

## 1. Nature of Business and Significant Accounting Policies

### Nature of Business

Reliv International, Inc. (the Company) produces a proprietary line of nutritional supplements addressing basic nutrition, specific wellness needs, weight management, and sports nutrition. These products are sold by subsidiaries of the Company to a sales force of independent distributors and licensees of the Company that sell products directly to consumers. The Company and its subsidiaries sell products to distributors throughout the United States and in Australia, Canada, New Zealand, Mexico, the United Kingdom/Ireland, Germany, the Philippines, Malaysia, and Singapore.

### Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its foreign and domestic subsidiaries. All significant intercompany accounts and transactions have been eliminated.

### Inventories

Inventories are valued at the lower of cost or market. Product cost includes raw materials, labor, and overhead costs and is accounted for using the first-in, first-out basis. On a periodic basis, the Company reviews its inventory levels, as compared to future demand requirements and the shelf life of the various products. Based on this review, the Company records inventory write-downs when necessary.

In 2006, the Company adopted SFAS No. 151, "Inventory Costs" which clarifies that abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) should be recognized as period charges, rather than as an inventory value. This standard also requires the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. The Company's pre-existing accounting policy for inventory valuation was generally consistent with this guidance, and therefore, the adoption of SFAS No. 151 did not have a significant impact on 2006 financial results.

### Property, Plant, and Equipment

Property, plant, and equipment are stated on the cost basis. Depreciation is computed using the straight-line or an accelerated method over the useful life of the related assets. Generally, computer equipment and software are depreciated over 5 years, office equipment and machinery over 7 years, and real property over 39 years.

### Foreign Currency Translation

All balance sheet accounts have been translated using the exchange rates in effect at the balance sheet date. Statements of income amounts have been translated using the average exchange rate for the year. The gains and losses resulting from the changes in exchange rates from year to year have been reported in other comprehensive income (loss). The foreign currency translation adjustment is the only component of accumulated other comprehensive loss. Foreign currency translation adjustments exclude income tax expense (benefit) given that the Company's investments in non-U.S. subsidiaries are deemed to be reinvested for an indefinite period of time. The transaction (gains) losses were (\$194,760), \$268,436, and (\$99,628) for 2006, 2005, and 2004, respectively.

### Revenue Recognition

The Company receives payment by credit card, personal check, or guaranteed funds for orders from independent distributors and makes related commission payments in the following month. Net sales reflect product sales less the distributor discount of 20 percent to 40 percent of the suggested retail price. Sales revenue and commission expenses are recorded when the merchandise is shipped, as this is the point title and risk of loss pass. In accordance with EITF 01-09, the Company presents distributor royalty and commission expense as an operating expense, rather than a reduction to net sales, as these payments are not made to the purchasing distributor.

Actual and estimated returns are classified as a reduction of net sales. The Company estimates and accrues a reserve for product returns based on the Company's return policy and historical experience. The Company records handling and freight income as a component of net sales and records handling and freight costs as a component of cost of products sold. Total revenues do not include sales tax as the Company considers itself a pass-through conduit for collecting and remitting applicable sales taxes.

### Income Taxes

The provision for income taxes is computed using the liability method. The primary differences between financial statement and taxable income result from financial statement accruals and reserves and differences between depreciation for book and tax purposes.

### Basic and Diluted Earnings per Share

Basic earnings per common share are computed using the weighted average number of common shares outstanding during the year. Diluted earnings per common share are computed using the weighted average number of common shares and potential dilutive common shares that were outstanding during the period. Potential dilutive common shares consist of outstanding stock options, outstanding stock warrants, and convertible preferred stock. See Note 8 for additional information regarding earnings per share.

### Stock-Based Compensation

The Company has a stock option plan for employees and eligible directors allowing for incentive and non-qualified stock options, which are described more fully in Note 7. On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123, "Share-Based Payments" ("SFAS No. 123(R)") using the modified prospective transition method. Under this method, the Company's consolidated financial statements for prior periods have not been restated and do not include the impact of SFAS No. 123(R). Accordingly, no compensation expense related to stock option awards was recognized in the years ended December 31, 2005 and 2004 because all stock options granted had an exercise price equal to the fair market value of the underlying common stock on the date of grant. The following table shows the effect on net income and earnings per share as if the fair-value-based method of accounting had been applied to all outstanding and unvested stock options prior to adoption of SFAS No. 123(R). For purposes of this pro forma disclosure, the estimated fair value of the stock option award is assumed to be expensed over the award's vesting periods using the Black-Scholes model.

Year ended December 31	2005	2004
<b>Basic:</b>		
Net income available to common shareholders, as reported	\$ 7,521,416	\$ 5,374,397
Deduct: total stock-based employee compensation expense determined under fair value-based method for all awards, net of related tax effects	1,645,036	52,125
Pro forma net income available to common shareholders	\$ 5,876,380	\$ 5,322,272
<b>Diluted:</b>		
Net income available to common shareholders, as reported	\$ 7,521,416	\$ 5,386,689
Deduct: total stock-based employee compensation expense determined under fair value-based method for all awards, net of related tax effects	1,645,036	52,125
Pro forma net income available to common shareholders	\$ 5,876,380	\$ 5,334,564
<b>Earnings per share:</b>		
Basic—as reported	\$ 0.47	\$ 0.34
Basic—pro forma	\$ 0.37	\$ 0.34
Diluted—as reported	\$ 0.46	\$ 0.31
Diluted—pro forma	\$ 0.36	\$ 0.31

The Company accounts for options granted to non-employees and warrants granted to distributors under the fair value approach required by EITF 96-18, "Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods, or Services."

### Advertising

Costs of sales aids and promotional materials are capitalized as inventories. All other advertising and promotional costs are expensed when incurred. The Company recorded \$81,000, \$52,000, and \$64,000 of advertising expense in 2006, 2005, and 2004, respectively.

### Research and Development Expenses

Research and development expenses which are charged to selling, general, and administrative expenses as incurred were \$437,000, \$558,000, and \$525,000 in 2006, 2005, and 2004, respectively.

### Cash Equivalents

The Company's policy is to consider the following as cash and cash equivalents: demand deposits, short-term investments with a maturity of three months or less when purchased, and highly liquid debt securities with insignificant interest rate risk and with original maturities from the date of purchase of generally three months or less.

### Short-Term Investments

Short-term investments, categorized as available-for-sale, are comprised of investment grade variable rate debt obligations issued by various state and municipal governments. Accordingly, investments in these securities are recorded at cost, which approximates fair value due to their variable interest rates, which typically reset every 35 days or less. Despite the long-term nature of their stated contractual maturities, the Company has the ability to quickly liquidate these securities and therefore classifies them as current assets. As a result of the resetting variable rates, no cumulative gross unrealized or realized holding gains or losses are recognized from these investments. In accordance with management's objective for their available-for-sale investments, each reset of the variable interest rate is not considered a sale and subsequent repurchase. Accordingly, this activity is presented net in the consolidated statements of cash flows.

Short-term investments also include certificates of deposit with original maturities at acquisition ranging from greater than ninety days and less than one year. Income generated from all short-term investments is presented as interest income in the consolidated statements of income.

### Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

### New Accounting Pronouncements

#### *Uncertain Tax Positions*

In July 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN No. 48"). FIN No. 48 prescribes a more likely than not threshold for financial statement presentation and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on de-recognition of income tax assets and liabilities, accounting for interest and penalties associated with tax positions, accounting for income taxes in interim periods, and income tax disclosures. For the Company, FIN No. 48 is effective as of January 1, 2007. The Company is currently evaluating the impact of FIN No. 48 on its consolidated financial statements.

### Fair Value Positions

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This statement clarifies how to measure fair value as permitted under other accounting pronouncements but does not require any new fair value measurements. The Company will be required to adopt SFAS No. 157 as of January 1, 2008. The Company is currently evaluating the impact of SFAS No. 157 and has not yet determined the impact on its financial statements.

### Reclassifications

In previous years, in addition to the required disclosure of "net sales," the Company reported "sales at suggested retail," representing the gross sales amount reflected on the Company's invoices to distributors before "distributor allowances." In the current year, the Company has reclassified the presentation of "net sales" by presenting "product sales" and "handling & freight income." Handling and freight income represents the amounts billed to distributors for shipping costs. Product sales represent the actual product purchase price typically paid by the Company's distributors, after giving effect to distributor allowances, which range from 20% to 40% of suggested retail prices. Subsequent to this classification, net sales represent product sales and handling & freight income.

To conform to the 2006 presentation, previously reported 2005 and 2004 amounts for other income have been reclassified to interest income and other income within the consolidated statements of income.

## 2. Property, Plant, and Equipment

Property, plant, and equipment at December 31, 2006 and 2005, consist of the following:

	2006	2005
Land	\$ 829,222	\$ 829,222
Building	9,565,221	9,553,311
Machinery and equipment	4,199,714	4,736,274
Office equipment	1,520,297	1,400,544
Computer equipment and software	2,441,264	2,536,415
	<u>18,555,718</u>	<u>19,055,766</u>
Less accumulated depreciation and amortization	9,121,172	8,915,325
	<u>\$ 9,434,546</u>	<u>\$ 10,140,441</u>

## 3. Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses at December 31, 2006 and 2005, consist of the following:

	2006	2005
Trade payables	\$ 3,824,951	\$ 3,165,871
Distributors' commissions	3,449,687	3,578,405
Sales taxes	421,923	518,870
Interest expense	—	31,000
Payroll and payroll taxes	918,695	864,624
	<u>\$ 8,615,256</u>	<u>\$ 8,158,770</u>

## 4. Short-Term Borrowings

On June 28, 2006, the Company entered into a new revolving loan agreement with its primary lender. The new agreement has an effective date of April 30, 2006 and replaces the prior revolving loan agreement with the same lender. Under the new agreement, the lender agreed to provide a line of credit for the Company in the amount of \$5 million, reduced from \$15 million under the prior agreement.

This new revolving line of credit facility expires on April 30, 2008, and any advances accrue interest at a variable interest rate based on LIBOR. Similar to the previous facility, the new facility includes covenants to maintain total stockholders' equity of not less than \$10.5 million, and that borrowings under the facility shall not exceed EBITDA by a ratio of 3.5:1. A commitment fee in an amount equal to 0.25% per year is payable quarterly on the average daily-unused portion of the revolver. At December 31, 2006, the Company had not utilized any of the new revolving line of credit facility and was in compliance with the minimum stockholders' equity covenant.

## 5. Long-Term Debt

Long-term debt at December 31, 2006 and 2005, consists of the following:

	2006	2005
Promissory note payable to a former officer/director payable in annual installments thru 2008, interest payable quarterly at 4% per annum (see Note 15)	\$ —	\$ 3,100,000
Notes payable — primarily vehicle loans	—	27,309
	—	3,127,309
Less current maturities	—	916,244
	\$ —	\$ 2,211,065

## 6. Investments

### Available-for-Sale Investments

Available-for-sale investments at December 31, 2006 are as follows:

	Cost	Unrealized gains/(losses)	Recorded basis	Cash and cash equivalents	Short-term investments
Cash	\$ 7,382,810	\$ —	\$ 7,382,810	\$ 7,382,810	\$ —
Municipal securities	5,000,000	—	5,000,000	—	5,000,000
Commercial paper	1,950,000	—	1,950,000	1,950,000	—
Certificates of deposit	1,924,000	—	1,924,000	—	1,924,000
Industrial revenue bonds	940,000	—	940,000	—	940,000
	\$ 17,196,810	\$ —	\$ 17,196,810	\$ 9,332,810	\$ 7,864,000

### Other Investment

In June 2006, the Company contributed \$1,000,000 as a limited partner in a private equity fund. In accordance with EITF Topic D-46, "Accounting for Limited Partnership Investments," the Company accounts for its investment under the equity method. Under this method, the Company's proportionate share of partnership income (loss) is recorded to other income (expense) with a corresponding increase (decrease) in the carrying value of its investment. For the year ended December 31, 2006, the Company's partnership income was \$32,000. The carrying value of this investment is included in "Other Assets" in the accompanying consolidated balance sheets.

## Other-Than-Temporary Impairment

All of the Company's available-for-sale and other investments are subject to a periodic impairment review. Investments are considered to be impaired when a decline in fair value is judged to be other-than-temporary. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded in other income (expense), and a new cost basis in the investment is established. For the year ended December 31, 2006, a review of the Company's investments has not resulted in any impairment.

## 7. Stockholders' Equity

### Stock Options

On January 1, 2006, the Company adopted SFAS 123(R). Prior to the adoption of SFAS 123(R), the Company had adopted the disclosure-only provisions of SFAS 123 and accounted for employee stock-based compensation under the intrinsic value method, and no expense related to stock options was recognized. The Company adopted the provisions of SFAS 123(R) using the modified prospective transition method. Under this method, the Company's consolidated financial statements as of and for the year ended December 31, 2006 reflect the impact of SFAS 123(R), while the consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123(R). SFAS 123(R) amends SFAS No. 95, "Statement of Cash Flows," to require that excess tax benefits be reported as a financing cash flow rather than as an operating cash flow.

The Company sponsors a stock option plan (the "2003 Plan") allowing for incentive stock options and non-qualified stock options to be granted to employees and eligible directors. The plan has been approved by the stockholders of the Company. The 2003 Plan provides that 1,000,000 shares may be issued under the plan at an option price not less than the fair market value of the stock at the time the option is granted. The 2003 Plan expires on March 20, 2013. The options vest pursuant to the schedule set forth for the plan. In 2005, the Company issued grants of 543,000 shares under the 2003 Plan. The 2005 option grants were issued with an exercise price equal to the fair value of the shares at the time of grant and were fully vested in the year of grant. Accordingly, no stock-based compensation expense has been recognized relating to the 2005 option grants. There were no stock option grants made during 2006. As of December 31, 2006, as adjusted for forfeitures, 480,000 shares remain available for grant under the 2003 Plan.

The fair value of the options granted in 2005 were estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions: risk-free interest rates ranging from 4.02% to 4.31%; dividend yield ranging from 0.55% to 0.80%; volatility factor of the expected price of the Company's stock ranging from 0.448 to 0.516; and a weighted average expected life of 7.0 years. The weighted average fair value of the options granted during 2005 was \$4.19 per share.

There were no options granted during the years ended December 31, 2004, 2003, and 2002. Upon adoption of SFAS No. 123(R) on January 1, 2006, there existed 128,720 unexercised stock options from grants made in 2001 under a prior stock option plan. The fair value of options granted in 2001 were estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions: risk-free interest rates ranging from 3.07% to 4.78%; dividend yield of zero; volatility factor of the expected price of the Company's stock of 0.729; and a weighted average expected life of 4.51 years. The weighted average fair value of options granted during 2001 was \$0.42. As of December 31, 2006, all stock options granted in 2001 were vested and have either been exercised or expired.

Compensation cost for the stock option plans was approximately \$63,000 for the year ended December 31, 2006 and has been recorded in selling, general, and administrative expense. As of December 31, 2006, there was no unrecognized compensation cost related to stock options.

A summary of the Company's stock option activity and related information for the years ended December 31 follows:

	2006		2005		2004	
	Options	Weighted Avg. Exercise Price	Options	Weighted Avg. Exercise Price	Options	Weighted Avg. Exercise Price
Outstanding beginning of the year	813,074	\$5.57	985,114	\$0.73	2,413,433	\$0.91
Granted	—		543,000	7.97	—	
Exercised	(247,457)	0.74	(710,286)	0.72	(1,428,319)	1.04
Forfeited	(45,617)	4.39	(4,754)	0.71	—	
Outstanding at end of year	520,000	\$7.96	813,074	\$5.57	985,114	\$0.73
Exercisable at end of year	520,000		684,354		727,676	

As of December 31, 2006:

Range of Exercise Prices	Options Outstanding		Weighted Avg. Exercise Price	Options Exercisable	
	Number Outstanding	Weighted Avg. Remaining Life		Number Exercisable	Weighted Avg. Exercise Price
\$7.92–\$8.68	520,000	8.05	\$7.96	520,000	\$7.96

A summary of the total intrinsic value, actual tax benefit realized, and cash received for stock options exercised for the years ended December 31 follows:

Year ended December 31	2006	2005	2004
Stock Options Exercised:			
Intrinsic value	\$2,262,000	\$5,557,000	\$10,155,000
Actual tax benefit realized	108,000	1,342,000	2,441,000
Cash received	121,000	143,000	179,000

Of the options exercised in 2006, 81,789 shares were paid with 6,537 mature shares of Company stock, owned six months or greater. In 2005, options for 523,344 were paid with 44,960 mature shares. In 2004, options for 1,183,438 shares were paid with 157,656 mature shares. These shares tendered as payment were valued at the fair market price on the date of exercise.

The intrinsic value for stock options outstanding at December 31, 2006 was \$372,000 with a weighted average remaining life of 8.05 years.

## Distributor Stock Purchase Plan

In November 1998, the Company established a Distributor Stock Purchase Plan. The plan allows distributors who have reached the “Ambassador” status the opportunity to allocate up to 10% of their monthly compensation into the plan to be used to purchase the Company’s common stock at the current market value. The plan also states that at the end of each year, the Company will grant warrants to purchase additional shares of the Company’s common stock based on the number of shares purchased by the distributors under the plan during the year. The warrant exercise price will equal the market price for the Company’s common stock at the date of issuance. The warrants issued shall be in the amount of 25% of the total shares purchased under the plan during the year. This plan commenced in January 1999, and a total of 28,995, 25,303, and 22,959 warrants were issued during the years ended December 31, 2006, 2005, and 2004, respectively. The warrants are fully vested upon grant. The weighted average fair values of warrants granted during 2006, 2005, and 2004 were \$2.76, \$4.04, and \$2.94 per share, respectively.

The Company records expense under the fair value method of SFAS No. 123(R) for warrants granted to distributors. Total expense recorded for these warrants was \$102,224, \$66,674, and \$77,367 in 2006, 2005, and 2004, respectively. The fair value of the warrants was estimated at the date of grant using a Black-Scholes option pricing model with the following assumptions:

Year ended December 31	2006	2005	2004
Expected warrant life (years)	2.5	2.5	2.5
Risk-free weighted average interest rate	4.74%	4.37%	3.08%
Stock price volatility	0.476	0.448	0.516
Dividend yield	1.0%	0.6%	0.8%

A summary of the Company’s warrant activity and related information for the years ended December 31 follows:

	2006		2005		2004	
	Warrants	Weighted Avg. Exercise Price	Warrants	Weighted Avg. Exercise Price	Warrants	Weighted Avg. Exercise Price
Outstanding beginning of the year	66,719	\$ 9.47	76,852	\$ 5.70	137,957	\$ 2.51
Granted	28,995	8.68	25,303	13.18	22,959	8.94
Exercised	(17,528)	5.28	(35,347)	3.94	(83,675)	1.35
Forfeited	(2,044)	5.12	(89)	3.73	(389)	0.84
Outstanding at end of year	76,142	\$10.25	66,719	\$ 9.47	76,852	\$ 5.70
Exercisable at end of year	76,142		66,719		76,852	

As of December 31, 2006

Range of Exercise Prices	Warrants Outstanding		Weighted Avg. Exercise Price	Warrants Exercisable	
	Number Outstanding	Weighted Avg. Remaining Life		Number Exercisable	Weighted Avg. Exercise Price
\$ 8.68	28,995	3.00	\$ 8.68	28,995	\$ 8.68
\$ 8.94	21,844	1.00	8.94	21,844	8.94
\$13.18	25,303	2.00	13.18	25,303	13.18
\$ 8.68 – \$13.18	76,142	2.09	\$10.25	76,142	\$10.25

A summary of the total intrinsic value, actual tax benefit realized, and cash received for stock warrants exercised for the years ended December 31 follows:

Year ended December 31	2006	2005	2004
Stock Warrants Exercised:			
Intrinsic value	\$78,000	\$212,000	\$509,000
Actual tax benefit realized	14,000	28,000	176,000
Cash received	93,000	131,000	113,000

The intrinsic value for stock warrants outstanding at December 31, 2006 was \$-0- with a weighted average remaining life of 2.09 years.

### Public Offering of Common Stock

On February 21, 2006, the Company filed a registration statement on Form S-3 with the Securities and Exchange Commission relating to an underwritten public offering of 2,000,000 shares of its common stock. On April 5, 2006, the Company commenced the public offering at a price of \$11.25 per share. The public offering was completed on April 11, 2006 and consisted of 1,200,000 shares of common stock offered and sold by the Company and 800,000 shares of common stock offered and sold by selling stockholders. The selling stockholders were four directors and/or officers of the Company. The underwriters had a 30-day option to purchase up to 300,000 additional shares from certain of the selling stockholders to cover over-allotments, if any. This option was exercised for the full 300,000 shares and closed on May 9, 2006. The Company did not receive any proceeds from the sale of common stock by the selling stockholders.

The Company used a portion of the net proceeds from the offering for the repayment of long-term debt and intends to use the remaining net proceeds for general corporate purposes, including working capital, continued domestic and international growth, and for possible product acquisitions. Net proceeds to the Company from the offering, after reduction for the underwriters' fees and other offering expenses, were \$11,919,000.

### Sale of Preferred Stock

On March 31, 2003, the Company sold an aggregate of 150,000 shares of preferred stock to three executive officers/directors. The "Series A Preferred Stock" ("Preferred Stock"), was designated by the Company's Board of Directors out of the 3,000,000 previously authorized shares of \$0.001 par value preferred stock. Each of the preferred stockholders purchased 50,000 shares of Preferred Stock for \$500,000 (\$10.00 per share).

The preferred stockholders were entitled to receive dividends at an annual rate of 6% of the shares' purchase price. These dividends accrued on a daily basis and were payable quarterly when declared by the Company's Board of Directors. All dividends on shares of Preferred Stock were cumulative.

In August 2003, the Company redeemed 17,500 shares from each executive officer/director for a total redemption of 52,500 shares at a value of \$525,000. In February 2004, the Company redeemed an additional 15,000 shares from each executive officer/director for a total redemption of 45,000 shares at a value of \$450,000. In April 2004, the Company redeemed the remaining 17,500 shares from each officer/director for a total redemption of 52,500 shares at a value of \$525,000.

## 8. Earnings per Share

The following table sets forth the computation of basic and diluted earnings per share:

Year ended December 31	2006	2005	2004
Numerator:			
Numerator for basic and diluted earnings per share — net income available to common shareholders	\$ 7,898,103	\$ 7,521,416	\$ 5,374,397
Effect of convertible preferred stock:			
Dividends on preferred stock	—	—	12,292
Numerator for diluted earnings per share	\$ 7,898,103	\$ 7,521,416	\$ 5,386,689
Denominator:			
Denominator for basic earnings per share — weighted average shares	16,465,000	15,885,000	15,662,000
Effect of convertible preferred stock and dilutive securities:			
Convertible preferred stock	—	—	52,000
Employee stock options and warrants	262,000	503,000	1,423,000
Denominator for diluted earnings per share — adjusted weighted average shares	16,727,000	16,388,000	17,137,000
Basic earnings per share	\$0.48	\$0.47	\$0.34
Diluted earnings per share	\$0.47	\$0.46	\$0.31

For the year ended, December 31, 2006, warrants to purchase 25,303 shares of common stock were not included in the denominator for diluted earnings per share because their effect would be anti-dilutive.

## 9. Leases

The Company leases certain office facilities, storage, equipment, and automobiles. These leases have varying terms, and certain leases have renewal and/or purchase options. Future minimum payments under non-cancelable leases with initial or remaining terms in excess of one year consist of the following at December 31, 2006:

2007	\$ 50,579
2008	23,688
2009	19,416
2010	8,090
2011	—
	\$101,773

Rent expense for all operating leases was \$62,392, \$57,632, and \$75,529 for the years ended December 31, 2006, 2005, and 2004, respectively.

## 10. Fair Value of Financial Instruments

The carrying values and fair values of the Company's financial instruments are approximately as follows:

	2006		2005	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	\$ 9,332,810	\$ 9,332,810	\$ 5,654,000	\$ 5,654,000
Short-term investments	7,864,000	7,864,000	—	—
Long-term debt, including current maturities	—	—	3,127,000	3,077,000

The carrying amount of cash equivalents and short-term investments approximates fair value because of the short maturity of those instruments. The fair value of long-term debt obligations was estimated based on the current rates offered to the Company for debt of the same remaining maturities.

## 11. Derivative Financial Instruments

The Company has various transactions with its foreign subsidiaries that are denominated in U.S. dollars and are subject to foreign currency exchange risk on these transactions.

The Company from time to time uses foreign currency exchange contracts to reduce its exposure to fluctuations in foreign exchange rates. The Company bases these contracts on the amount of cash flows that it expects to be remitted to the United States from its foreign operations and does not use such derivative financial instruments for trading or speculative purposes. The Company accounts for these contracts as free standing derivatives, such that gains or losses on the fair market value of these forward exchange contracts as of the balance sheet dates are recorded as other income and expense in the consolidated statements of income.

At December 31, 2005, the Company held forward exchange contracts totaling \$978,000 with maturities through December 2006. All such contracts were denominated in Canadian Dollars. At December 31, 2006, the Company no longer held any forward exchange contracts. The aggregate accrued loss on these contracts was \$-0-, and \$59,000 as of December 31, 2006, and 2005, respectively. The increase (decrease) in the aggregate accrued loss on these contracts was (\$59,000), (\$42,000), and \$55,000 for the years ended December 31, 2006, 2005 and 2004 respectively.

## 12. Income Taxes

The components of income before income taxes are as follows:

Year ended December 31	2006	2005	2004
United States	\$ 15,803,248	\$ 15,186,474	\$ 9,548,384
Foreign	(2,800,145)	(2,687,058)	(540,695)
	<b>\$ 13,003,103</b>	<b>\$ 12,499,416</b>	<b>\$ 9,007,689</b>

The components of the provision for income taxes are as follows:

Year ended December 31	2006	2005	2004
Current:			
Federal	\$ 4,340,000	\$ 4,594,000	\$ 2,963,000
State	924,000	705,000	392,000
Foreign	30,000	45,000	44,000
Total current	<b>5,294,000</b>	<b>5,344,000</b>	<b>3,399,000</b>
Deferred:			
Federal	(168,000)	(327,000)	138,000
State	(21,000)	(39,000)	18,000
Foreign	—	—	66,000
Total deferred	<b>(189,000)</b>	<b>(366,000)</b>	<b>222,000</b>
	<b>\$ 5,105,000</b>	<b>\$ 4,978,000</b>	<b>\$ 3,621,000</b>

The provision for income taxes is different from the amounts computed by applying the United States federal statutory income tax rate of 35%, 34%, and 34% for 2006, 2005, and 2004, respectively. The reasons for these differences are as follows:

Year ended December 31	2006	2005	2004
Income taxes at U.S. statutory rate	\$ 4,524,000	\$ 4,250,000	\$ 3,063,000
Impact of graduated federal taxes	(103,000)	—	—
State income taxes, net of federal benefit	727,000	666,000	410,000
Effect of foreign losses without an income tax benefit	—	50,000	126,000
Foreign corporate income taxes	30,000	45,000	45,000
Executive life insurance expense	16,000	33,000	8,000
Meals and entertainment	68,000	41,000	40,000
Extraterritorial income exclusion	(27,000)	(33,000)	(68,000)
Qualified production activities income – American Jobs Creation Act	(99,000)	(73,000)	—
Other	(31,000)	(1,000)	(3,000)
	\$ 5,105,000	\$ 4,978,000	\$ 3,621,000

The Company's effective tax rate is based on expected income, statutory tax rates and tax planning opportunities available to the Company in the various jurisdictions in which the Company operates. Significant judgment is required in determining the Company's effective tax rate and in evaluating its tax positions. In evaluating the exposure associated with various filing positions, the Company estimates reserves for probable exposures, which are adjusted quarterly in light of changing facts and circumstances, such as the progress of tax audits, case law and emerging legislation.

The components of the deferred tax assets and liabilities, and the related tax effects of each temporary difference at December 31, 2006 and 2005, are as follows:

	2006	2005
Deferred tax assets:		
Product refund reserve	\$ 162,000	\$ 145,000
Inventory obsolescence reserve	13,000	60,000
Vacation accrual	23,000	21,000
Compensation expense for warrants granted	64,000	42,000
Organization costs	96,000	70,000
Deferred compensation	393,000	406,000
Sales incentives	129,000	—
Miscellaneous accrued expenses	58,430	39,430
Foreign net operating loss carryforwards	2,393,000	1,813,000
Valuation allowance	(2,344,000)	(1,764,000)
	987,430	832,430
Deferred tax liabilities:		
Depreciation	435,000	469,000
Net deferred tax assets (liabilities)	\$ 552,430	\$ 363,430

The Company has a deferred tax asset of \$2,393,000, as of December 31, 2006, and \$1,813,000 as of December 31, 2005, relating to foreign net operating loss carryforwards. The Company has recorded a valuation allowance to the extent that it is more likely than not that this asset will not be realized before it expires beginning in 2007.

On October 22, 2004, the American Jobs Creation Act of 2004 (the "Act") was signed into law. One provision of the Act provides for a special one-time deduction of 85% of certain repatriated foreign earnings. The Company did not take advantage of this special provision. Through December 31, 2006, the Company has not recorded a provision for income taxes on the earnings of its foreign subsidiaries because such earnings are intended to be permanently reinvested outside the U.S. The cumulative amount of unremitted earnings on which the Company has not recognized United States income tax was \$40,000 at December 31, 2006.

### 13. Employee Benefit Plans

The Company sponsors a 401(k) employee savings plan which covers substantially all employees. Employees can contribute up to 15% of their gross income to the plan, and the Company matches a percentage of the employee's contribution at a rate of 50% in 2006 and 75% in 2005 and 2004. Company contributions under the 401(k) plan totaled \$283,000, \$384,000, and \$337,000 in 2006, 2005, and 2004, respectively.

On September 1, 2006, the Company established an employee stock ownership plan ("ESOP") which covers substantially all U.S. employees. Contributions to the ESOP are funded by the Company on a discretionary basis. For the year ended December 31, 2006, ESOP contribution expense was \$250,000.

### 14. Incentive Compensation Plans

In July 2001, the Board of Directors approved an incentive compensation plan effective for fiscal years beginning with 2001. Under the plan, the Company established a bonus pool payable on a semi-annual basis equal to 25% of the net income of the Company. Bonuses are payable on all profits, but only if the net income for each six-month period exceeds \$250,000. The bonus pool is allocated to executives according to a specified formula, with a portion allocated to a middle management group determined by the Executive Committee of the Board of Directors. The Company expensed a total of \$2,113,400, \$2,141,500, and \$1,580,000 to the participants of the bonus pool for 2006, 2005, and 2004, respectively.

The Company sponsors a Supplemental Executive Retirement Plan (SERP) to allow certain executives to defer a portion of their annual salary and bonus into a grantor trust. A grantor trust was established to hold the assets of the SERP. The Company funds the grantor trust by paying the amount deferred by the participant into the trust at the time of deferral. Investment earnings and losses accrue to the benefit or detriment of the participants. The SERP also provides for a discretionary matching contribution by the Company not to exceed 100% of the participant's annual contribution. In 2006, 2005, and 2004, the Company did not provide a match. The participants fully vest in the deferred compensation three years from the date they enter the SERP. The participants are not eligible to receive distribution under the SERP until retirement, death, or disability of the participant.

## 15. Related Party Transactions

In January 2004, the Company purchased a total of 116,564 shares of the Company's common stock from three officer/directors and one director. The total cost of the purchases was \$607,178, for a weighted average purchase price of \$5.21 per share. In April 2004, the Company purchased a total of 75,000 shares of the Company's common stock from two officer/directors. The total cost of the purchases was \$686,802, for a weighted average purchase price of \$9.16 per share. The price per share was based on a discount from the market price per share at the time of purchase in order to approximate the dilutive impact of their shares on the open market.

In March 2005 and May 2005, the Company purchased a total of 574,201 shares of the Company's common stock from three officer/directors and one former officer. The total cost of the purchases was \$5,435,313, for a weighted average purchase price of \$9.47 per share. The price per share was based on a discount from the market price per share at the time of purchase in order to approximate the dilutive impact of their shares on the open market.

In March 2005, the Company entered into a stock redemption agreement with an officer/director and his spouse (collectively "Seller"). Under the stock redemption agreement, the Company issued promissory notes ("Notes") totaling \$4,050,000 to the Seller in exchange for 450,000 shares of the Company's common stock (\$9.00 per share) owned by the Seller. Interest, at 4% per annum, accrued on the outstanding balance of the Notes and was payable quarterly. In 2005, the Company made principal payments on the Notes totaling \$950,000 resulting in a December 31, 2005 outstanding balance due on the Notes of \$3,100,000. In 2006, the Company made scheduled principal payments and principal prepayments (without penalty) on the Notes totaling \$3,100,000 resulting in a December 31, 2006 outstanding balance due on the Notes of \$-0-.

An officer/director of the Company is of counsel in a law firm which provides legal services to the Company. During the year ended December 31, 2006, the Company incurred legal fees to this firm of approximately \$114,000. Previously, this officer/director was a principal at another law firm. During the years ended December 31, 2005 and 2004, the Company incurred legal fees to his firm of approximately \$41,000 and \$182,000, respectively.

## 16. Segment Information

### Description of Products and Services by Segment

The Company operates in one reportable segment, a network marketing segment consisting of eight operating units that sell nutritional and dietary products to a sales force of independent distributors that sell the products directly to customers. These operating units are based on geographic regions.

Geographic area data for the years ended December 31, 2006, 2005, and 2004, follows:

	2006	2005	2004
<b>Net sales to external customers</b>			
United States	\$105,783,642	\$102,549,244	\$ 83,873,430
Australia/New Zealand	2,550,086	2,215,465	2,542,695
Canada	1,637,999	1,667,555	1,750,704
Mexico	1,433,462	1,607,473	2,634,394
United Kingdom	1,234,976	846,273	545,534
Malaysia/Singapore	1,804,704	2,031,045	2,770,664
Philippines	2,197,813	2,328,178	2,865,012
Germany	824,475	319,931	—
<b>Total net sales</b>	<b>\$ 117,467,157</b>	<b>\$ 113,565,164</b>	<b>\$ 96,982,433</b>
<b>Assets by area</b>			
United States	\$ 32,438,453	\$ 20,920,384	\$ 25,315,646
Australia/New Zealand	500,916	670,787	754,089
Canada	134,859	176,760	221,160
Mexico	1,250,811	1,323,482	1,834,229
United Kingdom	283,884	195,399	273,408
Malaysia/Singapore	1,209,616	1,414,909	1,716,929
Philippines	977,034	764,471	881,206
Germany	486,647	515,231	—
<b>Total consolidated assets</b>	<b>\$ 37,282,220</b>	<b>\$ 25,981,423</b>	<b>\$ 30,996,667</b>

The Company classifies its sales into three categories of products. Net sales by product category data for the years ended December 31, 2006, 2005, and 2004, follow:

	2006	2005	2004
<b>Net sales by product category</b>			
Nutritional and dietary supplements	\$102,295,598	\$ 99,254,075	\$ 83,982,424
Skin care products	1,119,836	1,131,012	1,229,187
Sales aids and other	2,081,986	1,660,296	2,353,498
Handling & freight income	11,969,737	11,519,781	9,417,324
<b>Total net sales</b>	<b>\$ 117,467,157</b>	<b>\$ 113,565,164</b>	<b>\$ 96,982,433</b>

## 17. Quarterly Financial Data (Unaudited)

(In thousands, except per share amounts)	First	Second	Third	Fourth
<b>2006</b>				
Net sales	\$ 31,195	\$ 27,849	\$ 29,779	\$ 28,644
Gross profit	\$ 26,113	\$ 23,126	\$ 24,828	\$ 23,880
Net income	\$ 2,450	\$ 1,620	\$ 1,804	\$ 2,024
Net income available to common shareholders	\$ 2,450	\$ 1,620	\$ 1,804	\$ 2,024
Earnings per share:				
Basic	\$ 0.16	\$ 0.10	\$ 0.11	\$ 0.12
Diluted	\$ 0.15	\$ 0.09	\$ 0.11	\$ 0.12
<b>2005</b>				
Net sales	\$ 28,979	\$ 28,546	\$ 28,555	\$ 27,485
Gross profit	\$ 24,036	\$ 23,835	\$ 23,681	\$ 22,749
Net income	\$ 2,063	\$ 1,979	\$ 1,668	\$ 1,811
Net income available to common shareholders	\$ 2,063	\$ 1,979	\$ 1,668	\$ 1,811
Earnings per share:				
Basic	\$ 0.13	\$ 0.12	\$ 0.11	\$ 0.11
Diluted	\$ 0.12	\$ 0.12	\$ 0.11	\$ 0.11