under the Exchange Act) during the most recent fiscal quarter covered by this report, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

No updates to report. Please refer to our recent SEC filings, including our Annual Report on Form 10-K for the 2006 fiscal year, for information regarding the status of certain legal proceedings.

**ITEM 1A. RISK FACTORS**

Our 2006 Annual Report on Form 10-K includes a detailed discussion of our risk factors. The information presented below updates one of these risk factors and should be read in conjunction with the risk factors and information disclosed in that Form 10-K and in subsequent Form 10-Q filings.

**Challenges by private parties to the form of our network marketing system could harm our business.**

We may be subject to challenges by private parties, including our distributors, to the form of our network marketing system or elements of our business. For example, class action lawsuits have recently been brought against two significant competitors that include allegations that the businesses involve unlawful pyramid schemes. In the United States, the network marketing industry and regulatory authorities have generally relied on the implementation of distributor rules and policies designed to promote retail sales to protect consumers and to prevent inappropriate activities and to distinguish between legitimate network marketing distribution plans and unlawful pyramid schemes. We have adopted rules and policies based on case law, rulings of the FTC, discussions with regulatory authorities in several states and domestic and global industry standards. Legal and regulatory requirements concerning network marketing systems, however, involve a high level of subjectivity, are inherently fact-based and are subject to judicial interpretation. Because of the foregoing, we can provide no assurance that we would not be harmed by the application or interpretation of statutes or regulations governing network marketing, particularly in any civil challenge by a current or former distributor.

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**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

**Issuer Purchases of Equity Securities**

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (in millions) <sup>(1)</sup>
January 1 - 31, 2007	593,200	\$ 18.05	593,200	\$ 49.9
February 1 - 28, 2007	708,500	\$ 17.72	708,500	\$ 37.3
March 1 - 31, 2007	1,357,000	\$ 16.71	1,357,000	\$ 14.6
Total	2,658,700		2,658,700	

(1)



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In August 1998, our board of directors approved a plan to repurchase \$10.0 million of our Class A common stock on the open market or in private transactions. Our board has from time to time increased the amount authorized under the plan and a total amount of \$235.0 million is currently authorized. As of March 31, 2007, we had repurchased approximately \$220.4 million of shares under the plan. There has been no termination or expiration of the plan since the initial date of approval.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

### ITEM 5. OTHER INFORMATION

None.

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### ITEM 6. EXHIBITS

<u>Exhibits Regulation S-K Number</u>	<u>Description</u>
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10.1	Performance Targets and Formulas for the 2006 Senior Executive Incentive Plan (incorporated by reference to Exhibit 10.51 to the Company's Annual Report on Form 10-K for the year ended December 31, 2006).
10.2	Nu Skin Enterprises, Inc. Series E Senior Notes Nos. E-1, E-2, E-3, E-4, and E-5 issued January 19, 2007 by the Company to Prudential Investment Management, Inc. and/or its affiliates pursuant to the Private Shelf Agreement (incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K filed January 25, 2007).
10.3	Summary of Non-management Director compensation effective year 2007 (incorporated by reference to Exhibit 10.63 to the Company's Annual Report on Form 10-K for the year ended December 31, 2006).
31.1	Certification by M. Truman Hunt, President and Chief Executive Officer, pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by Ritch N. Wood, Chief Financial Officer, pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification by M. Truman Hunt, President and Chief Executive Officer, pursuant to Section 1350, Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification by Ritch N. Wood, Chief Financial Officer, pursuant to Section 1350, Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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**SIGNATURE**

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

May 10, 2007

**NU SKIN ENTERPRISES, INC.**

By: /s/ Ritch N. Wood

Ritch N. Wood

Its: Chief Financial Officer

(Duly Authorized Officer and Principal Financial and Accounting Officer)

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