

NU SKIN ENTERPRISES INC  
Form 10-Q/A  
May 15, 2006

The following items were the subject  
of a Form 12b-25 and are included herein:  
Part I, Item 4, Controls and Procedures  
Exhibits 31.1, 31.2, 32.1 and 32.2

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

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**FORM 10-Q/A**

(Amendment No. 1)

(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, 2006

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

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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 28, 2006, 70,235,778 shares of the registrant's Class A common stock, \$.001 par value per share were outstanding.

## EXPLANATORY NOTE

This Amendment No. 1 to Form 10-Q (the "Amendment") amends the Quarterly Report on Form 10-Q for the quarter ended March 31, 2006, filed on May 10, 2006, and is being filed to include Part I, Item 4 "Controls and Procedures" and the CEO and CFO certifications identified as Exhibits 31.1, 31.2, 32.1 and 32.2, which were omitted from the original Form 10-Q filing and were the subject of a Form 12b-25 filed on May 11, 2006. There have been no other changes made in this filing.

## NU SKIN ENTERPRISES, INC.

### 2006 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.

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

(U.S. dollars in thousands)

|   | March 31,<br>2006 | December 31,<br>2005 |
|---|-------------------|----------------------|
| <b>ASSETS</b>   |                   |                      |
| Current assets:   |                   |                      |
| Cash and cash equivalents   | \$ 129,773        | \$ 155,409           |
| Current investments   | 15,825            |                      |
| Accounts receivable   | 16,511            | 16,683               |
| Inventories, net  | 99,746            | 99,399               |
| Prepaid expenses and other  | 33,633            | 36,663               |
|   | 295,488           | 308,154              |
| Property and equipment, net   | 71,754            | 84,053               |
| Goodwill  | 112,446           | 112,446              |
| Other intangible assets, net  | 93,653            | 91,137               |
| Other assets  | 83,486            | 83,076               |
| Total assets  | \$ 656,827        | \$ 678,866           |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                   |                      |
| Current liabilities:  |                   |                      |
| Accounts payable  | \$ 27,401         | \$ 20,276            |
| Accrued expenses  | 97,501            | 112,023              |
| Current portion of long-term debt   | 26,779            | 26,757               |
|   | 151,681           | 159,056              |
| Long-term debt  | 123,620           | 123,483              |
| Other liabilities   | 41,692            | 41,699               |
| Total liabilities   | 316,993           | 324,238              |
| Commitments and contingencies (Note 10)   |                   |                      |
| Stockholders' equity:   |                   |                      |
| Class A common stock - 500 million shares authorized, \$.001<br>par value, 90.6 million shares issued | 91                | 91                   |
| Additional paid-in capital  | 181,954           | 179,335              |
| Treasury stock, at cost 20.4 million and 20.5 million shares  | (283,950)         | (284,138)            |
| Accumulated other comprehensive loss  | (67,451)          | (67,197)             |
| Retained earnings   | 509,190           | 526,537              |
|   | 339,834           | 354,628              |
| Total liabilities and stockholders' equity  | \$ 656,827        | \$ 678,866           |

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

**NU SKIN ENTERPRISES, INC.**  
**Consolidated Statements of Income (Unaudited)**  
(U.S. dollars in thousands, except per share amounts)

|   | <b>Three Months Ended<br/>March 31,</b> |             |
|---|---|-------------|
|   | <b>2006</b>                             | <b>2005</b> |
| Revenue   | \$ 265,780                              | \$ 289,351  |
| Cost of sales   | 46,994                                  | 49,664      |
| Gross profit  | 218,786                                 | 239,687     |
| Operating expenses:                                       |   |             |
| Selling expenses  | 112,298                                 | 123,743     |
| General and administrative expenses                       | 90,003                                  | 87,183      |
| Impairment of assets and other                            | 20,840                                  |             |
| Restructuring and other charges                           | 11,115                                  |             |
| Total operating expenses                                  | 234,256                                 | 210,926     |
| Operating income (loss)                                   | (15,470)                                | 28,761      |
| Other income (expense), net                               | (1,054)                                 | (655)       |
| Income (loss) before (provision) benefit for income taxes | (16,524)                                | 28,106      |
| (Provision) benefit for income taxes                      | 6,196                                   | (10,399)    |
| Net income (loss)   | \$ (10,328)                             | \$ 17,707   |
| Net income (loss) per share (Note 3):                     |   |             |
| Basic   | \$ (0.15)                               | \$ 0.25     |
| Diluted   | \$ (0.15)                               | \$ 0.25     |
| Weighted-average common shares outstanding:               |   |             |
| Basic   | 70,131                                  | 69,747      |
| Diluted   | 70,131                                  | 71,353      |

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

**NU SKIN ENTERPRISES, INC.**  
**Consolidated Statements of Cash Flows (Unaudited)**  
(U.S. dollars in thousands)

|  | <b>Three Months Ended<br/>March 31,</b> |             |
|--|---|-------------|
|  | <b>2006</b>                             | <b>2005</b> |
| Cash flows from operating activities:                              |   |             |
| Net income (loss)  | \$ (10,328)                             | \$ 17,707   |
| Adjustments to reconcile net income (loss) to net cash provided by |   |             |

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|  | <b>Three Months Ended<br/>March 31,</b> |            |
|--|---|------------|
| Operating activities:                                |   |            |
| Depreciation and amortization                        | 7,585                                   | 7,338      |
| Amortization of deferred compensation                | 246                                     | 194        |
| Impairment of Scanner asset                          | 18,984                                  |            |
| Stock option expense                                 | 1,900                                   |            |
| Changes in operating assets and liabilities:         |   |            |
| Accounts receivable                                  | 172                                     | (1,333)    |
| Inventories, net                                     | (347)                                   | (3,786)    |
| Prepaid expenses and other                           | (873)                                   | 4,761      |
| Other assets   | 428                                     | (2,681)    |
| Accounts payable                                     | 7,125                                   | (4,291)    |
| Accrued expenses                                     | (13,397)                                | 10,783     |
| Other liabilities                                    | 118                                     | 385        |
| Net cash provided by operating activities            | 11,613                                  | 29,077     |
| Cash flows from investing activities:                |   |            |
| Purchases of property and equipment                  | (13,625)                                | (8,845)    |
| Proceeds from investment sales                       | 54,555                                  | 48,705     |
| Purchases of investments                             | (70,380)                                | (44,250)   |
| Purchase of long-term asset                          | (1,981)                                 | (1,746)    |
| Net cash used in investing activities                | (31,431)                                | (6,136)    |
| Cash flows from financing activities:                |   |            |
| Exercises of employee stock options                  | 651                                     | 1,709      |
| Proceeds from long-term debt                         |   | 30,000     |
| Payments of cash dividends                           | (7,019)                                 | (6,281)    |
| Income tax benefit of options exercised              | 186                                     |            |
| Repurchases of shares of common stock                | (175)                                   | (5,045)    |
| Net cash provided by (used in) financing activities  | (6,357)                                 | 20,383     |
| Effect of exchange rate changes on cash              | 539                                     | (2,387)    |
| Net increase (decrease) in cash and cash equivalents | (25,636)                                | 40,937     |
| Cash and cash equivalents, beginning of period       | 155,409                                 | 109,865    |
| Cash and cash equivalents, end of period             | \$ 129,773                              | \$ 150,802 |

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; North America, which consists of the United States and Canada; South Asia/Pacific, which consists of Australia, Brunei, Indonesia, Malaysia, New Zealand, the Philippines, Singapore

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and Thailand; and Other Markets, which consists of Brazil, Europe, Guatemala/Central America, Israel and Mexico (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 generally accepted accounting principles 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 generally accepted accounting principles 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 statements contain all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation of the Company's financial information as of March 31, 2006, and for the three-month periods ended March 31, 2006 and 2005. 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/A for the year ended December 31, 2005.

### 2. STOCK BASED COMPENSATION

Effective January 1, 2006, the Company adopted the fair value recognition provisions of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R), using the modified prospective transition method and therefore has not restated results for prior periods. Under this transition method, stock-based compensation expense for the first quarter of 2006 includes compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123). Stock-based compensation expense for all stock-based compensation awards granted after January 1, 2006 is based on the grant-dated fair value estimated in accordance with the provisions of SFAS 123R. The Company recognizes these compensation costs, net of an estimated forfeiture rate, on a straight-line basis over the requisite service period of the award, which is generally the option vesting term of four years. The Company estimated the forfeiture rate for the first quarter of 2006 based on its historical experience during the preceding four fiscal years.

In March 2005, the Securities and Exchange Commission (the SEC) issued Staff Accounting Bulletin No. 107 (SAB 107) regarding the SEC's interpretation of SFAS 123R and the valuation of share-based payments for public companies. The Company applied the provisions of SAB 107 in its adoption of SFAS 123R.

Prior to the adoption of SFAS 123R the Company recognized stock based compensation expense in accordance with Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to*

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

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*Employees* (APB 25). Accordingly, the Company generally recognized compensation expense only when it granted options with an exercise price less than the market value of the underlying shares. Any resulting compensation expense was recognized ratably over the associated service period, which was generally the option vesting term.

The Company has elected to follow the transition guidance indicated in Paragraph 81 of FASB Statement No. 123 (revised 2004) for purposes of calculating the pool of excess tax benefits available to absorb possible future tax deficiencies. As such, the Company has calculated its historical APIC pool of windfall tax benefits using the long-form method. Furthermore, the Company has elected to use a two-pool approach (segregating employee and nonemployee awards into two separate pools) when accounting for the pool of windfall tax benefits.

At March 31, 2006, the Company has stock-based employee compensation plans as described below:

#### *Employee Stock Purchase Plan*

Effective February 1, 2000, the Company's board of directors adopted the Employee Stock Purchase Plan (the Purchase Plan), which provides for the issuance of a maximum of 200,000 shares of Class A common stock. Eligible employees can have up to

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15% of their earnings withheld, up to certain maximums, to be used to purchase shares of the Company's Class A common stock on every April 30, July 31, October 31 or January 31 (the Purchase Date). The price of the Class A common stock purchased under the Purchase Plan will be equal to 85% of the lower of the fair market value of the Class A common stock on the commencement date of each three-month offering period or Purchase Date. The Company recognized approximately \$70,000 in compensation expense for this plan during the first quarter of 2006. The Company is considering terminating the Employee Stock Purchase Plan.

### *Equity Incentive Plans*

During the year ended December 31, 1996, the Company's board of directors adopted the Nu Skin Enterprises, Inc., 1996 Stock Incentive Plan (the 1996 Stock Incentive Plan). The 1996 Stock Incentive Plan provides for granting of stock awards and options to purchase common stock to executives, other employees, independent consultants and directors of the Company and its Subsidiaries. Options granted under the equity incentive plans are generally non-qualified stock options, but the plans permit some options granted to qualify as incentive stock options under the U.S. Internal Revenue Code. The exercise price of a stock option generally is equal to the fair market value of the Company's common stock on the option grant date. The contractual term of options granted since 1996 is generally ten years. Currently, all shares issued upon the exercise of options are from the Company's treasury shares. As of March 31, 2006, 13.0 million shares were authorized for issuance under the plans.

The total compensation expense related to these plans was \$1.9 million for the three months ended March 31, 2006. As a result of adopting SFAS 123R, income (loss) before provision for income taxes and net income (loss) for the three months ended March 31, 2006 was \$1.9 million and \$1.2 million lower, respectively, than if the Company had continued to account for stock-based compensation under APB 25. The impact on both basic and diluted earnings per share for the three months ended March 31, 2006 was an increased loss of \$0.02 per share. In addition, prior to the adoption of SFAS 123R, the Company presented the tax benefit of stock option exercises as a component of operating cash flows. Upon the adoption of SFAS 123R, tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options are classified as

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

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financing cash flows. For the three months ended March 31, 2006, all stock-based compensation expense was recorded within general and administrative expenses.

The pro forma table below reflects net income and basic and diluted net income per share for the first quarter of 2005, had the Company applied the fair value recognition provisions of SFAS 123, as follows (in thousands, except per share amounts):

|  | <b>Three Months Ended<br/>March 31, 2005</b> |         |
|--|--|---------|
| Net income, as reported  | \$   | 17,707  |
| Less: Stock-based compensation expense determined under the fair-value-based method for all awards, net of related tax effects |  | (1,728) |
| Pro forma net income   | \$   | 15,979  |
| Net income per share:  |  |         |
| Basic - as reported  | \$   | 0.25    |
| Basic - pro forma  | \$   | 0.23    |
| Diluted - as reported  | \$   | 0.25    |
| Diluted - pro forma  | \$   | 0.22    |

The fair value of stock option awards was estimated using the Black-Scholes option pricing model with the following assumptions and weighted-average fair values as follows:

| <b>Stock Options<sup>(1)</sup>:</b>              | <b>Three Months Ended<br/>March 31, 2005</b> |
|--|--|
| Weighted average grant date fair value of grants | \$ 10.90                                     |
| Risk-free interest rate                          | 4.1%   |
| Dividend yield                                   | 1.5%   |
| Expected volatility                              | 53.0%  |
| Expected life in months                          | 75 months                                    |

<sup>(1)</sup> The fair value calculation was based on stock options granted during the period. There were no stock option grants during the first quarter of 2006.

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

Option activity under the plans as of March 31, 2006 and changes during the three months ended March 31, 2006 were as follows:

|   | <b>Shares</b><br>(in thousands) | <b>Weighted-Average<br/>Exercise Price</b><br>\$ | <b>Weighted-<br/>Average<br/>Remaining<br/>Contractual<br/>Term</b><br>(in years) | <b>Aggregate<br/>Intrinsic Value</b><br>(in thousands) |
|---|---------------------------------|--|---|--|
| Outstanding at December 31, 2005              | 6,762.2                         | 15.99  |   |  |
| Granted                                       |                                 |  |   |  |
| Exercised                                     | (56.5)                          | 8.69   |   |  |
| Forfeited/cancelled/expired                   | (381.9)                         | 21.20  |   |  |
| Outstanding at March 31, 2006                 | 6,323.8                         | 15.74  | 7.02  | \$ 24,016  |
| Vested and expected to vest at March 31, 2006 | 5,817.9                         | 15.74  | 7.02  | 23,536   |
| Exercisable at March 31, 2006                 | 3,720.2                         | 12.98  | 6.06  | 20,261   |

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between the Company's closing stock price on the last trading day of the first quarter of 2006 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on March 31, 2006. This amount varies based on the fair market value of the Company's stock. The total intrinsic value of options exercised for the three months ended March 31, 2006 was \$0.5 million. The total fair value of options vested and expensed was \$1.2 million, net of tax, for the three months ended March 31, 2006.

Nonvested restricted stock awards as of March 31, 2006 and changes during the three months ended March 31, 2006 were as follows:

|                                | <b>Number of Shares</b><br>(in thousands) | <b>Weighted-Average<br/>Grant Date Fair Value</b><br>\$ |
|--------------------------------|---|---|
| Nonvested at December 31, 2005 | 172.5                                     | 15.30   |
| Granted                        |   |   |
| Vested                         | (62.5)                                    | 12.45   |
| Forfeited                      |   |   |
| Nonvested at March 31, 2006    | 110.0                                     | 16.92   |

As of March 31, 2006, there was \$1.3 million of unrecognized stock-based compensation expense related to nonvested restricted stock awards. That cost is expected to be recognized over a weighted-average period of 2.2 years.



In April 2006, the Board of Directors of the Company approved a new stock incentive plan that authorizes the issuance of up to 6 million shares of Class A Common Stock pursuant to stock-based awards to the Company's employees, directors and consultants. This plan is being submitted to the Company's stockholders for approval at the Company's 2006 Annual Meeting of Stockholders to be held in May of 2006. If the new plan is approved, no further grants will be made under the 1996 plan.

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

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**3. 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, 2006 and 2005, other stock options totaling 6.3 million and 0.7 million, respectively, were excluded from the calculation of diluted earnings per share because they were anti-dilutive.

**4. DIVIDENDS PER SHARE**

In February 2006, the board of directors declared a quarterly cash dividend of \$0.10 per share for all classes of common stock. This quarterly cash dividend of approximately \$7.0 million was paid on March 22, 2006, to stockholders of record on March 3, 2006.

**5. DERIVATIVE FINANCIAL INSTRUMENTS**

At March 31, 2006 and December 31, 2005, the Company held forward contracts designated as foreign currency cash flow hedges with notional amounts totaling approximately \$19.5 million and \$23.7 million, respectively, to hedge foreign-currency-denominated intercompany transactions. All such contracts were denominated in Japanese yen. As of March 31, 2006 and December 31, 2005, \$0.3 million and \$1.8 million, respectively, of net unrealized gain, net of related taxes, were recorded in accumulated other comprehensive loss. The contracts held at March 31, 2006 have maturities through March 2007 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 \$2.2 million for the three-month period ended March 31, 2006 and recognized pre-tax losses of \$0.2 million for the three-month period ended March 31, 2005. These gains and losses were recorded primarily as offsets to revenue in Japan in the respective periods.

**6. REPURCHASES OF COMMON STOCK**

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. During the three-month period ended March 31, 2005, the Company repurchased approximately 0.2 million shares of its Class A common stock under its open market repurchase plan for approximately \$5.0 million.

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

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**7. COMPREHENSIVE INCOME (LOSS)**

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The components of comprehensive income (loss), net of related tax, for the three-month periods ended March 31, 2006 and 2005, were as follows (in thousands):

|  | <b>Three Months Ended<br/>March 31,</b> |             |
|--|---|-------------|
|  | <b>2006</b>                             | <b>2005</b> |
| Net income (loss)  | \$ (10,328)                             | \$ 17,707   |
| Other comprehensive income (loss), net of tax:                                       |   |             |
| Foreign currency translation adjustment  | 816                                     | 4,737       |
| Net unrealized gains (losses) on foreign<br>currency cash flow hedges                | 291                                     | 2,680       |
| Less: Reclassification adjustment for realized<br>(gains) losses in current earnings | (1,361)                                 | 150         |
| Comprehensive income (loss)  | \$ (10,582)                             | \$ 25,274   |

### 8. 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, North America, South Asia/Pacific and Other Markets.

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

|                    | <b>Three Months Ended<br/>March 31,</b> |             |
|--------------------|---|-------------|
|                    | <b>2006</b>                             | <b>2005</b> |
| <b>Revenue:</b>    |   |             |
| North Asia         | \$ 140,614                              | \$ 160,829  |
| Greater China      | 51,952                                  | 59,127      |
| North America      | 38,060                                  | 35,992      |
| South Asia/Pacific | 20,647                                  | 20,635      |
| Other Markets      | 14,507                                  | 12,768      |
| Total              | \$ 265,780                              | \$ 289,351  |

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

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

|                 | <b>Three Months Ended<br/>March 31,</b> |             |
|-----------------|---|-------------|
|                 | <b>2006</b>                             | <b>2005</b> |
| <b>Revenue:</b> |   |             |
| Pharmanex       | \$ 148,904                              | \$ 165,499  |
| Nu Skin         | 110,501                                 | 118,346     |
| Big Planet      | 6,375                                   | 5,506       |
| Total           | \$ 265,780                              | \$ 289,351  |

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

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|                 |    | <b>Three Months Ended</b> |             |
|-----------------|----|---------------------------|-------------|
|                 |    | <b>March 31,</b>          |             |
| <b>Revenue:</b> |    | <b>2006</b>               | <b>2005</b> |
| Japan           | \$ | 115,216                   | \$ 141,231  |
| United States   |    | 35,705                    | 33,681      |
| Mainland China  |    | 19,722                    | 26,620      |

  

|                           |    | <b>March 31,</b> | <b>December 31,</b> |
|---------------------------|----|------------------|---------------------|
|                           |    | <b>2006</b>      | <b>2005</b>         |
| <b>Long-lived assets:</b> |    |                  |                     |
| Japan                     | \$ | 8,538            | \$ 14,234           |
| United States             |    | 35,355           | 37,235              |
| Mainland China            |    | 13,950           | 15,104              |

### 9. DEFERRED TAX ASSETS AND LIABILITIES

The Company accounts 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. 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, 2006, the Company has net deferred tax assets of \$28.3 million. The Company has netted these deferred tax assets and deferred tax liabilities by jurisdiction.

### 10. COMMITMENTS AND CONTINGENCIES

In 1999, the Company implemented a duty valuation methodology with respect to the importation of certain products into Japan. The Valuation Department of the Yokohama customs authority reviewed and approved this methodology at that time, and it has been reviewed on several occasions by the audit division of the Japan customs authority since then. In connection with recent audits, the Yokohama customs authorities have 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 that which was previously approved. The Company has disputed this assessment. The Company has also disputed the amount of duties it was required to pay on products imported from November of 2004 to June of 2005. The total amount assessed or in dispute is approximately \$25.0 million as of March 31, 2006, net of any recovery of consumption

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## NU SKIN ENTERPRISES, INC.

### Notes to Consolidated Financial Statements

taxes. Effective July 1, 2005, the Company implemented some modifications to its business structure in Japan and in the United States that it believes will eliminate any further customs valuation disputes with respect to product imports in Japan after that time.

Because the valuation methodology the Company used with respect to the products in dispute was reviewed and approved by the Japan customs authority, the Company believes the assessments are improper and has filed letters of protest with the Yokohama customs authority with respect to this entire amount. The Yokohama customs authority has not accepted the Company's letters of protest to date, and to follow proper administrative procedures the Company has filed appeals with the Japan Ministry of Finance. To the extent necessary, the Company plans to continue to file protests and appeals within the appropriate governmental channels concerning this issue. The Company may also choose to use the judicial court system in Japan if necessary to bring this issue to a resolution. In order to file its letters of protest, the Company was required to pay the \$25.0 million in customs duties and assessments, the amount of which it recorded in "Other Assets" in its Consolidated Balance Sheet. The Company has filed requests for refunds for this entire amount along with its letters of protest. To the extent that the Company is unsuccessful in recovering the amounts assessed and paid, the Company 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.

**11. PURCHASE OF LONG-TERM ASSET**

In March 2002, the Company acquired the exclusive rights to a new light-source technology related to measuring the level of certain antioxidants. The acquisition included contingent payments of up to \$8.5 million of cash and up to 1.2 million shares of the Company's Class A common stock if certain development and revenue targets were met. In 2004, some of these specific development and revenue targets were met resulting in contingent payments owed of approximately \$5.1 million of cash (of which \$1.8 million was paid during the first quarter of 2005) and 525,000 shares (of which 262,500 shares were issued in 2005) of the Company's Class A common stock. In 2005, all remaining targets were met and the total payments of \$8.5 million of cash and the value of the 1.2 million shares of stock have been added to the carrying value of other finite-lived intangible assets.

On March 7, 2006, the Company acquired Caroderm, Inc. for \$4.0 million. As a result of the acquisition, the Company acquired Caroderm's license to use the Scanner technology within the professional medical community. As the sole asset of Caroderm was its license and field of use rights with respect to the Scanner technology, all the consideration paid will be allocated to that asset and amortized over the period of the remaining license agreements related to the Scanner. As of March 31, 2006, the Company had paid approximately \$2.0 million of the purchase price and anticipates paying the remaining balance within the next two years.

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

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**12. 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, 2006, there were no outstanding balances under this revolving credit facility.

The Company also has a \$125.0 million multi-currency private uncommitted shelf facility with Prudential Investment Management, Inc. As of March 31, 2006, the Company had \$91.5 million outstanding under its shelf facility, \$15.0 million of which is included in the current portion of long-term debt. \$65.0 million of this long-term debt is U.S. dollar denominated, bears interest of approximately 4.5% per annum and is amortized in two tranches over five and seven years. The remaining \$26.5 million as of March 31, 2006, 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, 2006, the outstanding balance on the notes was 6.9 billion Japanese yen, or \$58.9 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 subsidiaries.

**13. 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.

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In addition, as of 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.

### 14. 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.

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

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The components of restructuring and other charges are summarized as follows (U.S. dollars in thousands):

|           | <b>Total Incurred<br/>During the 1st<br/>Quarter of 2006</b> | <b>Amounts Paid<br/>During the 1st<br/>Quarter of 2006</b> | <b>Accrued as of<br/>March 31, 2006</b> |
|-----------|--|--|---|
| Severance | \$ 10,072  | \$ 5,964   | \$ 4,108                                |
| Other     | 1,043  |  | 1,043                                   |
| Total     | \$ 11,115  | \$ 5,964   | \$ 5,151                                |

The amount accrued as of March 31, 2006 is included within accrued liabilities, the majority of which is expected to be paid by June 30, 2006.

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

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/A for the year ended December 31, 2005, filed with the Securities and Exchange Commission (SEC) on March 17, 2006, 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, 2006 decreased 8% to \$265.8 million compared to the same period in 2005. The decrease in revenue was primarily attributable to local currency declines in Japan and China and a 3% negative impact of foreign currency exchange rate fluctuations, particularly as a result of weakening of the Japanese yen. Revenue was positively impacted by growth in South Korea, the United States and Europe, and expansion into Indonesia during 2005.

During the first quarter of 2006, we recorded a loss per share of \$.15, compared to earnings per share of \$.25 for the same period in 2005. Earnings were negatively impacted by restructuring charges and impairment and other charges totaling \$32.0 million, or \$.29 per share, relating to a business transformation initiative that we implemented during the first quarter. These charges are more fully described in the sections below entitled Impairment of assets and other and Restructuring and other charges. Earnings for the first quarter of 2006 were also negatively impacted by foreign currency exchange fluctuations, lower revenue in Japan and China, and a \$5.0 million convention expense in Japan that was not incurred in the prior year period. Earnings for the first quarter also include \$1.9 million in stock option expense as a result of the implementation

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of a new accounting standard requiring the expensing of stock options beginning in the first quarter of 2006.

### **Revenue**

**North Asia.** The following table sets forth revenue for the three-month periods ended March 31, 2006 and 2005 for the North Asia region and its principal markets (in millions):

|                  |    | <b>2006</b> |    | <b>2005</b> | <b>Change</b> |
|------------------|----|-------------|----|-------------|---------------|
| Japan            | \$ | 115.2       | \$ | 141.2       | (18%)         |
| South Korea      |    | 25.4        |    | 19.6        | 30%           |
| North Asia total | \$ | 140.6       | \$ | 160.8       | (13%)         |

Foreign currency exchange rate fluctuations, particularly a significant weakening of the Japanese yen, negatively impacted revenue in North Asia by 6%. Revenue in this region was also negatively impacted by an 11% local currency decline in Japan in the first quarter of 2006 compared to the same prior year period. The executive distributor count in Japan decreased 8% compared to the prior year period.

We have experienced declines in revenue and executive and active distributor counts during the last several quarters, due to several factors that continued to negatively impact year-over-year comparisons in Japan during the first quarter of 2006, including:

modifications we made to our compensation plan in Japan in 2005 that we believe have negatively impacted revenue and distributor counts;

a scale-back of the roll-out of the first generation Pharmanex® BioPhotonic Scanner and related promotional campaigns during the latter part of 2005 in anticipation of the planned launch of the second generation scanner (the S2 or the Scanner );

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regulatory issues related to our nutritional supplements and the Scanner which impact the way in which we can market certain products, and which have resulted in some cases in delays in the launch of certain products;

some execution issues resulting in product quality challenges and stock outages in a market where consumers are very sensitive to product quality and service levels;

some adverse publicity and image challenges resulting from aggressive sales and recruiting techniques by some distributor leaders; and

continued competitive pressures.

Effective April 1, 2006, we implemented enhancements to distributor incentives in Japan in order to address the negative impact of the previous changes, although we anticipate that it could take a couple of quarters before we begin to see a positive impact on revenue as a result of these changes. In addition, in March of 2006 we launched the S2 Scanner in Japan, and we plan to launch our g3 nutrition drink in June, subject to necessary regulatory clearances. In our personal care category, we continue to work through the regulatory process in preparation for the launch of our Nu Skin® ProDerm Skin Analyzer (the ProDerm Skin Analyzer ), a handheld skin analysis tool, scheduled to begin later this year. We are also implementing a corporate image enhancement campaign that will include facility upgrades, media campaigns and various other initiatives.

Our South Korea market continued its strong growth in the first quarter of 2006 in both our personal care and nutrition businesses, becoming our third largest market and increasing 24% on a local currency basis compared to the same period in 2005. Executive and active distributor counts continued to grow significantly as well. We believe that these results are due to strong product and other initiatives and alignment of our distributor leaders behind these initiatives.

**Greater China.** The following table sets forth revenue for the three-month periods ended March 31, 2006 and 2005 for the Greater China region and its principal markets (in millions):

|                |    | <b>2006</b> |    | <b>2005</b> | <b>Change</b> |
|----------------|----|-------------|----|-------------|---------------|
| Taiwan         | \$ | 22.1        | \$ | 22.2        | *             |
| Mainland China |    | 19.7        |    | 26.6        | (26%)         |

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|                     |    | 2006 |    | 2005 | Change |
|---------------------|----|------|----|------|--------|
| Hong Kong           |    | 10.2 |    | 10.3 | (1%)   |
| Greater China total | \$ | 52.0 | \$ | 59.1 | (12%)  |

\* Less than 1%

Foreign currency exchange rate fluctuations did not significantly impact reported revenue in the Greater China region in the first quarter of 2006. China revenue decreased by 28% on a local currency basis in the first quarter of 2006 compared to the same period in 2005. We believe that continued consumer uncertainty in China regarding the impact of recently enacted direct selling regulations and uncertainty regarding the timing of the direct selling application process negatively impacted sales, and contributed to a 25% and 14% decline in our executive and active distributor counts, respectively, on a year-over-year basis in that market. In addition, we have experienced increased government and media scrutiny in China due to our status as a leading, global direct selling company and the increased focus on the direct selling industry, particularly following last year's publication of the new direct selling regulations. We are also facing increasing instances of certain sales employees making product sales through unauthorized channels at discounted prices. As a result of these and certain other activities of some of our sales representatives, we have focused on training our sales employees and enforcing our employee policies. We also made certain changes to our compensation plan last year in preparation for the anticipated addition of direct selling to our business model. These changes negatively impacted revenue as our sales representatives adapted to them. We continue to work through the direct selling application process and we look forward to being able to begin augmenting our current business model with a direct selling component after receiving a direct selling license. During the last couple of quarters, we have also experienced some increased product supply challenges in China as well as Taiwan and Hong Kong that have resulted in stock outages and delayed product launches.

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We recently launched the S2 Scanner and g3 nutrition drink in China. We also plan to launch the ProDerm Skin Analyzer in early 2007, which we anticipate will help reinvigorate enthusiasm for our Nu Skin products following declines in Nu Skin sales during the past year as sales leaders shifted their focus towards Pharmanex products. We also plan to continue to invest resources in continued expansion and build-out of our infrastructure in China.

Revenue in Taiwan grew 2% on a local currency basis in the first quarter of 2006 compared to the same prior year period, driven by continued success with the Scanner and new products such as g3 and relaunched Nu Skin 180°, as well as other initiatives. Hong Kong revenue was down 2% in local currency on a year-over-year basis in the first quarter. Sales to Chinese sales representatives purchasing in Hong Kong declined substantially compared to the same prior year period as additional Pharmanex products were introduced in China throughout 2005. Sales to Hong Kong distributors, however, increased on a year-over-year basis. Sales in both Taiwan and Hong Kong were bolstered by purchasing in advance of an April 1 price increase in these markets. Our executive distributor counts in Taiwan and Hong Kong remained strong, growing 3% and 12%, respectively, in the first quarter of 2006 compared to the same prior year period.

**North America.** The following table sets forth revenue for the three-month periods ended March 31, 2006 and 2005 for the North America region and its principal markets (in millions):

|                     |    | 2006 |    | 2005 | Change |
|---------------------|----|------|----|------|--------|
| United States       | \$ | 35.7 | \$ | 33.7 | 6%     |
| Canada              |    | 2.4  |    | 2.3  | 4%     |
| North America total | \$ | 38.1 | \$ | 36.0 | 6%     |

The increase in revenue in the United States was primarily related to growth in our digital imaging service and the positive response to the introduction of a number of new, innovative products and initiatives during the past year. In addition, subscription order revenue represented 61% of revenue in the first quarter of 2006, a 17% increase compared to the prior year period. These initiatives, as well as the recent launch of the S2 Scanner in the United States, have enhanced distributor enthusiasm and sponsorship. Our executive and active distributor counts grew 18% and 3%, respectively, in the first quarter of 2006 compared to the same prior year period. We also look forward to the upcoming launch of the ProDerm Skin Analyzer. We plan to introduce a limited number of initial units of this tool in the United States during the second quarter of 2006. This first version will enable distributors to demonstrate the effectiveness of our skin care products by providing close up skin images, while we continue to work on developing a model that will quantify skin conditions and attributes.

**South Asia/Pacific.** The following table sets forth revenue for the three-month periods ended March 31, 2006 and 2005 for the South Asia/Pacific region and its principal markets (in millions):

|                           |    | 2006 |    | 2005 | Change |
|---------------------------|----|------|----|------|--------|
| Singapore/Malaysia/Brunei | \$ | 7.4  | \$ | 10.8 | (31%)  |

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|                          | 2006    |  | 2005    | Change |
|--------------------------|---------|--|---------|--------|
| Thailand                 | 5.9     |  | 5.8     | 2%     |
| Australia/New Zealand    | 3.3     |  | 3.2     | 3%     |
| Indonesia                | 2.5     |  |         | N/A    |
| Philippines              | 1.5     |  | 0.8     | 88%    |
| South Asia/Pacific total | \$ 20.6 |  | \$ 20.6 |        |

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Foreign currency exchange rate fluctuations negatively impacted revenue in South Asia/Pacific by 1% during the first quarter of 2006 compared to the same period in 2005. This region benefited from \$2.5 million in revenue during the first quarter from Indonesia, which we opened for business in August of 2005. Year-over-year revenue comparisons in Singapore/Malaysia/Brunei were negatively impacted by continued declines following the opening of Indonesia as some of our distributor leaders in these markets have focused their attention on business opportunities in Indonesia and away from their home markets, as well as negative impacts from modifications to distributor incentives implemented in September of 2005. In the first quarter we also experienced declines in executive and active distributor counts in Singapore/Malaysia/Brunei as excitement surrounding the Indonesia opening faded to some degree.

Other Markets. The following table sets forth revenue for the three-month periods ended March 31, 2006 and 2005 for our Other Markets (in millions):

|                     | 2006    |  | 2005    | Change |
|---------------------|---------|--|---------|--------|
| Europe              | \$ 12.5 |  | \$ 11.2 | 12%    |
| Latin America       | 2.0     |  | 1.6     | 25%    |
| Other Markets total | \$ 14.5 |  | \$ 2.8  | 13%    |

Revenue growth in Europe resulted from continued success with the Scanner, the recent introduction of the S2 Scanner, our product subscription program, and continued expansion into Eastern Europe. Distributor sponsorship and leadership also remained strong, and we believe that our success in Europe is in part attributable to the strong alignment of distributor leaders behind certain initiatives in the various local markets. In April 2006, we opened operations in Russia, and we expect this market to contribute positively to our business in the Europe region.

### Gross profit

Gross profit as a percentage of revenue decreased to 82.3% for the three-month period ended March 31, 2006, from 82.8% for the same period in 2005. Lower gross margins resulted from a strengthening of the U.S. dollar, particularly against the Japanese yen.

### Selling expenses

Selling expenses as a percentage of revenue decreased to 42.3% for the three-month period ended March 31, 2006 from 42.8% for the same period in 2005. This decrease is attributable primarily to lower revenue in China, where selling expenses are generally higher as a percent of revenue compared to other markets, as well as short-term incentives paid in Japan in the prior year period. With the implementation of some additional enhancements to our compensation plan in Japan, we anticipate this could slightly increase selling expenses as a percentage of revenue going forward.

### General and administrative expenses

General and administrative expenses as a percentage of revenue for the three-month period ended March 31, 2006 increased to 33.9% from 30.1% for the same period in 2005. In U.S. dollars, general and administrative expenses for the three-month period ended March 31, 2006 increased to \$90.0 million from \$87.2 million for the same period in 2005. General and administrative expenses as a percentage of revenue for the first quarter of 2006 were impacted by:

lower overall revenue;

a \$5.0 million Japan convention expense that was not incurred in the prior-year period;

increased compensation cost of \$1.9 million related to stock option expenses as a result of the adoption of SFAS 123R in the first quarter of 2006; and

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a significantly lower amount of incentive bonuses paid in the first quarter of 2006, compared to the prior-year period.

### **Impairment of assets and other**

During the first quarter of 2006, we recorded impairment charges of \$20.8 million, primarily relating to our first generation BioPhotonic Scanners. In February 2006, as a result of our launch of and transition to the second generation BioPhotonic Scanner, we 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 first quarter of 2006 we completed a settlement agreement with a Big Planet vendor to terminate our purchase commitments for video technology for approximately \$1.8 million as we looked to change direction with our Big Planet business.

### **Restructuring and other charges**

During the first quarter of 2006, we recorded restructuring and other charges of \$11.1 million, primarily relating to our business transformation 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, our overall headcount was reduced by approximately 225 employees, the majority of which related to the elimination of positions at our U.S. headquarters. These expenses consisted primarily of severance and other compensation charges.

Although our business transformation initiative will be an ongoing process, nearly all of the restructuring expenses related to the transformation were incurred during the first quarter of 2006. We believe that these initiatives will generate savings of approximately \$14 million in 2006 and approximately \$30 million in 2007. We plan to reinvest a portion of these savings towards various growth initiatives, particularly in Japan and the roll-out of the S2 Scanner.

### **Other income (expense), net**

Other income (expense), net for the three-month period ended March 31, 2006 was approximately \$1.1 million of expense compared to \$0.7 million of expense for the same period in 2005. 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. The increase in other expense in 2005 was primarily a result of the effect of foreign exchange fluctuation on our yen-based bank debt.

### **Provision for income taxes**

Provision for income taxes for the three-month period ended March 31, 2006 was a \$6.2 million benefit compared to a \$10.4 million expense for the same period in 2005. The effective tax rate was 37.5% of pre-tax income during the three-month period ended March 31, 2006, compared to the rate of 37.0% in the same prior-year period.

### **Net income (loss)**

As a result of the foregoing factors, net income (loss) for the three-month period ended March 31, 2006 decreased to a loss of \$10.3 million from income of \$17.7 million for the same period in 2005.

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## **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 and dividends, 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 \$11.6 million in cash from operations during the three-month period ended March 31, 2006, compared to \$29.1 million during the same period in 2005. This decrease in cash generated from operations is due to lower revenue and profitability in 2006 as well as the increased payment of taxes during the first quarter of 2006.

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As of March 31, 2006, working capital was \$143.8 million, compared to \$149.1 million as of December 31, 2005. Cash and cash equivalents at March 31, 2006 and December 31, 2005 were \$129.8 million and \$155.4 million, respectively. The decrease in cash balances and working capital was primarily due to the shift at March 31, 2006 in cash and cash equivalents to short-term investments as well as the payment of consumption taxes in Japan during the first quarter of 2006.

We anticipate capital expenditures of approximately \$40 million to \$45 million for 2006, of which we incurred \$13.6 million in the first quarter. These capital expenditures are primarily related to:

purchases of Scanners;

purchases of computer systems and software; and

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

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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, 2006:

| Facility or Arrangement <sup>(1)</sup>                                 | Original Principal Amount | Balance as of March 31, 2006 <sup>(2)</sup>           | Interest Rate | Repayment terms  |
|--|---------------------------|---|---------------|--|
| <b>2000 Japanese yen denominated notes</b>                             | 9.7 billion yen           | 6.9 billion yen (\$58.9 million as of March 31, 2006) | 3.0%          | Notes due October 2010, with annual principal payments that began in October 2004. |
| <b>2003 \$125.0 million multi-currency uncommitted shelf facility:</b> |                           |   |               |  |
| U.S. dollar denominated:   | \$50.0 million            | \$50.0 million  | 4.5%          | Notes due April 2010 with annual principal payments beginning April 2006.          |
|  | \$25.0 million            | \$15.0 million  | 4.0%          | Notes due April 2008 with annual principal payments that began in October 2004.    |
| Japanese yen denominated:  | 3.1 billion yen           | 3.1 billion yen (\$26.5 million as of March 31, 2006) | 1.7%          | Notes due April 2014, with annual principal payments beginning April 2008.         |
| <b>2004 \$25.0 million revolving credit facility</b>                   | N/A                       | N/A   | N/A           | N/A  |

<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 2006, we repurchased approximately 10,000 shares of Class A common stock under this program for an aggregate amount of approximately \$0.2 million. Currently, approximately \$52.3 million is available under the stock repurchase program for repurchases.

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In February 2006, our board of directors declared a quarterly cash dividend of \$0.10 per share for all shares of Class A common stock. This quarterly cash dividend of \$7.0 million was paid on March 22, 2006 to stockholders of record on March 3, 2006. 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.

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. The Valuation Department of the Yokohama customs authorities reviewed and approved this methodology at that time, and it has been reviewed on several occasions by the audit division of the Japan customs authorities since then. In connection with recent audits, the Yokohama customs authorities have 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. We have also disputed the amount of duties we were required to pay on products imported from November of 2004 to June of 2005. 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 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 have filed letters of protest with Yokohama customs with respect to most of this amount, and intend to file letters of protest with respect to the rest. Yokohama customs has not accepted our letters of protest to date, and to follow proper administrative procedures we have filed appeals with the Japan Ministry of Finance. To the extent necessary, we plan to continue to file protests and appeals within the appropriate governmental channels concerning this issue. We may also choose to use the judicial court system in Japan if necessary to bring this issue to a resolution. In order to file our letters of protest, we were required to pay 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.

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### **Stock-Based Compensation Expense**

Effective January 1, 2006, we adopted the fair value recognition provisions of Statement of Financial Accounting Standards ( SFAS ) No. 123 (revised 2004), Share-Based Payment ( SFAS 123R ) using the modified prospective transition method and therefore have not restated results for prior periods. Our results of operations for the first quarter of 2006 were impacted by the recognition of non-cash expense related to the fair

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value of our stock-based compensation awards. During the first quarter of 2006, we recorded \$1.9 million in pre-tax stock-based compensation expense. Total stock-based compensation expense, net of tax, for the three months ended March 31, 2006 was \$1.2 million.

### 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.

**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 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, 2006, we had net deferred tax assets of \$28.3 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.

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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 SFAS No. 5, *Accounting for Contingencies*, 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.

**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 definite 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*. For example, with the recent completion of the earnout payments in connection with the acquisition of Scanner-related technology, we have recorded an intangible asset of approximately \$42.0 million, which we are amortizing over the life of the patent related to the technology. We are required to make judgments regarding the useful life 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, 2006 or 2005. 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, and therefore have not restated prior periods' results. 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, 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

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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 a combination of historical and implied volatility of the Company's common stock.

### 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.

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.

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### 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, 2006 |           | As of March 31, 2005 |           |
|--------------------|----------------------|-----------|----------------------|-----------|
|                    | Active               | Executive | Active               | Executive |
| North Asia         | 321,000              | 15,851    | 337,000              | 16,444    |
| Greater China      | 177,000              | 6,900     | 205,000              | 9,150     |
| North America      | 139,000              | 3,799     | 134,000              | 3,252     |
| South Asia/Pacific | 77,000               | 1,951     | 72,000               | 2,098     |
| Other Markets      | 55,000               | 1,692     | 49,000               | 1,489     |
| Total              | 769,000              | 30,193    | 797,000              | 32,433    |

### 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. In addition, in recent months we have seen a weakening of the Japanese yen against the U.S. dollar. Any further 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, 2006, we had \$19.5 million of these contracts with expiration dates through March 2007. All of these contracts were denominated in Japanese yen. For the three-month period ended March 31, 2006, we recorded pre-tax gains of \$2.2 million, which were offset against our revenue in Japan, and gains of \$0.3 million as of March 31, 2006, 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, 2006, 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 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 direct selling in China;

our expectation that we will spend approximately \$40 million to \$45 million for capital expenditures during 2006;

our plans to continue to invest resources in continued expansion and build-out of our infrastructure in China;

our expectation that the Russian market will contribute positively to our business in the European region;

our belief that our business transformation initiative will provide savings, and our plans to invest some of these savings into various growth initiatives;

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;

our plans to continue protesting and appealing assessments by the Yokohama customs authority for duties on products imported into Japan; and

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.

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. 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:

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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 current restrictions on direct selling, government regulators in China scrutinize very closely activities of direct selling companies or activities that resemble direct selling. Although China has recently adopted new direct selling regulations, we have not yet received a direct selling license, and we continue to operate using our retail store/employed sales representative model. Government scrutiny has increased following the adoption of new direct selling and anti-pyramiding regulations, and we continue to be subject to various investigations and inquiries by regulators regarding our business model. In addition, we could face risks that any improper actions by our local sales employees, or any overseas distributors, in violation of local laws or our policies could result in regulatory investigations and penalties that could harm our business. The regulatory environment in China is rapidly evolving, and government officials in China often exercise significant discretion in deciding how to interpret and apply applicable regulations. Any determination that our operations or activities, or the activities of our employed sales representatives or distributors living outside China, are not in compliance with applicable regulations, could result in the imposition of substantial fines, extended interruptions of business, restrictions on our ability to obtain a direct selling license, open new stores or obtain approvals for service centers or expand into new locations, changes to our business model, the termination of required licenses to conduct business, limitations on the number of sales persons we can employ, 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. Although we have applied for a direct selling license and anticipate that we will be able to obtain a direct selling license under these regulations, the timing and application process are not clear, and there can be no assurance that we will be able to obtain such a license. Our future growth in China could be harmed if we do not receive a direct selling license or if the direct selling application process is delayed further than anticipated. Also, we may face increased competition or competitive disadvantages if other companies begin receiving direct selling licenses before we do. In addition, 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 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 planned direct selling business. In addition, there can be no assurance that we will be able to successfully grow our business through direct selling activities given the restrictive nature of the new direct selling regulations.
- (d) Our ability to retain key and executive level distributors or to sponsor new executive distributors is critical to our success. 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

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building and developing new distributor leaders. In addition, some initiatives may have unanticipated negative impacts on our markets. For example, during the past year certain modifications were made to compensation incentives in China, Japan, and Singapore that appear not to have been as well received by some distributors as expected, contributing to declines in distributor numbers and revenue results. We have recently implemented compensation plan enhancements in Japan designed to address the negative impacts of previous changes, but there can be no assurance that these measures will be successful in generating distributor excitement.

- (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 introduction of 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 are currently in the process of finalizing the hardware and software design specifications for our ProDerm unit. We have experienced delays and challenges in completion of the design that will quantify skin conditions and attributes. 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 we are currently working through the regulatory process for the planned introduction of the ProDerm tool in that market. 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.
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- (g) As we begin operations in Russia, prepare for the implementation of direct selling regulations 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 two 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 Russia and China are not as successful as the distributor leaders from these other markets anticipate, this can also dampen distributor enthusiasm.
  - (h) As we 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.
  - (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. Recent negative publicity concerning certain 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. 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 changes in regulations applicable to our business or any of our nutritional products that limit our ability to market such products, 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 were recently 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



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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 5 to the Financial Statements contained in Item 1 of Part I.

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### **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 defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as the result of a material weakness identified and discussed below, our disclosure controls and procedures were not effective as of March 31, 2006.

Notwithstanding the material weakness discussed below, our management has concluded that the consolidated financial statements included in this Quarterly Report on Form 10-Q/A fairly states, in all material respects, our financial position, results of operations and cash flows for the periods presented in conformity with accounting principles generally accepted in the United States of America.

#### **Material Weakness in Internal Control Over Financial Reporting**

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. As of March 31, 2006, we did not maintain effective controls related to the accuracy of our impairment evaluation of long-lived assets, as required under Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-lived Assets* (SFAS 144). Specifically, management's review of the impairment analysis and computation failed to detect an error in the application of the discount rate used to estimate the fair value of the first generation BioPhotonic (S1) Scanners. This control deficiency resulted in a material adjustment to the impairment charge that we had initially recorded relating to our S1 Scanners in our first quarter financial statements. This control deficiency could result in a misstatement of our long-lived assets and related impairment charges that would result in a material misstatement to the annual or interim consolidated financial statements that would not be prevented or detected. Accordingly, management has determined that this control deficiency constitutes a material weakness.

#### **Remediation Steps to Address Material Weakness**

We plan to remediate this material weakness by enhancing our internal controls surrounding the review of our impairment analyses and computations related to long-lived assets including analyses performed in accordance with SFAS 144, SFAS No. 142, *Goodwill and Other Intangible Assets*, and other similar cash flow analyses. Our remediation plan includes the implementation of the following controls and procedures:

Management will improve its review process by developing formal checklists which will provide guidance regarding matters to consider when performing impairment analyses, such as the appropriate discount rate, time periods, cash flow assumptions and other details.

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Management will perform a detailed review of the computations and assumptions using the checklist to ensure that appropriate matters have been considered.

To ensure that the appropriate impairment analyses and related checklist are considered and completed, as appropriate, these procedures will be added to our quarterly closing checklist, which is reviewed each quarter for completeness by management

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Management will provide ongoing training, as necessary, regarding the appropriate methodologies and assumptions to utilize in performing impairment analyses.

### **Changes in internal controls.**

Other than described above, there has been no change 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 has materially affected, or is 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 2005 fiscal year, and amendments thereto for information regarding the status of certain legal proceedings.

### **ITEM 1A. RISK FACTORS**

Our 2005 Annual Report on Form 10-K, and amendments thereto, includes a detailed discussion of our risk factors. The information presented below updates four of those risk factors and should be read in conjunction with the risk factors and information disclosed in that Form 10-K.

**Because our Japanese operations account for a majority of our business, adverse changes in our business operations in Japan would harm our business.**

Approximately 48% of our 2005 revenue was generated in Japan. We have experienced declines in our business in this market during the past several quarters, and many of our competitors have seen their businesses in this market contract in the last few years. We believe our operating results have been negatively impacted by a variety of factors, including the unanticipated impact of compensation plan changes, regulatory issues, and production difficulties. In addition, we continue to face increasing competition from existing and new competitors in Japan. Our financial results would be harmed and our business could continue to decline if our products, business opportunity or planned growth initiatives do not retain and generate continued interest and enthusiasm among our distributors and consumers in this market. Current and planned initiatives in this market include the introduction of the second-generation BioPhotonic Scanner, the Nu Skin® ProDerm Skin Analyzer and g3 nutrition drink. We have also recently introduced compensation plan enhancements in Japan designed to address the negative impacts of previous compensation plan changes. If these and other planned initiatives are delayed, are impacted by regulatory constraints or do not generate distributor excitement or attract new distributors or customers in Japan, it may limit our prospects for renewed growth in that market and harm our financial results. Our plans to launch g3 nutrition drink in June, for example, is subject to certain regulatory risks. The Gak fruit ingredient in g3 has not yet been recognized as an approved food. Although we are working with the regulatory authorities on this issue, any delay or failure of the government to list this ingredient as an approved food could negatively impact our plans to launch g3 in Japan.

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**Technical and regulatory issues associated with the second generation BioPhotonic Scanner and the Nu Skin® ProDerm Skin Analyzer could negatively impact the success of these programs, which could harm our business.**

Our current and planned initiatives surrounding the introduction of the S2 Scanner and the Nu Skin® ProDerm Skin Analyzer in our various markets are subject to technical and regulatory risks and uncertainties. The S2 is smaller, more portable, and faster than its predecessor in terms of calibration and scan time. However, the S2 is a newly developed tool and we cannot be certain that the units we introduce in the field will consistently perform according to expectation in terms of speed, accuracy and other factors. If the S2 does not perform as expected, distributors may be limited in their ability to utilize this tool, and distributor enthusiasm may be dampened with respect to this tool. As with any new, innovative technology, we have also experienced challenges in our development of the ProDerm tool. As we continue to work through these technical issues, we have elected to introduce a limited number of an initial version that has fewer features than we initially anticipated, while we continue to refine the technology. The initial version of this tool that we plan to launch during the next couple of quarters will provide close-up skin images that will enable distributors to demonstrate the effectiveness of our skin care products. We plan to aggressively continue to work on the development of an updated version that will provide a quantifiable assessment of skin conditions and attributes. There can be no assurance, however, that we will be successful in achieving this result. Our plans with respect to the launch of the ProDerm are also subject to regulatory risks, particularly in Japan, where we are currently working through the regulatory process for the planned introduction of the ProDerm Skin Analyzer in that market. It appears that regulatory restrictions 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.

**Laws and regulations may prohibit or severely restrict our direct sales efforts and cause our revenue and profitability to decline.**

Various government agencies throughout the world regulate direct sales practices. These laws and regulations are generally intended to prevent fraudulent or deceptive schemes, often referred to as pyramid schemes, that compensate participants for recruiting additional participants irrespective of product sales, use high pressure recruiting methods and/or do not involve legitimate products. The laws and regulations in our current markets often:

- impose order cancellations, product returns, inventory buy-backs and cooling-off rights for consumers and distributors;
- require us or our distributors to register with governmental agencies;
- impose reporting requirements to regulatory agencies; and/or
- require us to ensure that distributors are not being compensated based upon the recruitment of new distributors.

Complying with these widely varying and sometimes inconsistent rules and regulations can be difficult and require the devotion of significant resources on our part. If we are unable to continue business in existing markets or commence operations in new markets because of these laws, our revenue and profitability will decline. Countries where we currently do business could change their laws or regulations to negatively affect or prohibit completely direct sales efforts. In addition, government agencies and courts in the countries where we operate may use their powers and discretion in interpreting and applying laws in a manner that limits our ability to operate or otherwise harms our business or adopt new laws or regulations that could impose additional restrictions. For example, the FTC in the United States has recently proposed new regulations which would impose additional disclosure requirements and waiting periods that are more restrictive. If any governmental authority were to bring a regulatory enforcement action against us that interrupts our business, revenue and earnings would likely suffer.

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**Although our distributors are independent contractors, improper distributor actions that violate laws or regulations could harm our business.**

Distributor activities in our existing markets that violate governmental laws or regulations could result in governmental actions against us in markets where we operate. Except in China, our distributors are not employees and act independently of us. We implement strict policies and procedures to ensure our distributors will comply with legal requirements. However, given the size of our distributor force, we experience problems with distributors from time to time. For example, product claims made by some of our distributors in 1990 and 1991 led to an investigation by the FTC, which resulted in our entering into a consent decree with the FTC as described below. In addition, recent rulings by the Korean FTC and by judicial authorities against our company and other companies in Korea indicate that vicarious liability may be imposed on us for the criminal activity of our independent distributors.

**If we are unable to retain our existing independent distributors and recruit additional distributors, our revenue will not increase and may even decline.**

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We distribute almost all of our products through our independent distributors (including China sales representatives) and we depend on them to generate virtually all of our revenue. Our distributors may terminate their services at any time, and, like most direct selling companies, we experience high turnover among distributors from year to year. As a result, in order to maintain sales and increase sales in the future, we need to continue to retain existing distributors and recruit additional distributors. To increase our revenue, we must increase the number of and/or the productivity of our distributors.

We have experienced periodic declines in both active distributors and executive distributors in the past. The number of our active and executive distributors may not increase and could decline again in the future. While we take many steps to help train, motivate and retain distributors, we cannot accurately predict how the number and productivity of distributors may fluctuate because we rely primarily upon our distributor leaders to recruit, train and motivate new distributors. Our operating results could be harmed if we and our distributor leaders do not generate sufficient interest in our business to retain existing distributors and attract new distributors.

The number and productivity of our distributors also depends on several additional factors, including:

any adverse publicity regarding us, our products, our distribution channel or our competitors;

a lack of interest in, or the technical failure of, existing or new products;

the public's perception of our products and their ingredients;

the public's perception of our distributors and direct selling businesses in general;

our actions to enforce our policies and procedures;

general economic and business conditions; and

potential saturation or maturity levels in a given country or market which could negatively impact our ability to attract and retain distributors in such market.

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 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 developing new distributor leaders. There can be no assurance that our initiatives such as the Scanner and others will 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, during the past year certain modifications we made to compensation incentives in China, Japan and Singapore were not received or understood well by some distributors, resulting in unanticipated negative impacts on distributor numbers and revenue in these markets. The introduction of a new product or key initiative such as the Scanner can also negatively impact other product lines to the extent our distributor leaders focus their efforts on the new product or initiative.

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

#### **Share Repurchases**

| Period                | (a)<br>Total Number<br>of Shares<br>Purchased | (b)<br>Average Price<br>Paid per Share | (c)<br>Total Number of Shares<br>purchased as Part of<br>Publicly Announced<br>Plans or Programs | (d)<br>Approximate Dollar Value<br>of Shares that May Yet Be<br>Purchased Under the<br>Plans or Program<br>(in millions) <sup>(1)</sup> |
|-----------------------|---|--|--|---|
| January 1 - 31, 2006  |   | N/A                                    |  | \$ 52.5   |
| February 1 - 28, 2006 | 10,000  | \$ 17.47                               | 10,000   | \$ 52.3   |
| March 1 - 31, 2006    |   | N/A                                    |  | \$ 52.3   |
| Total                 | 10,000  |  | 10,000   |   |

#### Share Repurchases

(1) 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 \$160.0 million is currently authorized. As of March 31, 2006, we had repurchased approximately \$107.7 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**

In Item 9B of our Annual Report on Form 10-K for the year ended December 31, 2005, we described the material terms of a severance arrangement we agreed to in March of 2006 with Lori Bush, who had previously been serving as the President of our Nu Skin division. On April 20, 2006, we entered into a definitive settlement and release agreement with Ms. Bush, containing the terms previously agreed to. As a result of further analysis of tax implications, the definitive agreement provides for a lump sum severance payment instead of payments over time as previously agreed to. Reference is made to the complete text of the settlement and release agreement with Ms. Bush, attached as Exhibit 10.3 to this Report and incorporated by reference in this Item 5.

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**ITEM 6. EXHIBITS**

**Exhibits  
Regulation  
S-K  
Number**

**Description**

| Exhibits<br>Regulation<br>S-K<br>Number | Description  |
|---|--|
| 10.1                                    | Joseph Y. Chang Employment Agreement dated April 17, 2006 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed April 18, 2006).  |
| 10.2                                    | Severance letter with Lori Bush dated March 10, 2006 (incorporated by reference to Exhibit 10.60 to the Company's Annual Report on Form 10-K/A filed March 17, 2006).  |
| 10.3                                    | Settlement and Release Agreement with Lori Bush dated April 20, 2006.  |
| 10.4                                    | Severance letter with Richard King dated March 2, 2006 (incorporated by reference to Exhibit 10.59 to the Company's Annual Report on Form 10-K/A filed March 17, 2006).  |
| 10.5                                    | Agreement and Plan of Merger dated March 7, 2006 by and among Nu Skin International, Inc. ("NSI"), Pharmanex License Acquisition Corporation (a wholly-owned subsidiary of NSI), Caroderm, Inc. ("Caroderm") and certain shareholders of Caroderm (incorporated by reference to Exhibit 10.58 to the Company's Annual Report on Form 10-K/A filed March 17, 2006). |
| 10.6                                    | Summary of Team Elite Travel Policy (incorporated by reference to Exhibit 10.61 to the Company's Annual Report on Form 10-K/A filed March 17, 2006).   |
| 10.7                                    | CEO compensation changes.  |

**Exhibits  
Regulation  
S-K  
Number**

**Description**

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|      |   |
|------|---|
| 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 15, 2006

**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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