

Forward-looking Statements

This annual report includes both historical and "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. We have based these forward-looking statements on our current expectations and projections about future results. Words such as "may," "should," "could," "would," "expect," "plan," "anticipate," "believe," "estimate," "predict," "potential," "continue," or similar words are intended to identify forward-looking statements, although not all forward-looking statements contain these words. Although we believe that our opinions and expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements, and our actual results may differ substantially from the views and expectations set forth in this annual report. We disclaim any intent or obligation to update any forward-looking statements after the date of this annual report to conform such statements to actual results or to changes in our opinions or expectations.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with and our financial statements and related notes included elsewhere in this annual report. The following discussion and analysis discusses the financial condition and results of our operations on a consolidated basis, unless otherwise indicated.

Overview

We are a developer, manufacturer and marketer of a proprietary line of nutritional supplements addressing basic nutrition, specific wellness needs, weight management and sports nutrition. We also offer a line of skin care products. We sell our products through an international network marketing system using independent distributors. Sales in the United States represented approximately 90.3% of worldwide net sales for the year ended December 31, 2005 compared to approximately 86.5% for the year ended December 31, 2004. Our international operations currently generate sales through distributor networks in Australia, Canada, Germany, Ireland, Malaysia, Mexico, New Zealand, the Philippines, Singapore and the United Kingdom.

We derive our revenues principally through product sales made by our global independent distributor base, which, as of December 31, 2005, consisted of approximately 65,480 distributors. Our sales can be affected by several factors, including our ability to attract new distributors and retain our existing distributor base, our ability to properly train and motivate our distributor base and our ability to develop new products and successfully maintain our current product line.

All of our sales to distributors outside the United States are made in the respective local currency; therefore, our earnings and cash flows are subject to fluctuations due to changes in foreign currency rates as compared to the U.S. dollar. As a result, exchange rate fluctuations may have an effect on sales and gross margins. Accounting practices require that our results from operations be converted to U.S. dollars for reporting purposes. Consequently, our reported earnings may be significantly affected by fluctuations in currency exchange rates, generally increasing with a weaker U.S. dollar and decreasing with a strengthening U.S. dollar. Products manufactured by us for sale to our foreign subsidiaries are transacted in U.S. dollars. From time to time, we enter into foreign exchange forward contracts to mitigate our foreign currency exchange risk.

Components of Net Sales and Expense

Sales at suggested retail primarily represents the gross sales amounts on our invoices to our distributors before distributor allowances, and also includes freight and handling income and sales of marketing materials. Distributor allowances on product purchases represents the discount given to a distributor in purchasing nutritional supplements or skin care products from us. The amount of the discount can range between 20% to 40% of suggested retail price, depending on the rank of a particular distributor. Net sales reflect the items included in sales at suggested retail, less the distributor allowances. We record net sales and the related commission expense when the merchandise is shipped.

Our primary expenses include cost of products sold, distributor royalties and commissions and selling, general and administrative expenses.

Cost of products sold primarily consists of expenses related to raw materials, labor, quality control and overhead directly associated with production of our products and sales materials, as well as shipping costs relating to the shipment of products to distributors, and duties and taxes associated with product exports. Cost of products sold is impacted by the cost of the ingredients used in our products, the cost of shipping the distributors' orders, along with our efficiency in managing the production of our products.

Distributor royalties and commissions are monthly payments made to Master Affiliates and above, based on products sold by Master Affiliates and above sponsored by such Master Affiliates or higher-level distributors. Based on our distributor agreements, these expenses typically approximate 23% of sales at suggested retail. Also, we include other sales leadership bonuses, such as Ambassador bonuses, in this line item. We generally expect total distributor royalties and commissions to approximate 40% of our net sales. Distributor royalties and commissions are directly related to the level of our sales and, absent any changes in our distributor compensation plan, should continue at comparable levels as a percentage of net sales as in recent periods.

Selling, general and administrative expenses include the compensation and benefits paid to our employees, all other selling expenses, marketing, promotional expenses, travel and other corporate administrative expenses. These other corporate administrative expenses include professional fees, depreciation and amortization, occupancy costs, communication costs and other similar operating expenses. Selling, general and administrative expenses can be affected by a number of factors, including staffing levels and the cost of providing competitive salaries and benefits; the amount we decide to invest in distributor training and motivational initiatives; the cost of regulatory compliance, such as the costs incurred to comply with the various provisions of the Sarbanes-Oxley Act of 2002; and other administrative costs.

Results of Operations

The following table sets forth selected results of our operations expressed as a percentage of net sales for the years ended December 31, 2005, 2004 and 2003. Our results of operations for the periods described below are not necessarily indicative of results of operations for future periods.

	Year Ended December 31		
	2005	2004	2003
Net sales	100.0%	100.0%	100.0%
Costs and expenses:			
Cost of products sold	17.0	17.2	17.2
Distributor royalties and commissions	40.0	39.8	38.9
Selling, general and administrative	32.0	33.7	34.4
Income from operations	11.0	9.3	9.5
Interest expense	-0.3	-0.3	-0.3
Other income	0.3	0.3	0.2
Income before income taxes	11.0	9.3	9.4
Provision for income taxes	4.4	3.7	3.8
Net income	6.6%	5.6%	5.7%

Year Ended December 31, 2005 Compared to Year Ended December 31, 2004

Net Sales Sales in the United States grew by 22.3% in the year ended December 31, 2005 compared to 2004. During 2005, our international sales declined by 16.0% over the prior year, primarily the result of price increases and changes made to the distributor qualification requirements made in our Mexican and Philippine markets. Also contributing to the net sales increase during 2005 were sales from the introduction of our newest product, CardioSentials. Introduced in February 2005, net sales of this product were \$3.9 million for the year ended December 31, 2005.

The following table summarizes net sales by geographic market ranked by the date we began operations in each market for the years ended December 31, 2005 and 2004.

Net Sales by Region (in thousands)	2005		2004		Change from prior year	Change in %
	Amount	% of sales	Amount	% of sales		
United States	\$ 102,549	90.3%	\$ 83,873	86.5%	\$ 18,676	22.3%
Australia/New Zealand	2,215	2.0	2,543	2.6	(328)	-12.9
Canada	1,668	1.5	1,751	1.8	(83)	-4.7
Mexico	1,608	1.4	2,634	2.7	(1,026)	-39.0
United Kingdom/Ireland	846	0.7	545	0.6	301	55.2
Philippines	2,328	2.0	2,865	3.0	(537)	-18.7
Malaysia/Singapore	2,031	1.8	2,771	2.9	(740)	-26.7
Germany	320	0.3	—	—	320	—
Consolidated total	\$ 113,565	100.0%	\$ 96,982	100.0%	\$ 16,583	17.1%

The following table sets forth, as of December 31, 2005 and 2004, the number of our active distributors and Master Affiliates and above. The total number of active distributors includes Master Affiliates and above. We define an active distributor as one that enrolls as a distributor or renews its distributorship during the prior twelve months. Master Affiliates and above are distributors that have attained the highest level of discount and are eligible for royalties generated by Master Affiliates and above in their down-line organization. Growth in the number of active distributors and Master Affiliates and above is a key factor in continuing the growth of our business.

Active Distributors and Master Affiliates and Above by Region	2005		2004		Change in %	
	Distributors	Master Affiliates and Above	Distributors	Master Affiliates and Above	Distributors	Master Affiliates and Above
United States	52,040	15,840	47,190	12,460	10.3%	27.1%
Australia/New Zealand	2,410	250	3,040	290	-20.7	-13.8
Canada	1,210	210	1,480	210	-18.2	0.0
Mexico	1,630	310	9,000	710	-81.9	-56.3
United Kingdom/Ireland	750	100	450	60	66.7	66.7
Philippines	4,070	490	6,760	650	-39.8	-24.6
Malaysia/Singapore	3,250	590	5,280	730	-38.4	-19.2
Germany	120	50	—	—	—	—
Consolidated total	65,480	17,840	73,200	15,110	-10.5%	18.1%

In the United States, new distributor enrollments, high retention and continued growth in the number of Master Affiliates and above continue to be key factors in our sales growth. In 2005, over 23,030 new distributors were enrolled in the United States, as compared to approximately 22,980 in 2004. Distributor retention in the United States was approximately 62.9% for 2005 compared to a rate of 57.7% for 2004. The number of distributors reaching Master Affiliate and above has also continued to improve in the United States. In 2005, approximately 8,120 distributors qualified as new Master Affiliates and 61.6% of the Master Affiliates and above as of December 31, 2004 requalified as Master Affiliates and above during 2005. This compares to approximately 6,860 new Master Affiliates and a requalification rate of 61.2% in 2004. We attribute the increase in net distributor enrollment and retention in part to the momentum created by the consistency and reinforcement of our training programs and business opportunity presentations, in the form of regional distributor conferences and other corporate-sponsored meetings. This has resulted in more distributors reaching the Master Affiliate level and above, who generally are more experienced and productive distributors.

During the year ended December 31, 2005, net sales in our international operations declined in aggregate by 16.0% to \$11.0 million compared to \$13.1 million for the year ended December 31, 2004. The decrease in international sales occurred primarily in Mexico, Malaysia/Singapore and the Philippines because of a change in our distributor qualification requirements, which resulted in a decrease in our number of distributors in those markets. When net sales are converted using the 2004 exchange rate for both 2004 and 2005, international net sales declined 18.1% for 2005 compared to the prior year, as the U.S. dollar weakened against every currency in which we conduct operations during 2005.

Net sales in the Australia/New Zealand market decreased by 12.9% in 2005 compared to 2004. New distributor enrollments were 725 in 2005 compared to 1,419 in 2004. When net sales are converted using the 2004 exchange rate for both 2004 and 2005, net sales in this market decreased by 15.6%. As a result of the decline in sales during the first half of 2005, the contract of the sales manager for that market was terminated during the second quarter of 2005, and we named a new sales manager in September 2005. The combined net loss for the Australia/New Zealand market was \$115,000 in 2005, compared to a net loss of \$132,000 in 2004.

Net sales in Canada decreased by 4.7% in 2005 compared to 2004. The decline in net sales is due in part to the decline in new distributor enrollments. New distributor enrollments were 489 in 2005 compared to 853 in 2004. When measured in local currency, Canadian net sales decreased by 11.1% in 2005 compared to 2004. Net income in Canada was \$77,000 for 2005, compared to \$249,000 in 2004.

Net sales in Mexico decreased 39.0% in 2005 compared to 2004. New distributor enrollments were 1,048 in 2005 compared to 7,904 in 2004. When measured in local currency, 2005 net sales declined by 41.3%. Net sales declined subsequent to a price increase and change in distributor qualification requirements, effective March 1, 2005, to make the Mexican business model consistent with the rest of our markets. The net loss in Mexico for 2005 was \$446,000, compared to a net loss of \$113,000 in 2004.

Net sales in the United Kingdom increased by 55.2% for 2005 compared to 2004, as the efforts of our new general manager and national sales manager in the UK began to show positive results. When measured in local currency, net sales in the UK increased by 56.3% in 2005, compared to the prior year. New distributor enrollments were 447 in 2005 compared to 193 in 2004. However, the added staffing and sales development expenses more than offset the gain in sales. The net loss incurred in the UK was \$421,000 in 2005, compared to a net loss of \$183,000 in 2004.

As in Mexico, we changed our distributor qualification requirements and increased prices in the Philippines effective February 2005. Net sales in the Philippines declined by 18.7% in 2005 compared to the prior year. New distributor enrollments were 2,993 in 2005 compared to 5,360 in 2004. When measured in local currency, 2005 net sales declined by 20.2%. The net loss in the Philippines for 2005 was \$104,000, compared to a net loss of \$164,000 in 2004.

Net sales in the Malaysia/Singapore market decreased by approximately 26.7% in 2005 compared to the prior year. New distributor enrollments were 2,546 in 2005 compared to 4,906 in 2004. In comparison to 2004, currency fluctuation in 2005 had a negligible effect on sales in this market. Net sales decreased in Malaysia/Singapore because our new distributor enrollments declined by nearly 48.1% during 2005 compared to 2004, and our active distributor count decreased by 38.4%. The decrease in new distributors in this market resulted from a change in our distributor qualification requirements. The combined net loss for Malaysia/Singapore for 2005 was \$392,000, compared to a net loss of \$170,000 in 2004.

We began operations in Germany in July 2005. We had net sales of approximately \$320,000 during our first six months.

Our Direct Select program is available for distributors and their retail customers to order products in less than case lots directly from us. In the United States during 2005, we processed a total of approximately 76,000 orders under this program at a suggested retail sales value of \$8.4 million, compared to 58,800 orders, at a suggested retail value of \$6.2 million during 2004. The average order size at suggested retail value increased in 2005 to \$111 compared to \$106 during 2004.

Cost of Products Sold Cost of products sold as a percentage of net sales decreased slightly to 17.0% for the year ended December 31, 2005 compared to 17.2% for the year ended December 31, 2004. Raw material costs remained fairly stable throughout the year, and operating efficiencies gradually improved during 2005 subsequent to the installation of new production equipment during the third and fourth quarters of 2004.

Distributor Royalties and Commissions Distributor royalties and commissions as a percentage of net sales increased slightly to 40.0% for the year ended December 31, 2005 compared to 39.8% for the same period in 2004. The increase is due to changes made during the first quarter of 2005 to the distributor compensation plan in the Philippines and Mexico, resulting in commission payments being made on the full suggested retail value of the products sold. With these changes, commission payments are now uniform throughout our domestic and international markets.

Selling, General and Administrative Expenses For 2005, selling, general and administrative, or SGA, expenses increased by \$3.6 million compared to 2004. However, SGA expenses as a percentage of net sales declined from 33.7% in 2004 to 32.0% in 2005.

Sales and marketing expenses represented approximately \$1.9 million of the 2005 increase, including increased credit card fees due to the higher sales volume, and increased promotional bonuses and promotional trip expenses related to sales volume. General and administrative expenses increased by approximately \$1.6 million, primarily in salaries and bonuses, fringe benefit expenses,

travel expenses, professional service fees, and director's fees. These increases were offset by declines in certain areas. Legal fees decreased by \$163,000, and accounting fees and related expenses decreased by \$669,000 in 2005 compared to the prior year. The decrease in accounting fees and related expenses is due in part to our establishment of an internal audit department to supplement management's efforts related to documenting and assessing our internal controls. In the prior year, we incurred additional third party expenses with the adoption of the internal control documentation requirements of the Sarbanes-Oxley Act.

During 2005, we incurred SGA expenses of approximately \$645,000 in our most recent market entry, Germany. We began sales in Germany on July 18, 2005.

Interest Expense Interest expense increased to \$313,000 for the year ended December 31, 2005 compared to \$243,000 for 2004. The increase is the result of higher interest rates on the term loan on our headquarters facility, coupled with additional interest expense incurred on a note we entered into in March 2005 to purchase the shares of our common stock owned by a former officer and director and his wife. The interest rate on the term loan on our headquarters facility was a variable rate loan with interest equal to the prime rate. This loan was paid in full in June 2005. The note to purchase the stock owned by the former officer and director was for \$3.5 million with an interest rate of 4.0% per year, of which \$3.1 million was outstanding as of December 31, 2005. We also issued a note for \$593,000 to the wife of the former officer and director, which was repaid immediately after its issuance.

Income Taxes We recorded income tax expense of \$5.0 million for 2005, an effective rate of 39.8%. In 2004, we recorded income tax expense of \$3.6 million, an effective rate of 40.2%. The lower effective rate in 2005 is the result of the new Domestic Manufacturing Deduction, enacted by the American Jobs Creation Act of 2004, beginning with the 2005 tax year.

Net Income Our net income improved to \$7.5 million (\$0.47 per share basic and \$0.46 per share diluted) for the year ended December 31, 2005 compared to \$5.4 million (\$0.34 per share basic and \$0.31 per share diluted) for 2004. Profitability continued to increase as net sales improved in the United States, as discussed above. Net income in the United States was \$9.2 million in 2005, compared to \$5.9 million in 2004. The net loss from international operations was \$1.7 million in 2005, compared to a net loss of \$513,000 in 2004.

Year Ended December 31, 2004 Compared to Year Ended December 31, 2003

Net Sales Sales in the United States, our largest market, grew by 27.4% in 2004 compared to 2003. Our international operations experienced a sales increase of 17.8% in 2004 compared to 2003, due primarily to the first full year of operation in Malaysia. We continued to implement our uniform distributor compensation plan and business model across our foreign operations. These changes reduced operating margin in the foreign markets, and, along with other sales development expenses, reduced net income in the international markets overall, but are essential to the consistent execution of our business model and sustainability of our international growth. During 2004, we did not introduce any new products in the United States; however, we introduced certain core products into our foreign markets, including FibRestore and ReversAge in Malaysia.

The following table summarizes the net sales by geographic market for the years ended December 31, 2004 and 2003:

Net Sales by Region (in thousands)	2004		2003		Change from prior year	Change in %
	Amount	% of sales	Amount	% of sales		
United States	\$ 83,873	86.5%	\$ 65,832	85.5%	\$ 18,041	27.4%
Australia/New Zealand	2,543	2.6	2,060	2.7	483	23.4
Canada	1,751	1.8	1,256	1.6	495	39.4
Mexico	2,634	2.7	3,338	4.3	(704)	-21.1
United Kingdom/Ireland	545	0.6	475	0.6	70	14.7
Philippines	2,865	3.0	3,419	4.4	(554)	-16.2
Malaysia/Singapore	2,771	2.9	580	0.8	2,191	377.8
Consolidated total	\$ 96,982	100.0%	\$ 76,960	100.0%	\$ 20,022	26.0%

The following table sets forth the number of our active distributors and Master Affiliates and above as of December 31, 2004 and 2003:

Active Distributors and Master Affiliates and Above by Region	2004		2003		Change in %	
	Distributors	Master Affiliates and Above	Distributors	Master Affiliates and Above	Distributors	Master Affiliates and Above
United States	47,190	12,460	41,000	9,150	15.1%	36.2%
Australia/New Zealand	3,040	290	2,580	240	17.8	20.8
Canada	1,480	210	1,140	180	29.8	16.7
Mexico	9,000	710	7,700	1,370	16.9	-48.2
United Kingdom/Ireland	450	60	410	80	9.8	-25.0
Philippines	6,760	650	7,380	810	-8.4	-19.8
Malaysia/Singapore	5,280	730	1,350	190	291.1	284.2
Consolidated total	73,200	15,110	61,560	12,020	-18.9%	25.7%

In the United States, our largest market, the number of active distributors increased to 47,190 at December 31, 2004 from 41,000 at December 31, 2003. New distributor enrollments in the United States increased to 22,975 in 2004 compared to 20,800 in 2003. The retention rate of distributors who renew their annual agreement was 57.7% in 2004, as compared to a renewal rate of

53.7% in the prior year. The renewal rate was also slightly better than the average renewal rate over the last five years of 55.0%. Master Affiliates and above increased to 12,460 in the United States as of December 31, 2004 from 9,150 as of December 31, 2003. Nearly 6,900 distributors qualified as new Master Affiliates in 2004 and 61.2% of the Master Affiliates and above as of December 31, 2003, requalified as Master Affiliates and above during 2004. In 2004, we processed approximately 207,170 wholesale orders in the United States at an average retail price of \$504 compared to approximately 171,900 orders at an average of \$480 in 2003.

The increase in distributor enrollment and retention in the United States in 2004 was due in part to the momentum created by the consistency and reinforcement of our training programs and business opportunity presentations, in the form of regional distributor conferences and other corporate-sponsored meetings. Also, we held our annual international distributor conference in St. Louis, Missouri in August 2004 with approximately 6,000 distributors in attendance. These activities have resulted in more distributors reaching the Master Affiliate level and above, who generally are more experienced and productive distributors.

In the Australia/New Zealand market, net sales increased to \$2.5 million in 2004 from \$2.1 million in 2003. New distributor enrollments during 2004 in the Australia/New Zealand market were 1,419, as compared to 905 in 2003. Distributor renewals in the market were 63.1% in 2004 as compared to 65.3% in 2003. A portion of the sales increase as measured in U.S. dollars is the result of the strengthening of the Australian and New Zealand dollars relative to the U.S. dollar, but sales in Australia measured in local currency increased in 2004, as well. On a local currency basis, sales in Australia increased by 11.1% in 2004 compared to 2003, whereas local currency sales in New Zealand decreased by 9.3% in 2004 compared to 2003. In September 2003, we changed our compensation plan to pay royalties based on the full retail price of products. This change in the compensation plan was part of our worldwide plan to make the business model seamless from country to country. As a result of the additional royalty expense due to the compensation plan change, along with the added expenses of the new sales manager, the market experienced a net loss in 2004. The combined net loss for the Australia/New Zealand market was \$132,000 in 2004 compared to net income of \$2,000 in 2003. Similar changes in the compensation plans were made in Canada and the United Kingdom earlier in 2003, and similar changes were made for the Mexican and Philippine markets in 2005.

Net sales in Canada increased in 2004 to \$1.8 million from \$1.3 million in 2003. During 2004, the Canadian dollar continued to strengthen considerably compared to the U.S. dollar, and this caused a portion of the net sales improvement, when expressed in U.S. dollars. In Canadian dollars, net sales improved by 28.9% in 2004 compared to 2003. New distributor enrollments were 853 in 2004 compared to 594 in 2003, with a distributor renewal rate of 55.0% during 2004. The Canadian operation showed an increase in net income in 2004 to \$249,000, as compared to a net income of \$155,000 in 2003. Growth in the Canadian market is a by-product of the success being experienced in the U.S. market, as the same sales development strategies are used in Canada.

Net sales in Mexico in 2004 were \$2.6 million compared to \$3.3 million in 2003. New distributor enrollments increased in 2004 to 7,904 compared to 5,939 in 2003. Net sales in Mexico declined due in part to more stringent Master Affiliate qualification requirements and other changes to the distributor compensation plan, as the distributor force in Mexico was adversely affected by these changes. The net loss in this market decreased to \$113,000 in 2004, as compared to a net loss of \$134,000 in 2003.

Net sales in the United Kingdom in 2004 were \$545,000 compared to \$475,000 in 2003. The increase in net sales is almost entirely due to the stronger UK pound compared to the U.S. dollar. Net sales in UK pounds for 2004 increased by 2.7% compared to 2003. New distributor enrollments were 193 in 2004 compared to 166 in 2003. The net loss incurred in this market increased to \$183,000 in 2004 from \$115,000 in 2003. The increase in sales was offset by higher commission expenses, as we made a change to the UK compensation plan, similar to the Australia/New Zealand market, to pay royalties on the full retail value of the products.

Net sales in the Philippines in 2004 were \$2.9 million compared to \$3.4 million in 2003. New distributor enrollments were 5,360 in 2004 compared to 6,311 in 2003. As in Mexico, net sales declined due in part to the changes made in the business model and distributor compensation plan, which resulted in fewer distributors in the Philippines. The Philippines operations had a net loss of \$164,000 in 2004 compared to a net loss of \$15,000 in 2003. Approximately \$65,000 of the net loss was due to a valuation allowance recorded against deferred tax assets for net operating loss carryforwards that the likelihood of utilization is uncertain prior to their expiration in 2005 and 2006. Additionally, the Philippines operation was subject to a minimum corporate income tax based on gross profit of approximately \$45,000.

Malaysia/Singapore had net sales of \$2.8 million during 2004 compared to net sales of \$580,000 during 2003. Malaysia opened in September 2003, and Singapore opened in March 2004. Approximately 4,900 new distributors enrolled during 2004 in this market compared to approximately 1,200 new distributor enrollments during the last four months of 2003. We had a net loss of \$170,000 in this market in 2004 compared to a net loss of \$237,000 during 2003, Malaysia's start-up year.

Our Direct Select Program is available for distributors and their retail customers to order products in less than case lots directly from us. In the United States in 2004, the program processed a total of 58,800 orders for a suggested retail value of \$6.2 million compared to 40,300 orders totaling \$4.3 million in 2003. The average order size at suggested retail value remained constant at \$106 in both 2004 and 2003.

Cost of Products Sold Cost of products sold as a percentage of net sales remained steady at 17.2% for 2003 and 2004. Increased volume efficiencies were offset by expenses incurred in the start-up of a manufacturing equipment upgrade installed during the third and fourth quarters of 2004. Overall ingredient costs in 2004 were stable, with nominal price increases on some items. Also, the cost of increased analytical testing procedures required under Australian regulations increased cost of products sold.

Distributor Royalties and Commissions Distributor royalties and commissions as a percentage of net sales increased to 39.8% in 2004 compared to 38.9% in 2003. The continuing increase in the percentage was the result of royalty payments being made on the full retail value of the products in most of our international markets. These expenses are governed by our Distributor Agreements and are directly related to the level of sales. Included in the 2004 distributor royalties and commissions are royalties of \$2.0 million earned through the Ambassador Program as compared to \$1.5 million in 2003. The Ambassador Program compensates distributors at the highest levels for their leadership and development of sales. As of December 31, 2004, there were 238 Ambassadors compared to 210 Ambassadors at the end of 2003.

Selling, General and Administrative Expenses SGA expenses as a percentage of net sales were 33.7% for 2004 and 34.4% in 2003. The percentage decrease is due to the increase in our net sales. Total SGA expenses increased from \$26.4 million in 2003 to \$32.7 million in 2004.

In 2004, total distribution and warehouse expenses increased to \$1.6 million from \$1.5 million in 2003 primarily due to increased expenses in the United States to support the growth in sales.

Total sales and marketing expenses in 2004 were \$14.5 million compared to \$11.9 million in 2003, an increase of 21.9% in 2004. Amounts paid in the “Star Director Bonus” and other volume-related bonuses paid to distributors increased by \$1.1 million in 2004 as compared to 2003, as the result of increased sales. The Star Director Program compensates distributors who reach certain levels of sales organization growth with bonuses based on the retail sales of their distributor network. In 2004, \$3.6 million was paid through this program compared to \$2.8 million in 2003. Credit card processing fees also increased by \$408,000 in 2004 as compared to 2003, also as the result of increased sales. Distributor training and other distributor support expenses increased by \$304,000. Sales and marketing expenses, as a percentage of net sales, were 14.9% in 2004 and 15.4% in 2003.

Total general and administrative expenses in 2004 were \$16.6 million compared to \$13.1 million in 2003. The expenses paid to outside parties in 2004 to supplement management’s documentation and assessment of internal controls required under Section 404 of the Sarbanes-Oxley Act were the most significant component of this increase. Accounting fees increased by \$1.3 million from 2003 to 2004. Most of this increase was related to the expenses incurred to perform the work required under the Sarbanes-Oxley Act. Because of the increase in our stock price over the first six months of 2004, we became classified as an “accelerated filer.” As a result, the period of time in which we had to perform this internal control assessment was compressed. Many of these costs were one-time expenses, as part of the first year start-up and documentation under the Sarbanes-Oxley Act.

Total staff compensation and fringe benefits increased by 13.9%, or \$1.3 million, in 2004 compared to 2003. This increase is due to the increase in incentive compensation bonuses paid during 2004, the addition of Malaysia and Singapore and various staffing increases, primarily in the United States. Significant changes in general and administrative expenses included an increase in travel expenses by \$167,000 in 2004 compared to 2003; business insurance expenses increased by \$191,000 in 2004 compared to 2003; and director’s fees, investor relations expenses and other expenses related to being a publicly-traded company increased by \$356,000 in 2004 compared to 2003.

Interest Expense Interest expense in 2004 was \$243,000 compared to \$235,000 in 2003. Interest expense increased slightly in 2004, as the prime rate increased from 4.0% at the end of 2003 to 5.25% at the end of 2004. The term loan on our headquarters facility was a variable rate instrument equal to the prime rate.

Income Taxes Income tax expense was \$3.6 million for 2004 and \$2.9 million for 2003. The effective tax rate for 2004 was 40.2%. State income taxes, along with foreign losses with no U.S. tax benefit, represent most of the increase over the U.S. statutory tax rate of 34.0%. Also, in the Philippines, a minimum corporate income tax and a valuation allowance recorded against the deferred tax asset had a slight impact on the effective tax rate in 2004. The effective tax rate for 2003 was 39.8%.

Net Income Our 2004 net income available to common stockholders was \$5.4 million or \$0.31 per share diluted. This compares with net income of \$4.3 million or \$0.26 per share diluted in 2003. Net income in the United States, our primary market, was \$5.9 million in 2004 compared to net income of \$4.7 million in 2003 and led to our overall improvement in both sales and profitability. Net loss from international operations was \$513,000 in 2004 compared with a net loss of \$344,000 in 2003. Our net income was adversely impacted by the expenses we incurred related to the first year of management’s documentation and assessment of internal controls as required by Section 404 of the Sarbanes-Oxley Act of 2002.

Financial Condition, Liquidity and Capital Resources

We generated \$12.5 million of net cash during 2005 from operating activities, \$1.6 million was used in investing activities, and we used \$15.2 million in financing activities. This compares to \$7.4 million of net cash provided by operating activities, \$1.8 million used in investing activities, and \$3.4 million used in financing activities in 2004. Cash and cash equivalents decreased by \$4.5 million to \$5.7 million as of December 31, 2005 compared to December 31, 2004.

Significant changes in working capital items consisted of a decrease in inventories of \$327,000, an increase in accounts payable and accrued expenses of \$538,000, and a decrease in refundable income taxes payable of \$1.3 million in 2005. The decrease in inventory is a result of better production efficiencies gained from manufacturing equipment upgrades installed during the third and fourth quarters of 2004. The increase in accounts payable and accrued expenses is due to increased production volume and other expenses related to the increase in sales volume, coupled with the increase in distributor commissions payable at December 31, 2005 compared to December 31, 2004. This increase in distributor commissions payable is the result of higher total sales in December 2005 compared to December 2004. The decrease in the refundable income taxes is the result of a refund received from the Internal Revenue Service on the overpayment of income tax deposits.

Our net investing activities included \$1.7 million, \$1.9 million, and \$1.0 million for capital expenditures in the years ended December 31, 2005, 2004 and 2003, respectively. The most significant financing activity in 2005 was \$13.8 million in purchases of treasury stock. Of the \$13.8 million in stock purchases, \$9.7 million was paid in cash and notes were issued for the remaining \$4.1 million. As of December 31, 2005, \$3.1 million of the notes was outstanding. The majority of this treasury stock was purchased from a former officer, a former officer and director and his wife, and three of our current officers and directors. In March 2005, we announced that our board of directors had approved a stock repurchase plan of our common stock of up to \$15 million over the next three years. We purchased approximately \$4.3 million of stock in the open market during 2005. In June 2005, we also paid the remaining balance of the long-term debt on our headquarters facility totaling approximately \$3.5 million. In 2005, we also paid \$1.2 million in common stock dividends and received \$274,000 in proceeds from the exercise of options and warrants. In 2004, we

paid \$975,000 for the redemption of preferred stock, \$12,000 in preferred stock dividends and \$1.0 million in common stock dividends. We also used \$1.3 million to purchase treasury stock and received \$292,000 in proceeds from the exercise of options and warrants. In 2004, all treasury stock was purchased from related parties. During 2003, we purchased \$1.2 million of treasury stock and received \$142,000 in proceeds from the sale of treasury stock and \$328,000 in proceeds from the exercise of options and warrants.

Stockholders' equity decreased to \$12.6 million at December 31, 2005 compared with \$18.2 million at December 31, 2004. The decrease is primarily due to a stock repurchase of approximately \$4.1 million of our common stock from a former officer and director and his wife in the first quarter of 2005, stock purchases from three of our officers and directors totaling \$5.1 million that took place in May 2005 and \$4.6 million of other 2005 treasury stock purchases, offset by our net income during 2005. Stockholders' equity also increased by \$1.4 million and \$2.6 million as the result of the tax benefit from the exercise of nonqualified options and warrants during the years ended December 31, 2005 and 2004, respectively.

Our working capital balance was \$4.0 million at December 31, 2005 compared to \$11.5 million at December 31, 2004. The current ratio at December 31, 2005 was 1.4 compared to 2.4 at previous year-end. In June 2005, we entered into a new \$15 million secured revolving credit facility with our primary lender. This new facility replaced our previous operating line of credit that had a maximum borrowing limit of \$1 million. The new facility expires in April 2007, and any advances accrue interest at a variable interest rate based on LIBOR. The credit facility is secured by all of our assets. The new facility includes covenants to maintain total stockholders' equity of not less than \$10.5 million, and that the ratio of borrowings under the facility to EBITDA shall not exceed 3.5 to 1.0. At December 31, 2005, we had not utilized any of the new revolving line of credit facility and were in compliance with the minimum stockholders' equity covenant.

Management believes that our internally generated funds and the borrowing capacity under the new revolving line of credit facility will be sufficient to meet working capital requirements for the remainder of 2006.

Contractual Obligations The table below presents our contractual obligations and commercial commitments as of December 31, 2005. This consists of our long-term debt and operating leases. For the long-term debt, the amounts shown represent the principal and interest amounts by year of anticipated maturity for our debt obligations and related average interest rates based on the weighted-average interest rates at the end of the period. For the operating leases, the amounts shown represent the future minimum payments under noncancelable leases with initial or remaining terms in excess of one year as of December 31, 2005.

	Less Than 1 year	1-3 years	3-5 years	More than 5 years	Total
Promissory note ⁽¹⁾	\$ 1,006	\$ 2,285	\$ —	\$ —	\$ 3,291
Other debt	17	11	—	—	28
Operating leases	66	112	8	—	186
Total Obligations	\$ 1,089	\$ 2,408	\$ 8	\$ —	\$ 3,505

⁽¹⁾The outstanding principal amount of the promissory note was \$3.1 million at December 31, 2005 and accrues interest at 4.0% per year.

Critical Accounting Policies Our financial statements are based on the selection and application of significant accounting policies, which require management to make significant estimates and assumptions. We believe that the following are some of the more critical judgment areas in the application of our accounting policies that currently affect our financial condition and results of operations.

Inventories Inventories are valued at the lower of cost or market. Product cost includes raw material, labor and overhead costs and is accounted for using the first-in, first-out basis. On a periodic basis, we review our inventory levels in each country for estimated obsolescence or unmarketable items, as compared to future demand requirements and the shelf life of the various products. Based on this review, we record inventory write-downs when costs exceed expected net realizable value. Historically, our estimates of our obsolete or unmarketable items have been materially accurate.

Foreign Currency Translation All balance sheet accounts are translated using the exchange rates in effect at the balance sheet date. Statements of operations amounts are translated using the average exchange rate for the year-to-date periods. The gains and losses resulting from the changes in exchange rates during this interim period have been reported in other comprehensive loss. Foreign currency translation adjustments exclude income tax expense (benefit) given that our investments in non-U.S. subsidiaries are deemed to be reinvested for an indefinite period of time.

Legal Proceedings In the ordinary course of business, we are subject to various legal proceedings, including lawsuits and other claims related to labor, product and other matters. We are required to assess the likelihood of adverse judgments and outcomes to these matters as well as the range of potential loss. Such assessments are required to determine whether a loss contingency reserve is required under the provisions of SFAS No. 5, Accounting for Contingencies, and to determine the amount of required reserves, if any. These assessments are subjective in nature. Management makes these assessments for each individual matter based on consultation with outside counsel and based on prior experience with similar claims. To the extent additional information becomes available or our strategies or assessments change, our estimates of potential liability for a given matter may change. Changes to estimates of liability would result in a corresponding additional charge or benefit recognized in the statement of operations in the period in which such changes become known. We recognize the costs associated with legal defense in the periods incurred. Accordingly, the future costs of defending claims are not included in our estimated liability.

Income Tax Matters We face challenges from domestic and foreign tax authorities regarding the amount of taxes due. These challenges include questions regarding the timing and amount of deductions and the allocation of income among various taxing jurisdictions. In evaluating the exposure associated with our various filing positions, we estimate reserves for probable exposures. Based on our evaluation of our tax positions, we believe we have appropriately accrued for probable exposures. To the extent we were to prevail in matters for which accruals have been established or be required to pay amounts in excess of our reserves, our effective tax rate in a given financial statement period may be materially impacted.

At December 31, 2005, we had deferred tax assets related to net operating loss carryforwards and other income tax credits with a tax value of \$1.9 million. These net operating loss carryforwards have various expiration dates, depending on the country in which they occurred. A valuation allowance of \$1.8 million has been established for a portion of these deferred tax assets based on projected future taxable income and the expiration dates of these carryforwards.

Quantitative And Qualitative Disclosures Regarding Market Risk

Foreign Currency Risk Our earnings and cash flows are subject to fluctuations due to changes in foreign currency rates as we have several foreign subsidiaries and continue to explore expansion into other foreign countries. As a result, exchange rate fluctuations may have an effect on sales and gross margins. Accounting practices require that our results from operations be converted to U.S. dollars for reporting purposes. Consequently, our reported earnings in future periods may be significantly affected by fluctuations in currency exchange rates, generally increasing with a weaker U.S. dollar and decreasing with a strengthening U.S. dollar. Products manufactured by us for sale to our foreign subsidiaries are transacted in U.S. dollars.

Net sales outside of the United States represented 9.7%, 13.5%, and 14.5% of total net sales in 2005, 2004, and 2003, respectively. Our primary exposures to adverse currency fluctuations would result in an increase in the cost of goods sold, relative to foreign net sales, as the vast majority of the products sold are purchased from the parent company in the United States, with prices denominated in U.S. dollars. As of December 31, 2005, we had a net investment in our foreign subsidiaries of \$3.8 million (in U.S. dollars).

We have performed a sensitivity analysis as of December 31, 2005 that measures the change in the results of our foreign operations arising from a hypothetical 10% adverse movement in the exchange rate of all of the currencies in the countries in which we presently operate. Using the results of operations for 2005 for our foreign operations as a basis for comparison, an adverse movement of 10% would create a potential reduction in our net income of less than \$50,000 and reduce the value of the net investment in the foreign subsidiaries by \$380,000.

We enter into foreign exchange forward contracts with a financial institution to sell Canadian dollars in order to protect against currency exchange risk associated with expected future cash flows. We have accounted for these contracts as freestanding derivatives, such that gains or losses on the fair market value of these forward exchange contracts are recorded as other income and expense in the consolidated statements of operations. The net change in the fair value of these forward contracts, as of December 31, 2005 was a cumulative expense of \$59,000. As of December 31, 2005, we had no hedging instruments in place to offset exposure to the Australian or New Zealand dollars, Mexican or Philippine pesos, the Malaysian ringgit, the Singapore dollar, the EU Euro, or the British pound.

Interest Rate Risk We have \$3.1 million in long-term debt with a weighted-average effective interest rate of 4.03% at December 31, 2005. Of this amount, all but \$27,000 is debt with a fixed interest rate of 4.0%. Since substantially all of our long-term debt has a fixed interest rate, we are not subject to any interest rate risk.

We also are exposed to market risk in changes in commodity prices in some of the raw materials we purchase for our manufacturing needs. However, this presents a risk that would not have a material effect on our results of operations or financial condition.

Management's Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Our management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. This evaluation included review of the documentation of controls, evaluation of the design effectiveness of controls, testing of the operation effectiveness of controls and a conclusion on this evaluation. Although there are inherent limitations in the effectiveness of any system of internal control over financial reporting, based on our evaluation, management has concluded our internal controls over financial reporting were effective as of December 31, 2005.

Ernst & Young LLP, an independent registered public accounting firm, has issued an attestation report on management's assessment of internal control over financial reporting as of December 31, 2005, which is included elsewhere in this annual report.