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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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(Mark One)

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

For the quarterly period ended September 30, 2004.

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File No. 000-24657

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**MANNATECH, INCORPORATED**

(Exact Name of Registrant as Specified in its Charter)

**Texas**  
(State or other Jurisdiction of  
Incorporation or Organization)

**75-2508900**  
(I.R.S. Employer  
Identification No.)

**600 S. Royal Lane, Suite 200**  
**Coppell, Texas 75019**  
(Address of Principal Executive Offices, including Zip Code)

**Registrant's Telephone Number, including Area Code: (972) 471-7400**

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of November 1, 2004, the number of shares outstanding of the registrant's sole class of common stock, par value \$0.0001 per share was 26,477,955.

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Since its initial public offering, Mannatech’s common stock has traded on the NASDAQ National Market under the symbol “MTEX.” Corporate filings can be viewed on Mannatech’s corporate website at [www.mannatech.com](http://www.mannatech.com) or by contacting Mannatech’s investor relations department at [ir@mannatech.com](mailto:ir@mannatech.com) or calling 972-471-6512.

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## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements

**MANNATECH, INCORPORATED**  
CONSOLIDATED BALANCE SHEETS (UNAUDITED)  
(in thousands, except share amounts)

	December 31, 2003	September 30, 2004
<b>ASSETS</b>		
Cash and cash equivalents	\$ 28,291	\$ 28,598
Restricted cash	2,140	392
Accounts receivable	134	709
Current portion of notes receivable from shareholders	55	—
Inventories	7,861	12,857
Prepaid expenses and other current assets	2,084	3,678
Deferred tax assets	2,363	3,958
	<hr/>	<hr/>
<b>Total current assets</b>	<b>42,928</b>	<b>50,192</b>
Property and equipment, net	5,514	8,360
Long-term investments	9,994	17,088
Notes receivable from shareholders, excluding current portion	150	157
Deferred tax assets	631	632
Restricted cash	—	959
Other assets	806	1,388
	<hr/>	<hr/>
<b>Total assets</b>	<b>\$ 60,023</b>	<b>\$ 78,776</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current portion of capital leases and notes payable	\$ 16	\$ 9
Accounts payable	2,687	1,684
Accrued expenses	19,940	27,942
Deferred revenue	3,142	3,498
Current portion of accrued severance related to former executives	953	420
	<hr/>	<hr/>
<b>Total current liabilities</b>	<b>26,738</b>	<b>33,553</b>
Capital leases and notes payable, excluding current portion	32	26
Accrued severance related to former executives, excluding current portion	359	67
Long-term liabilities	106	1,083
Deferred tax liabilities	—	15
	<hr/>	<hr/>
<b>Total liabilities</b>	<b>27,235</b>	<b>34,744</b>
Commitments and contingencies	—	—
<b>Shareholders' equity:</b>		
Preferred stock, \$0.01 par value, 1,000,000 shares authorized, no shares issued and outstanding	—	—
Common stock, \$0.0001 par value, 99,000,000 shares authorized, 26,227,171 shares issued and 26,183,422 outstanding in 2003 and 26,489,170 shares issued and 26,414,855 outstanding in 2004	3	3
Additional paid-in capital	24,175	25,704
Retained earnings	9,271	19,516
Accumulated other comprehensive loss	(422)	(629)
	<hr/>	<hr/>
	33,027	44,594
Less treasury stock, at cost, 43,749 shares in 2003 and 74,315 in 2004	(239)	(562)
	<hr/>	<hr/>
<b>Total shareholders' equity</b>	<b>32,788</b>	<b>44,032</b>
	<hr/>	<hr/>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 60,023</b>	<b>\$ 78,776</b>

See accompanying notes to consolidated financial statements.

**MANNATECH, INCORPORATED**  
**CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)**  
**(in thousands, except per share information)**

	Three months ended September 30,		Nine months ended September 30,	
	2003	2004	2003	2004
<b>Net sales</b>	<b>\$49,738</b>	<b>\$77,577</b>	<b>\$136,727</b>	<b>\$210,282</b>
Cost of sales	8,187	11,931	22,282	31,871
Commissions and incentives	20,981	34,702	56,912	94,707
	29,168	46,633	79,194	126,578
<b>Gross profit</b>	<b>20,570</b>	<b>30,944</b>	<b>57,533</b>	<b>83,704</b>
Operating expenses:				
Selling and administrative expenses	10,131	12,279	29,228	36,110
Other operating costs	6,096	9,588	18,982	24,915
Severance expenses	425	—	1,841	—
Total operating expenses	16,652	21,867	50,051	61,025
<b>Income from operations</b>	<b>3,918</b>	<b>9,077</b>	<b>7,482</b>	<b>22,679</b>
Interest income	81	136	214	430
Interest expense	(17)	0	(21)	(16)
Other income (expense), net	223	(191)	232	(1,038)
<b>Income before income taxes</b>	<b>4,205</b>	<b>9,022</b>	<b>7,907</b>	<b>22,055</b>
Income taxes	(1,323)	(2,193)	(2,435)	(6,547)
<b>Net income</b>	<b>\$ 2,882</b>	<b>\$ 6,829</b>	<b>\$ 5,472</b>	<b>\$ 15,508</b>
<b>Earnings per common share:</b>				
Basic	\$ 0.11	\$ 0.26	\$ 0.22	\$ 0.59
Diluted	\$ 0.11	\$ 0.25	\$ 0.21	\$ 0.57
<b>Weighted-average common shares outstanding:</b>				
Basic	25,655	26,393	25,325	26,324
Diluted	26,213	27,460	26,000	27,407

See accompanying notes to consolidated financial statements.

**MANNATECH, INCORPORATED**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**  
**(in thousands)**

	Nine months ended September 30,	
	2003	2004
<b>Cash flows from operating activities:</b>		
Net income	\$ 5,472	\$ 15,508
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Depreciation and amortization	2,462	1,955
Loss on disposal of assets	22	171
Accounting charge related to stock options and warrants granted	1,163	42
Tax benefit of exercising stock options	919	718
Deferred income taxes	71	(1,581)
<b>Changes in operating assets and liabilities:</b>		
(Increase) in accounts receivable	(27)	(585)
(Increase) decrease in inventories	307	(5,025)
(Increase) in prepaid expenses and other current assets	(1,327)	(1,594)
(Increase) in other assets	(1,484)	(602)
Decrease in accounts payable	(80)	(995)
Increase (decrease) in accrued expenses	(505)	9,058
Increase in deferred revenue	2,884	356
Increase (decrease) in accrued severance to former executives	592	(825)
<b>Net cash provided by operating activities</b>	<b>10,469</b>	<b>16,601</b>
<b>Cash flows from investing activities:</b>		
Acquisition of property and equipment	(774)	(5,002)
Purchases of investments	(12,001)	(7,094)
Repayments by shareholders/related parties	188	48
(Increase) decrease in restricted cash	(2,134)	793
<b>Net cash used in investing activities</b>	<b>(14,721)</b>	<b>(11,255)</b>
<b>Cash flows from financing activities:</b>		
Payment of cash dividend	—	(5,263)
Proceeds from stock options exercised	1,495	446
Repayment of capital lease obligation	(5)	(13)
Repayment of note payable	(129)	—
<b>Net cash provided by financing activities</b>	<b>1,361</b>	<b>(4,830)</b>
Effect of exchange rate changes on cash and cash equivalents	303	(208)
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(2,588)</b>	<b>308</b>
<b>Cash and cash equivalents:</b>		
Beginning of the period	17,693	28,290
End of the period	\$ 15,105	\$ 28,598
<b>SUMMARY OF NON-CASH INVESTING AND FINANCING ACTIVITIES:</b>		
Asset retirement obligations related to operating leases	\$ 250	\$ —
Treasury shares tendered to exercise stock options	\$ 100	\$ 323

See accompanying notes to consolidated financial statements.

**MANNATECH, INCORPORATED**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Mannatech, Incorporated (the "Company") was incorporated in the state of Texas on November 4, 1993 and is located in Coppell, Texas. The Company develops and sells high-quality, proprietary nutritional supplements, topical products, and weight-management products primarily through a global network-marketing system operating in the United States, Canada, Australia, the United Kingdom, Japan, New Zealand, and the Republic of Korea herein referred to as ("South Korea"). The Company opened operations in South Korea in September 2004 and plans to open operations in Taiwan in the first half of 2005. Independent associates ("associates") purchase the Company's products at published wholesale prices for the purpose of personal consumption and/or sale to retail customers. Members ("members") purchase the Company's products at a discount from published retail prices. Only associates are eligible to earn commissions and incentives on their downline growth and sales volume. The Company has twelve wholly-owned subsidiaries, although only the following subsidiaries are currently active:

<u>Wholly-owned subsidiary name</u>	<u>Date incorporated</u>	<u>Location of subsidiary</u>	<u>Date operations began</u>
Mannatech Australia Pty Limited	April 1998	St. Leonards, Australia	October 1998
Mannatech Ltd.	November 1998	Oxfordshire, U.K.	November 1999
Mannatech Japan, Inc.	January 2000	Tokyo, Japan	September 2000
Mannatech Korea Limited	February 2004	Seoul, Republic of Korea	September 2004
Mannatech Taiwan Corporation	June 2004	Coppell, Texas	First half of 2005*

\* estimated date its branch will begin sales operations in Taiwan.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles from interim financial information, the instructions for Form 10-Q, and Rule 10-01 of Regulation S-X. Accordingly, the consolidated financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. However, in the opinion of Company's management, the accompanying unaudited consolidated financial statements contain all adjustments, including normal recurring adjustments, considered necessary for a fair statement of the Company's consolidated financial information as of, and for, the period presented. The consolidated results of operations for an interim period are not necessarily indicative of the consolidated results of operations to be expected for the entire fiscal year. For further information, refer to the Company's consolidated financial statements and accompanying footnotes included in the Company's annual report on Form 10-K for the year ended December 31, 2003 filed with the United States Securities and Exchange Commission on March 14, 2004.

**Principles of Consolidation**

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

**Reclassification**

Certain balances from prior years' have been reclassified to conform to the Company's 2004 consolidated financial statement presentation.

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### **Revenue Recognition**

The Company's revenues are primarily derived from sales of its products, sales of its starter and renewal packs, and shipping fees. Substantially all product sales are sold to associates at published wholesale prices and to members at discounted published retail prices. The Company records a reserve for expected sales refunds based on its historical experience. The Company defers certain revenues and amortizes it over twelve months. Total deferred revenue at December 31, 2003 and September 30, 2004 was \$3.1 million and \$3.5 million, respectively. Total deferred revenue consisted of revenue received from customer product sales, which were shipped to customers but not received, revenue related to a one-year magazine subscription, and revenue from its pack sales when the pack sale price exceeds the estimated wholesale value of all individual components within the pack. At December 31, 2003 and September 30, 2004, total deferred revenue related to undelivered shipments was approximately \$2.7 million and \$2.8 million, respectively. At December 31, 2003 and September 30, 2004, deferred revenue related to magazine subscription and revenue exceeding the total average wholesale value was \$0.4 million and \$0.7 million, respectively.

### **Shipping and Handling Costs**

The Company records freight and shipping revenue collected from associates and members as revenue. The Company records shipping and handling costs associated with shipping products to its associates and members as selling and administrative expenses. Total shipping and handling costs included in selling and administrative expenses were approximately \$2.5 million for the three months ended September 30, 2003 and approximately \$3.3 million for the three months ended September 30, 2004. For the nine months ended September 30, 2003, total shipping and handling costs included in selling and administrative expenses were approximately \$6.9 million and approximately \$9.6 million for the nine months ended September 30, 2004.

### **Accounting for Stock-Based Compensation**

The Company has three stock-based compensation plans. The Company generally grants stock options to its employees and board members at the fair market value of the stock on the date of grant. The stock options vest over three years and are exercisable for ten years. Stock options granted to shareholders who own five percent or more of the Company's outstanding common stock are granted at an exercise price that may not be less than 110% of the fair market value of the Company's common stock on the date of grant and have a term no greater than five years.

For stock-based compensation issued to nonemployees, the Company is required to follow Statement of Financial Accounting Standards No. 123 ("SFAS 123"), "Accounting for Stock-Based Compensation" and its related interpretations. Under SFAS 123, stock-based compensation to nonemployees is measured and recognized at the fair value on the date of grant.

For stock-based compensation issued to employees and members of its Board of Directors, the Company elected to follow Accounting Principles Board Opinion No. 25, ("APB 25") "Accounting for Stock Issued to Employees" and its related interpretations. Under the recognition and measurement principles of APB 25, no compensation expense is recognized unless the market price of the stock option exceeds the exercise price on the date of grant.

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For disclosure purposes only, the Company estimated the fair value for all of its stock options granted to employees and board members on the date of grant using the fair-value based option-pricing model and estimated the amount of expense that it would have recognized for each stock option granted over its vesting period. The following table illustrates the effect on the Company's net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123 to all of its stock options:

	For the three-months ended September 30,		For the nine-months ended September 30,	
	2003	2004	2003	2004
(in thousands, except per share amounts)				
Consolidated net income, as reported	\$ 2,882	\$ 6,829	\$ 5,472	\$ 15,508
Add: Stock-based employee compensation expense included in reported net income, net of related tax effect	5	36	715	59
Deduct: Total stock-based employee compensation expense determined under a fair value based method for all awards, net of related tax effect	(140)	(133)	(776)	(399)
<b>Pro forma net income</b>	<b>\$ 2,747</b>	<b>\$ 6,732</b>	<b>\$ 5,411</b>	<b>\$ 15,168</b>
<b>Basic Earnings Per Share:</b>				
As reported	\$ 0.11	\$ 0.26	\$ 0.22	\$ 0.59
Pro forma	\$ 0.11	\$ 0.26	\$ 0.22	\$ 0.58
<b>Diluted Earnings Per Share:</b>				
As reported	\$ 0.11	\$ 0.25	\$ 0.21	\$ 0.57
Pro forma	\$ 0.10	\$ 0.25	\$ 0.21	\$ 0.55

### **Earnings Per Share**

Basic Earnings Per Share ("EPS") calculations are based on the weighted-average number of common shares outstanding during the period, while diluted EPS calculations are calculated using the weighted-average number of common shares and dilutive common share equivalents outstanding during the period. The Company's average closing price for the period is used to calculate the dilution of stock options and warrants in its EPS calculation.

The following data shows the amounts used in computing EPS and their effect on the weighted-average number of common shares and dilutive common share equivalents for the three months ended September 30, 2003 and 2004. At September 30, 2003, 714,100 common stock options and 100,000 warrants were excluded from the diluted EPS calculation, as their effect was antidilutive. At September 30, 2004, none of the common stock options or warrants were excluded from the diluted EPS calculation. The amounts are rounded to the nearest thousand, except for per share amounts.

	For the three months ended September 30, 2003			For the three months ended September 30, 2004		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
<b>Basic EPS:</b>						
Net income available to common shareholders	\$ 2,882	25,655	\$ 0.11	\$ 6,829	26,393	\$ 0.26
Effect of dilutive securities:						
Stock options	—	522	—	—	970	(0.01)
Warrants	—	36	—	—	97	—
<b>Diluted EPS:</b>						
Net income available to common shareholders plus assumed conversions	\$ 2,882	26,213	\$ 0.11	\$ 6,829	27,460	\$ 0.25



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The following data shows the amounts used in computing EPS and their effect on the weighted-average number of common shares and dilutive common share equivalents for the nine months ended September 30, 2003 and 2004. At September 30, 2003, 714,100 common stock options and 100,000 warrants were excluded from the diluted EPS calculation, as their effect was antidilutive. At September 30, 2004, none of the common stock options or warrants were excluded from the diluted EPS calculation. The amounts are rounded to the nearest thousand, except for per share amounts.

	For the nine months ended September 30, 2003			For the nine months ended September 30, 2004		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
<b>Basic EPS:</b>						
Net income available to common shareholders	\$ 5,472	25,325	\$ 0.22	\$ 15,508	26,324	\$ 0.59
Effect of dilutive securities:						
Stock options	—	634	(0.01)	—	987	(0.02)
Warrants	—	41	—	—	96	—
<b>Diluted EPS:</b>						
Net income available to common shareholders plus assumed conversions	\$ 5,472	26,000	\$ 0.21	\$ 15,508	27,407	\$ 0.57

## **NOTE 2 TRANSACTIONS WITH AFFILIATES AND RELATED PARTIES**

### **MannaRelief**

The Company's Chairman and Chief Executive Officer, Samuel L. Caster, founded MannaRelief in 1999 and serves as its Chairman. Under the Internal Revenue Code, MannaRelief is a 501(c)(3) charitable organization that provides glyconutritional products to under-privileged children. Donald Herndon, who serves as the Company's Vice President of Field Services, also serves on MannaRelief's Board. Mr. Herndon is the brother-in-law to Mr. Caster and is also the brother-in-law to Terry L. Persinger, who serves as the Company's President, Chief Operating Officer and is a member of the Company's Board of Directors.

During 2003 and 2004, the Company made cash contributions to MannaRelief, sold products to MannaRelief at cost plus shipping and handling charges, and shipped the purchased products to MannaRelief's chosen recipients. In addition certain Company employees and consultants periodically work on various fund raising projects and events for MannaRelief at no cost to MannaRelief. For both the three months ended September 30, 2003 and 2004, the Company sold products to MannaRelief at cost plus shipping and handling of approximately \$0.1 million and \$0.2 million, respectively and made annual cash contributions of approximately \$0.1 million for both 2003 and 2004. For the first nine months of 2003 and 2004, the Company sold products to MannaRelief at cost plus shipping and handling of approximately \$0.3 million and \$0.6 million, respectively and made annual cash contributions of approximately \$0.2 million for both 2003 and 2004.

### **Clinical Study with St. George's Hospital**

In September 2004, the Company signed a cancelable three-year research agreement with St. Georges Hospital & Medical School, the employer of Dr. John Axford, who is a member of the Company's Board of Directors. Pursuant to the research agreement, the Company agreed to provide approximately \$0.7 million over three years to fund the research costs related to a clinical study. St. George's Hospital & Medical School is located in London, England where Dr. Axford is the Lead Investigator in the clinical study funded by the Company. This is the Company's second clinical study funded with St. George's Hospital & Medical School. As of September 30, 2004, the Company paid St. George's Hospital \$0.2 million toward this clinical study.

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**NOTE 3 INVESTMENTS**

The Company classifies its investments as available-for-sale. At September 30, 2004, the Company's investments consisted of the following:

	Amortized cost	Gross unrealized loss	Fair Value
	(in thousands)		
<b>Long-term:</b>			
Federal Home Loan Bank	\$ 4,000	\$ (37)	\$ 3,963
Guaranteed student loan securities	12,125	—	12,125
State regulated utility company obligation	1,000	—	1,000
<b>Total investments</b>	<b>\$ 17,125</b>	<b>\$ (37)</b>	<b>\$ 17,088</b>

The Company's fair value of investments by contractual maturity at December 31, 2003 and September 30, 2004, are as follows:

	December 31, 2003	September 30, 2004
	(in thousands)	
Due in one year or less and restricted for use	\$ 2,140	\$ —
Due in one year or less	—	—
Due between one and three years	3,994	3,963
Due after three years	6,000	13,125
	<b>\$ 12,134</b>	<b>\$ 17,088</b>

**NOTE 4 INVENTORIES**

At December 31, 2003 and September 30, 2004, inventories consisted of the following:

	December 31, 2003	September 30, 2004
	(in thousands)	
Raw materials	\$ 1,517	\$ 1,646
Finished goods, less inventory reserves for obsolescence of \$246 in 2003 and in 2004, respectively	6,344	11,211
	<b>\$ 7,861</b>	<b>\$ 12,857</b>

**NOTE 5 COMPREHENSIVE INCOME**

Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from nonowner sources and includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. The Company's comprehensive income is as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2003	2004	2003	2004
	(in thousands)			
Net income	\$ 2,882	\$ 6,829	\$ 5,472	\$ 15,508
Foreign currency translation adjustment	322	(145)	317	(187)
Unrealized loss (gain) from investments classified as available- for-sale, net of related tax effect of \$11 for 2004	8	14	8	(20)
<b>Comprehensive income</b>	<b>\$ 3,212</b>	<b>\$ 6,698</b>	<b>\$ 5,797</b>	<b>\$ 15,301</b>

**NOTE 6 COMMITMENTS AND CONTINGENCIES**

**Royalty Agreement.** On August 7, 2003, the Company entered into a royalty agreement with Dr. Bill H. McAnalley, its Chief Science Officer. While Dr. McAnalley is employed by the Company, the Company has agreed to pay him the greater of an annual executive bonus or his annual royalty. Pursuant to the royalty agreement, if Dr. McAnalley's employment with the Company ceases, the Company is required to pay Dr. McAnalley or his heirs, royalties for ten years based on the Company's annual global sales of its products in excess of \$105.4 million for each of the ten years. As of September 30, 2004, the Company accrued approximately \$0.6 million related to future payments due to Dr. McAnalley for this royalty agreement.

**Non-Compete and Confidentiality Agreement.** In July 2002, the Company entered into a Non-Compete and Confidentiality Agreement with Dr. H. Reginald McDaniel, a former medical director, who resigned from the Company in June 2002. Under the terms of the Non-Compete and Confidentiality Agreement, the Company agreed to pay Dr. McDaniel \$25,000 a month for one year, as consideration for his continued compliance with the non-compete clause of this agreement. The Company has amended the Non-Compete and Confidentiality Agreement and agreed to extend the agreement to pay Dr. McDaniel \$25,000 a month through January 2005.

**Consulting and Lockup Agreement.** In October 2001, the Company entered into a two-year Consulting and Lockup Agreement with Mr. J. Stanley Fredrick. Mr. Fredrick serves as the Company's Lead Director on its Board of Directors. This Agreement was modified in June 2003 to eliminate the consulting arrangement; however Mr. Fredrick remains prohibited from selling any of his shares of the Company's common stock while this agreement remains in effect, unless he obtains prior approval from the Company's Board of Directors. In June 2004, the Company's Board of Directors granted Mr. Fredrick permission to sell up to 350,000 shares of his Company's common stock. As of November 1, 2004, Mr. Fredrick had sold 232,073 shares of his Company common stock and holds 3,267,927 shares of the Company's common stock.

**Repurchase Plan.** On June 30, 2004, the Company's Board of Directors authorized the Company to repurchase up to 1.3 million shares of the Company's outstanding common stock. The Company has not formalized or adopted any Stock Repurchase Plan and currently has no present plans to initiate any repurchase activity in the near future. As of November 1, 2004, the Company had not repurchased any of its common stock in the open market or through any private sales.

**Operating Leases.** In the second quarter of 2004, the Company signed new building leases with lessors in the United Kingdom, Japan, South Korea, and Taiwan, and moved its operations in the United Kingdom and Japan into new facilities in September 2004 and October 2004, respectively. In addition, the Company opened operations in South Korea in September 2004 and plans to open operations in Taiwan in the first half of 2005. The new building leases expire on various dates from August 2006 through November 2009. Future minimum rental commitments related to these four building leases are approximately \$0.2 million for the remainder of 2004, \$1.2 million in 2005, \$1.2 million in 2006, \$0.5 million in 2007, \$0.2 million in 2008, and \$0.1 million in 2009.

**Purchase Commitment.** In August 2004, the Company entered into a three year purchase agreement with a supplier to purchase certain raw materials. Under this agreement, the Company is required to purchase \$3.9 million in 2005 and \$3.5 million in both 2006 and 2007. As of September 30, 2004, the Company had paid a deposit of \$0.2 million related to its 2005 purchase requirement.

**NOTE 7 RECENT ACCOUNTING PRONOUNCEMENTS**

**FIN 46R.** In December 2003, the Financial Accounting Standards Board (“FASB”) issued a revised Interpretation No.46 (“FIN 46R”), “Consolidation of Variable Interest Entities, and Interpretation of Accounting Research Bulletin No. 51,” which replaced the original interpretation issued in January 2003. FIN 46R requires certain entities to be consolidated by enterprises that lack majority voting interest when equity investors of those entities have insignificant capital at risk or lack voting rights, the obligation to absorb expected losses, or the right to receive expected returns. Entities identified with these characteristics are called variable interest entities and the interests that enterprises have in these entities are called variable interest. These interests are derived from certain guarantees, leases, loans, or other arrangements that result in risks and rewards that are disproportionate to the voting interests in the entities. The adoption of FIN 46R as of March 31, 2004 did not have a material effect on the Company’s consolidated financial condition, results of operations, or cash flows.

**NOTE 8 LITIGATION**

On June 11, 2004, the Australian Therapeutic Goods Administration notified the Company of a complaint that an Australian associate had made therapeutic claims to promote the Company’s products. In response to this complaint, the Company conducted an investigation and terminated this associates’ account. In November 2004, the Australian Therapeutic Goods Administration indicated its agreement to the action proposed by the Company, including the Company’s plans for ongoing education and compliance training for its associates over the next three years. However, the Australian Therapeutic Goods Administration will continue to monitor the Company’s activities.

On January 1, 2004, the Canadian Natural Health Product Regulations came into force, which applies to all Natural Health Products sold in Canada. The Natural Health Product Regulations require companies selling Natural Health Products in Canada to obtain a product license prior to sale. Regulatory compliance action in connection with products on the market prior to January 1, 2004 is subject to the priority classification of the product ingredients. As a result, companies selling products containing priority one ingredients were required to submit an application for a product license by June 30, 2004 and companies selling products containing priority two ingredients are required to submit an application for a product license by December 31, 2004. The Company did not file a license application for its products containing priority one ingredients by June 30, 2004 and accordingly must await receipt of its product license for these products before resuming sale of these products in Canada. As of November 1, 2004, the Company had submitted product license applications for all of its products containing priority one ingredients and expects to have license applications submitted for all of its products containing priority two ingredients prior to December 31, 2004. In the meantime, the Company products remain available for personal consumption by Canadian consumers in accordance with Health Canada’s Importation of Human Use Drugs for Personal Use Enforcement Directive. In addition, the Company is also reformulating certain of its products in order to prospectively comply with these new regulations in Canada and has recorded an inventory reserve of \$0.1 million as of September 30, 2004 related to any products, which it may not be able to sell in the future. The Company believes this will not have a significant impact on its overall consolidated sales or operations and does not expect it to significantly restrict its ability to continue its operations in Canada.

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**Note 9 SEGMENT INFORMATION**

The Company conducts its business within one industry segment. No single associate has ever accounted for more than 10% of the Company's total sales.

The Company aggregates its operating segments because it operates as a single reportable segment as a seller of nutritional supplements, optimal health products, and weight-management products through its network-marketing distribution channels operating in seven different countries. In each country, the Company markets its products and pays commissions and incentives in similar environments. The Company's management reviews all of its financial information by country and concentrates its internal reporting and analysis of revenues on pack sales and product sales. The Company sells its products through its independent associates and distributes its products through similar distribution channels in each country. Each of the Company's operations sells primarily the same products and possesses similar economic characteristics such as similar gross margins. The Company's Canadian operation is serviced through its United States corporate facility and its products are shipped through a third party distribution facility located in Canada. The Company's New Zealand operation is serviced through its Australian operations and its products are shipped through a third party distribution facility located in Australia. Net sales by country and net sales information, for the three and nine months ended September 30, 2003 and 2004, respectively are in millions and are as follows:

	Three months ended September 30,							Total
	United States	Canada	Australia	United Kingdom	Japan	New Zealand	South Korea	
<b>2004</b>	\$ 51.3	\$ 5.6	\$ 8.0	\$ 2.6	\$ 6.5	\$ 3.4	\$ 0.2	\$ 77.6
	66.1%	7.2%	10.3%	3.3%	8.4%	4.4%	0.3%	100.0%
<b>2003</b>	\$ 33.4	\$ 4.1	\$ 4.2	\$ 1.3	\$ 4.9	\$ 1.8	—	\$ 49.7
	67.2%	8.2%	8.5%	2.6%	9.9%	3.6%	—	100.0%
	Nine months ended September 30,							Total
	United States	Canada	Australia	United Kingdom	Japan	New Zealand	South Korea	
<b>2004</b>	\$ 137.6	\$ 16.1	\$ 21.8	\$ 8.0	\$ 17.4	\$ 9.1	\$ 0.2	\$ 210.2
	65.4%	7.7%	10.4%	3.8%	8.3%	4.3%	0.1%	100.0%
<b>2003</b>	\$ 93.0	\$ 12.2	\$ 10.2	\$ 2.9	\$ 13.5	\$ 4.9	—	\$ 136.7
	68.0%	8.9%	7.5%	2.1%	9.9%	3.6%	—	100.0%
	Three months ended September 30,		Nine months ended September 30,					
	2003	2004	2003	2004				
Consolidated product sales	\$ 36.7	\$ 53.3	\$ 101.8	\$ 148.1				
Consolidated pack sales	10.6	19.6	28.9	52.6				
Consolidated other, including freight	2.4	4.7	6.0	9.5				
<b>Total net sales</b>	<b>\$ 49.7</b>	<b>\$ 77.6</b>	<b>\$ 136.7</b>	<b>\$ 210.2</b>				

The Company's Canada and New Zealand operations operate through offices in the United States and Australia, respectively. Long-lived assets by country include property, plant and equipment and are as follows:

Country	December 31, 2003	September 30, 2004
	(in millions)	
Australia	\$ 0.3	\$ 0.3
Japan	0.5	0.4
South Korea	0.0	0.6
United Kingdom	0.1	0.2
United States	4.6	6.9
	<b>\$ 5.5</b>	<b>\$ 8.4</b>

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion is intended to assist in the understanding of Mannatech's consolidated financial position and its results of operations for the three months and nine months ended September 30, 2004 as compared to the same periods in 2003. Unless stated otherwise, all financial information presented below, throughout this report, and in the consolidated financial statements and related notes includes Mannatech and all of its subsidiaries on a consolidated basis and are rounded to the nearest million.

### **Company Overview**

For over a decade, Mannatech has developed innovative, high-quality, proprietary nutritional supplements, topical products, and weight-management products that are primarily sold through a global network-marketing system. Currently Mannatech operates in the United States, Canada, Australia, the United Kingdom, Japan, New Zealand, and South Korea. Mannatech plans to open operations in Taiwan in the first half of 2005.

Mannatech operates as a single segment and primarily sells its products to a network of approximately 342,000 associates and members who have purchased Mannatech's packs and products within the last 12 months. Mannatech aggregates its operating segments because it believes it operates as a single reportable segment selling its nutritional supplements and optimal health products in similar distribution channels in each of its operations. Mannatech's management reviews all of its financial revenue information in each country by pack sales and by product sales. Each of Mannatech's operations sells primarily the same products and possesses similar economic characteristics, such as similar gross margins.

Mannatech derives its revenues from sales of its products, sales of its starter and renewal packs, and from shipping fees, but defers the recognition of its revenues until its customers receive their shipments. Substantially all of Mannatech's product sales are sold to its independent associates at published wholesale prices, sold to its members at discounted published retail prices, and sold to its retail customers at published retail prices. Mannatech believes the majority of its product sales are for personal consumption; however, Mannatech cannot distinguish its personal consumption sales from its other sales because it has no involvement in the transaction after delivery other than usual and customary product returns.

Mannatech periodically changes its starter and renewal packs to meet current market demands. Each of Mannatech's starter and renewal packs includes some combination of its products and promotional materials and entitles associates and members to published discounts related to Mannatech's retail prices. Mannatech tries to offer comparable packs in each country in which it does business; however, because each country has different regulatory guidelines, not all of Mannatech's packs can be offered in all countries.

For the three months ended September 30, 2004, consolidated net sales increased by 56.1% as compared to the same period in 2003. For the nine months ended September 30, 2004, consolidated net sales increased by 53.8% as compared to the same period in 2003. Mannatech believes that its future success in increasing net sales is dependent on the following factors:

- continuing to follow its product development strategy, which includes enhancing its existing proprietary products and introducing new products;
- continuing its planned international expansion; and
- attracting new associates and retaining continuing associates to purchase its products by introducing new incentives and products and refining its existing commissions and incentives plan.

In 2004, Mannatech continued to focus on registering its Ambrotose AO<sup>®</sup> product in its existing foreign markets and registering its most popular products in South Korea and Taiwan. Mannatech has delayed the introduction of its unique water-filtration device pending further research.

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**Commissions and incentives** include commissions on sales and paying incentives, including offering an annual travel incentive. Commissions are dependent on the commissionable sales mix and range between 40% and 46% of Mannatech's net sales and Incentives range between 2% and 3% of Mannatech's net sales. Commissions and incentives are earned by Mannatech's independent associates in accordance with Mannatech's global associate career and compensation plan and are based on commissionable net sales, which consist of sales of finished products and packs.

Periodically, Mannatech offers travel incentives and contests, which are designed to stimulate both pack and product sales. In March 2004, Mannatech announced its 2004 travel incentive, which is a five-day cruise for two in the Caribbean in November 2004. Independent associates who achieved certain sales levels from February 28, 2004 through July 16, 2004 qualified for this 2004 travel incentive. Approximately 1,165 associates qualified for the 2004 travel incentive at an estimated cost to Mannatech of \$3.1 million.

Mannatech's global associate career and compensation plan allows new and existing independent associates to build their individual global networks by expanding their existing downlines into newly-opened international markets rather than requiring them to establish new downlines to qualify for commissions and incentives within each newly-opened country.

**Net income** increased by 137.0% to \$6.8 million for the three months ended September 30, 2004 and by 183.4% to \$15.5 million for the first nine months of 2004 as compared to the same periods in 2003. Mannatech's diluted earnings per share for the three months ended September 30, 2004 increased by 127.3% to \$0.25 per diluted share as compared to \$0.11 per diluted share for the comparable period in 2003. For the nine months ended September 30, 2004, diluted earnings per share increased by 171.4% to \$0.57 per diluted share as compared to \$0.21 per diluted share for the comparable period in 2003. Mannatech believes the strong increase in its net income and diluted earnings per share was the result of continuing to increase net sales in all countries related to the increase in independent associates and its ability to contain operating expenses.

### **Outlook**

Mannatech believes the remainder of 2004 should continue to be strong and expects its commissions and incentives as a percentage of net sales to remain in the 42% to 46% range for the remainder of 2004 based on its expected increase in net sales. In the fourth quarter of 2004, Mannatech expects to capitalize an additional \$1.2 million to \$1.5 million in payroll and consulting fees related to its planned internally-developed capital software projects.

### **Critical Accounting Policies and Estimates**

In response to SEC Release No. 33-8040, "Cautionary Advice Regarding Disclosure About Critical Accounting Policies," Mannatech reviews its policies related to the portrayal of its consolidated financial condition and consolidated results of operations that require the application of significant judgment by Mannatech's management. Mannatech also analyzes the need for certain estimates, including the need for such items as inventory reserves, impairment of long-lived assets, capitalization of software development, tax valuation allowances, revenue recognition, sales returns, accounting for stock options and warrants, contingencies and litigation. Mannatech bases any estimates needed on its historical experience, industry standards, and various other assumptions that may be reasonable under the circumstances. Mannatech cautions its readers that actual results could differ from its estimates under different assumptions or conditions. If circumstances change relating to the various assumptions or conditions used in such estimates Mannatech could experience an adverse effect on its consolidated financial condition, changes in financial condition, and results of operations.

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Mannatech's has identified the following critical accounting policies at September 30, 2004:

### ***Inventory Reserves***

Mannatech reviews its inventory carrying value and compares it to the fair market value and any inventory value in excess of its estimated fair market value is written down. In addition, Mannatech reviews its inventory for obsolescence and any inventory identified as obsolete is reserved or written off. Mannatech's determination of obsolescence is based on assumptions about the demand for its products, product expiration dates, estimated future sales, and management's future plans. In the future, if actual sales or management plans are less favorable than those originally projected by management, additional inventory reserves or write-downs may be required. Mannatech's inventory value at September 30, 2004 was \$12.9 million, which includes an inventory reserve of approximately \$0.2 million.

### ***Asset Impairment***

Mannatech reviews the book value of its property and equipment for impairment whenever an event or change in circumstances indicates that the net book value of an asset or group of assets may not be recoverable. Mannatech's impairment review includes a comparison of future projected cash flows generated by the asset or group of assets with its associated carrying value. Mannatech believes its expected future cash flows approximate or exceed its net book value. However, if circumstances change and the net book value of the asset or group of assets exceeds expected cash flows (undiscounted and without interest charges), Mannatech would have to recognize an impairment loss to the extent the net book value of its property and equipment exceeds its fair value. At September 30, 2004, the net book value of Mannatech's property and equipment was \$8.4 million.

### ***Software Capitalization***

During 2004, Mannatech began the development of several information technology projects that are expected to increase functionality, improve the efficiency and effectiveness of its operations and internal controls, and expand its reporting capabilities. Internally-developed software projects include the establishment of a comprehensive Japanese E-Commerce system, translation and application development of its Korean computer application software, and development of its global re-architecture project. In September 2004, Mannatech substantially completed the development of the South Korea computer application project and the Japanese E-Commerce system totaling \$0.8 million, of which \$0.7 million related to capitalized payroll and contractors' fees.

In the third quarter of 2004, Mannatech also capitalized approximately \$1.3 million in payroll, contractors and consulting fees related to its global re-architecture project. The global re-architecture project consists of a phase 1 and phase 2. Phase 1 includes design and implementation of a multi-faceted financial system that is estimated to be put into production in January 2005. Phase 2 includes the design and implementation of its sales and customer support and data management system and is estimated to be put into production in January 2006. Phase 1 is estimated to cost between \$3.2 million and \$3.7 million, of which \$2.7 to \$3.3 million will be capitalized payroll, contractors, and consulting fees. Phase 2 is estimated to cost between \$8.0 million and \$10.0 million, of which \$5.0 million to \$7.0 million will be capitalized payroll, contractors, and consulting fees.

Mannatech amortizes capitalized payroll, contractors and consulting fees related to internally developed software over the estimated useful life of the software application, which is three or five years. If accounting standards change or if the capitalized software becomes obsolete, Mannatech may be required to write-off its capitalized software or accelerate its amortization period. As of September 30, 2004, Mannatech's net book value of approximately \$1.9 million related to all of its capitalized payroll, contractors, and consultants costs for its internally-developed software projects.

### ***Tax Valuation Allowances***

Mannatech evaluates the probability of realizing the future benefits of any of its deferred tax assets and records a valuation allowance when it believes a portion or all of its deferred tax assets may not be realized. If Mannatech is unable to realize the expected future benefits of its deferred tax assets, it would be required to provide an additional valuation allowance. As of September 30, 2004, Mannatech recorded net deferred tax assets of \$4.7 million, which includes a valuation allowance of approximately \$0.1 million related to its net operating loss for its South Korean operations, which is expected to be carried forward.



***Deferred Revenues***

Mannatech defers all of its revenue until its customers receive their shipments. Mannatech also defers a portion of its revenue from the sale of its starter and renewal packs because of a one-year magazine subscription offered in certain of its packs. In addition, Mannatech defers the portion of revenue from each pack that exceeds the total average wholesale value of all individual components included in such packs. Mannatech amortizes its deferred revenues associated with its magazine subscriptions and any pack sales that exceed the total average wholesale value of the individual components in the packs over twelve months. Although Mannatech has no immediate plans to significantly change the contents of its packs or its shipping methods, any such changes in the future could result in additional revenue deferrals or could cause Mannatech to recognize its deferred revenue over a longer period of time.

***Accounting for Stock-Based Compensation***

Currently, Mannatech follows Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and its related interpretations for stock options granted to employees and members of its Board of Directors. Under the recognition and measurement principles of APB 25, Mannatech is not required to recognize any compensation expense unless the market price of the stock exceeds the exercise price on the date of grant or the terms of the grant are subsequently modified.

FASB has recently indicated that it expects to issue a change in the recognition and measurement principles for equity-based compensation granted to employees and board members. Under the proposed rules, all companies, including Mannatech, would be required to recognize compensation expense related to stock options and warrants granted to employees and board members after December 15, 2004. The compensation expense would be calculated based on the number of options expected to vest and would be recognized over the stock options' vesting period, which could have a material effect on Mannatech's future consolidated results of operations. On July 20, 2004, the United States House of Representatives approved a proposed bill to prevent FASB from issuing its proposed guidance on expensing stock options and to block the mandatory expensing of stock options by corporations until the United States Secretary of Commerce and the United States Secretary of Labor complete a one-year joint study on the economic impact of the FASB proposal. After the joint study is completed, corporations would only be required to expense stock options granted to their five highest-paid executives rather than having to expense stock options granted to all employees. However, the bill would allow, but not require, corporations to expense stock options that are granted to other employees under existing accounting guidance. If the bill is passed into law, the United States Securities and Exchange Commission will be able to regard these accounting principles as "generally accepted." The bill is currently in the United States Senate. In March 2004, FASB issued an exposure draft "Share-Based Payment—an amendment of SFAS 123 and SFAS 95 and expects to finalize it by the end of 2004, which is effective for June 15, 2004.

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**Results of Operations**

The following table summarizes Mannatech's consolidated operating results as a percentage of net sales for each of the three and nine months ended September 30, 2003 and 2004:

	Three months ended September 30,		Nine months ended September 30,	
	2003	2004	2003	2004
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	16.4	15.4	16.3	15.2
Commissions and incentives	42.2	44.7	41.6	45.0
<b>Gross profit</b>	<b>41.4</b>	<b>39.9</b>	<b>42.1</b>	<b>39.8</b>
Operating expenses:				
Selling and administrative expenses	20.4	15.8	21.4	17.2
Other operating costs	12.3	12.4	13.9	11.8
Severance expenses	0.8	0.0	1.3	0.0
<b>Income from operations</b>	<b>7.9</b>	<b>11.7</b>	<b>5.5</b>	<b>10.8</b>
Interest income	0.2	0.2	0.2	0.2
Interest expense	0.0	0.0	0.0	0.0
Other income (expense), net	0.4	(0.3)	0.1	(0.5)
<b>Income before income taxes</b>	<b>8.5</b>	<b>11.6</b>	<b>5.8</b>	<b>10.5</b>
Income taxes	(2.7)	(2.8)	(1.8)	(3.1)
<b>Net income</b>	<b>5.8%</b>	<b>8.8%</b>	<b>4.0%</b>	<b>7.4%</b>

**2004 Compared to 2003**

*Net Sales*

**Net Sales in Dollars and as a Percentage of Consolidated Net Sales**  
(in millions)

	Three months ended September 30,							Total
	United States	Canada	Australia	United Kingdom	Japan	New Zealand	South Korea	
<b>2004</b>	\$ 51.3 66.1%	\$ 5.6 7.2%	\$ 8.0 10.3%	\$ 2.6 3.3%	\$ 6.5 8.4%	\$ 3.4 4.4%	\$ 0.2 0.3%	\$ 77.6 100.0%
<b>2003</b>	\$ 33.4 67.2%	\$ 4.1 8.2%	\$ 4.2 8.5%	\$ 1.3 2.6%	\$ 4.9 9.9%	\$ 1.8 3.6%	—	\$ 49.7 100.0%

  

	Nine months ended September 30,							Total
	United States	Canada	Australia	United Kingdom	Japan	New Zealand	South Korea	
<b>2004</b>	\$137.6 65.4%	\$ 16.1 7.7%	\$ 21.8 10.4%	\$ 8.0 3.8%	\$17.4 8.3%	\$ 9.1 4.3%	\$ 0.2 0.1%	\$210.2 100.0%
<b>2003</b>	\$ 93.0 68.0%	\$ 12.2 8.9%	\$ 10.2 7.5%	\$ 2.9 2.1%	\$13.5 9.9%	\$ 4.9 3.6%	—	\$136.7 100.0%

**Recap of Consolidated Net Sales**  
(in millions)

	For the three months ended September 30,		Percentage change	For the nine months ended September 30,		Percentage change
	2003	2004	2004 over 2003	2003	2004	2004 over 2003
	(in millions)			(in millions)		
Consolidated product sales	\$ 36.7	\$ 53.3	45.2%	\$ 101.8	\$ 148.1	45.5%
Consolidated pack sales	10.6	19.6	84.9%	28.9	52.6	82.0%
Consolidated other, including freight	2.4	4.7	95.8%	6.0	9.5	58.3%
<b>Total net sales</b>	<b>\$ 49.7</b>	<b>\$ 77.6</b>	<b>56.1%</b>	<b>\$ 136.7</b>	<b>\$ 210.2</b>	<b>53.8%</b>

Mannatech's net sales increased in all countries for the three and nine months ended September 30, 2004 as compared to the same period in 2003. For the three months ended September 30, 2004, net sales increased \$27.9 million, or 56.1%, to \$77.6 million as compared to the same period in 2003. For the first nine months of 2004, net sales increased \$73.5 million, or 53.8%, to \$210.2 million as compared to the same period in 2003.

**Product Sales**

Mannatech's product sales have increased in 2004 in all countries. The increase is primarily the result of an increase in the number of associates and members purchasing Mannatech products and an increase in sales volume. Mannatech is continuing to look at ways to improve its existing products and is exploring new products to bring to market. At its corporate-sponsored event held in Portland, Oregon in September 2004, Mannatech introduced its reformulated Phyto•Bears® product and renamed it Manna•Bears.™ Mannatech has delayed its plans to introduce a unique water-filtration device pending further research.

For the three months ended September 30, 2004, existing product sales increased by approximately \$16.6 million, or 45.2%, to \$53.3 million as compared to the same period in 2003. For the first nine months of 2004, existing product sales increased by \$46.3 million, or 45.5%, to \$148.1 million as compared to the same period in 2003. The increase in Mannatech's existing product sales related to a continued increase in the number of new and existing associates and members purchasing Mannatech products and an increase in sales volume.

**Pack Sales**

For the three months ended September 30, 2004, Mannatech had approximately 46,000 new independent associates and members purchasing packs as compared to 34,000 new independent associates and members purchasing packs for the same period in 2003. For the twelve months ended September 30, 2004, the number of new and continuing independent associates and members who purchased packs increased by approximately 99,000, or 40.7%, to approximately 342,000 at September 30, 2004 as compared to approximately 243,000 at September 30, 2003. The number of new and continuing independent associates and members who purchased Mannatech's products during the preceding 12 months, by quarter, were as follows:

Associates & Members	For the twelve months ended									
	September 30, 2003		December 31, 2003		March 31, 2004		June 30, 2004		September 30, 2004	
New	125,000	51.4%	134,000	50.8%	141,000	49.1%	150,000	47.8%	162,000	47.3%
Continuing	118,000	48.6%	130,000	49.2%	146,000	50.9%	164,000	52.2%	180,000	52.7%
<b>Total</b>	<b>243,000</b>	<b>100.0%</b>	<b>264,000</b>	<b>100.0%</b>	<b>287,000</b>	<b>100.0%</b>	<b>314,000</b>	<b>100.0%</b>	<b>342,000</b>	<b>100.0%</b>

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For the three months ended September 30, 2004, pack sales increased by \$9.0 million, or 84.9%, to \$19.6 million, as compared to the same period in 2003. For the first nine months of 2004, pack sales increased by \$23.7 million, or 82.0%, to \$52.6 million as compared to the first nine months of 2003. Mannatech believes this continued increase relates to the increase in the number of new associates and the increase in the number of continuing associates who purchase products and who continue to purchase pack upgrades and annual renewal packs from Mannatech.

New associates and members purchasing packs accounted for 74.3% of the total increase in overall pack sales for the three months ended September 30, 2004 and accounted for 70.2% of the total increase in overall pack sales for the first nine months of 2004. For the three months ended September 30, 2004, pack sales to new associates and members increased by \$6.8 million, or 91.8%, to \$14.1 million as compared to the same period in 2003. For the first nine months of 2004, pack sales to new associates and members increased by \$16.6 million, or 82.0%, to \$37.0 million as compared to the same period in 2003. Mannatech continues to believe the overall increase in the number of packs sold to new associates and members and packs sold to continuing associates over the past few years correlates to the changes made in Mannatech's revamped global associate career and compensation plan; introducing new associate incentives, including an annual travel incentive; introducing new products; and implementing several key management changes in 2003.

### Other Sales

Other sales, which primarily relates to freight, increased by \$2.3 million to \$4.7 million for the three months ended September 30, 2004. This increase related to the increase in pack and product sales and to the increase in freight revenue collected from associates and members for the three months ended September 30, 2004 as compared to the same period in 2003. Other sales increased by \$3.5 million to \$9.5 million for the first nine months of 2004 as compared to the same period in 2003, which also related to the increase in pack and product sales for the first nine months of 2004, as compared to the same period in 2003.

### Cost of Sales

Cost of sales consists of products purchased from third-party manufacturers, costs of promotional materials sold to Mannatech's independent associates, costs of freight-in, and provisions for slow moving or obsolete inventories. Mannatech's inventory turnover ratio decreased to 4.1 for the first nine months of 2004 as compared to 4.8 for the same period in 2003. The decrease in the inventory turnover rates was due to the increase in inventory related to expected net sales growth, beginning operations in South Korea, as well as an increase in inventory levels related to registering Mannatech's Ambrotose AO<sup>®</sup> product in its foreign locations in 2004. Mannatech's sales mix of products and packs affects its cost of sales and gross profit differently because the gross margins for its products vary and because the average gross margin of its products sold is higher than the average gross margin of its packs sold. Mannatech's sales mix can be influenced by the following:

- changes in Mannatech's commission and incentive programs;
- changes in Mannatech's sales prices;
- changes in consumer demand;
- changes in economic conditions;
- changes in regulations;
- announcements of new scientific studies and developments;
- introduction of new products; and
- discontinuation of existing products.

For the three months ended September 30, 2004, cost of sales increased by \$3.7 million, or 45.7%, to \$11.9 million as compared to the same period in 2003. The increase was due to an increase in the volume of packs and products sold. Cost of sales as a percentage of net sales decreased to 15.4% for the three months ended September 30, 2004 as compared to 16.4% for the same period in 2003. This decrease as a percentage of net sales was the result of a change in product mix sold, which favorably impacted Mannatech's gross profit.

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For the first nine months of 2004, cost of sales increased by \$9.6 million, or 43.0%, to \$31.9 million as compared to the same period in 2003. The increase was due to an increase in the volume of packs and products sold during 2004 as compared to the same period in 2003. Cost of sales as a percentage of net sales decreased from 16.3% for the first nine months of 2003 to 15.2% for the same period in 2004. This decrease as a percentage of net sales was the result of a change in product mix sold and cost efficiencies gained from certain manufacturers in 2004, which favorably impacted Mannatech's gross profit.

For the first nine months of 2004, Mannatech wrote off \$1.0 million in inventory and increased its provision for inventory write-offs by \$0.1 million, which related to product and promotional materials in Canada that may have to be destroyed related to Mannatech's failure to comply with the recent changes in government regulations in Canada. See Item 1. Legal Proceedings contained in Part II herein for discussion about the Canadian regulatory matter.

### ***Commissions and Incentives***

Commissions and incentives include both commissions related to commissionable net sales and various incentives, including an annual travel incentive, which can be earned by associates. Mannatech announces its annual travel incentive at its annual corporate-sponsored event, called Mannafest, which is usually held in March of every year. For the three months ended September 30, 2004, commissions and incentives increased by \$13.7 million, or 65.4%, to \$34.7 million as compared to the same period in 2003. As a percentage of net sales, commissions and incentives increased for the three months ended September 30, 2004 to 44.7% as compared to 42.2% for the same period in 2003. For the first nine months of 2004 commissions and incentives increased by \$37.8 million, or 66.4%, to \$94.7 million as compared to the same period in 2003. As a percentage of net sales, commissions and incentives increased for the first nine months of 2004 to 45.0% as compared to 41.6% for the same period in 2003.

#### **Commissions**

All of the \$13.7 million increase from commissions and incentives related to an increase in commissionable net sales for the three months ended September 30, 2004 as compared to the same period in 2003. As a percentage of net sales, commissions increased for the three months ended September 30, 2004 to 43.1% as compared to 39.6% for the same period in 2003. Mannatech attributes the increase in commissions to the change in mix of packs sold toward the higher dollar packs and the increase in the number of new and continuing associates who qualify for commissions. The shift toward the higher dollar packs is evident by the increase in the average pack sale, which increased by 23.4% to \$311.83 for the three months ended September 30, 2004 as compared to \$252.68 for the same period in 2003.

From the total increase in commissions and incentives of \$37.8 million, commissions related to commissionable net sales increased by \$36.9 million to \$90.9 million for the first nine months of 2004 as compared to the same period in 2003. As a percentage of net sales, commissions increased for the first nine months of 2004 to 43.2% as compared to 39.4% for the same period in 2003. Mannatech attributes the increase in commissions to the change in mix of packs sold toward the higher dollar packs and the increase in the number of new and continuing associates who qualify for commissions. The shift toward the higher dollar packs is partially the result of an increase in the number of associates who qualified for Mannatech's 2004 annual travel incentive as reflected in the average pack sale increasing 25.1% to \$308.42 for the first nine months of 2004 as compared to \$246.62 for the same period in 2003. Mannatech expects commissions as a percentage of net sales to continue to range between 44% to 46% of net sales if the number of its associates continues to increase and the shift of the pack mix sold continues to shift toward the higher dollar packs.

#### **Incentives**

For the three months ended September 30, 2004, incentives costs remained the same as compared to the same period in 2003. However, for the first nine months of 2004, incentives costs increased by \$0.9 million to \$3.8 million as compared to \$2.9 million for the same period in 2003. As a percentage of net sales, incentives decreased to 1.8% for the first nine months of 2004 as compared the same period in 2003. The dollar increase for the first nine months of 2004 related to the approximately 415 additional associates who qualified for Mannatech's 2004 annual travel incentive as compared to the number of associates who qualified for the 2003 travel incentive. The total cost associated with Mannatech's 2004 annual travel incentive was \$3.2 million whereas the total cost associated with the 2003 travel incentive was approximately \$2.2 million.

### **Gross Profit**

For the three months ended September 30, 2004, gross profit increased by \$10.3 million, or 50.4%, to \$30.9 million as compared to \$20.6 million in the same period in 2003. This increase was primarily the result of a strong increase in net sales partially offset by an increase in commissions related to an increase in the number of associates earning commissions. As a percentage of net sales, gross profit decreased for the three months ended September 30, 2004 to 39.9% as compared to 41.4% for the same period in 2003. This percentage decrease was due to an increase in commissions and incentives, which related to the increase in the number of associates and the change in sales mix sold as compared to the same period in 2003.

For the first nine months of 2004, gross profit increased by \$26.2 million, or 45.6%, to \$83.7 million as compared to \$57.5 million for the same period in 2003. This increase was primarily the result of a strong increase in net sales partially offset by an increase in commissions and incentives related to an increase in the accrual for Mannatech's 2004 annual travel incentive and the increase in the number of associates earning commissions. As a percentage of net sales, gross profit decreased for the first nine months of 2004 to 39.8% as compared to 42.1% for the same period in 2003. This decrease was primarily due to the increase in commissions and incentives, which continue to relate to the sales mix sold and the increase in expected expenses related to the 2004 travel incentive as compared to the same period in 2003.

### **Selling and Administrative Expenses**

Selling and administrative expenses include a combination of both fixed and variable expenses and consist of compensation and benefits for employees, contract labor, outbound shipping and freight, and marketing-related expenses, such as monthly magazine development costs and hosting Mannatech's corporate-sponsored events. For the three months ended September 30, 2004, selling and administrative expenses increased by \$2.2 million, or 21.2%, to \$12.3 million as compared to the same period in 2003. The dollar increase in selling and administrative expenses primarily consists of an increase in compensation-related costs and out-bound freight costs including third-party distribution costs associated with the increase in net sales. Selling and administrative expenses as a percentage of net sales decreased from 20.4% for the three months ended September 30, 2003 to 15.8% in the same period in 2004. The decrease in selling and administrative expenses as a percentage of net sales in 2004 was primarily due to Mannatech's ability to control costs, while strongly increasing net sales.

For the first nine months of 2004, selling and administrative expenses increased by \$6.9 million, or 23.6%, to \$36.1 million as compared to the same period in 2003. The dollar increase in selling and administrative expenses primarily consists of an increase in compensation-related costs, corporate-sponsored rally expenses, and out-bound freight costs including third-party distribution costs associated with the increase in net sales. Selling and administrative expenses as a percentage of net sales decreased from 21.4% for the first nine months of 2003 to 17.2% in the same period in 2004. The decrease in selling and administrative expenses as a percentage of net sales in 2004 was primarily due to Mannatech's ability to control costs while increasing net sales.

Compensation related costs included in selling and administrative expenses, increased for the three months ended September 30, 2004 by \$0.9 million to \$7.3 million as compared to the same period in 2003. In 2004, wages, contractors and related benefits expense increased by \$1.4 million which resulted from an increase of globally hiring additional employees and contractors during the three months ended September 30, 2004. This increase was partially offset by capitalizing costs totaling \$0.4 million in wages and contracting expenses related to internally-developed software projects. For the first nine months of 2004, compensation related costs increased by \$3.0 million to \$21.6 million as compared to the same period in 2003. In 2004, the increase was composed of a \$3.1 million increase in wages and benefits related to globally hiring additional employees and contractors during the first nine months of 2004, which was partially offset by capitalizing costs totaling \$1.1 million in wages and contractor's expense related to internally-developed software projects. Compensation also increased by \$1.0 million related to an increase in the corporate performance bonuses accrued resulting from the improvement of Mannatech's operations.

Out-bound freight and third-party distribution costs increased for the three months ended September 30, 2004 by \$0.9 million to \$3.3 million as compared to the same period in 2003. The increase in these costs consisted of an increase in out-bound freight of \$0.7 million and an increase in third-party distribution costs of \$0.2 million, which related to the increase in net sales volume and a shift in sales mix. Out-bound freight and third party distribution costs increased for the first nine months of 2004 by \$2.7 million to \$9.6 million as compared to the same period in 2003, which consisted of an increase in out-bound freight of \$2.1 million and an increase in third-party distribution costs of \$0.6 million. The increases in 2004 relate to the increase in net sales volume and a shift in sales mix.

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Mannatech typically sponsors its largest annual corporate-sponsored event in Texas each year in the month of March. For the three months ended September 30, 2004, expenses related to Mannatech's corporate-sponsored event increased by \$0.4 million to \$1.6 million, which correlated to the additional costs associated with increased attendance at its corporate-sponsored events held in its international offices and expenses related to opening operations in South Korea. For the first nine months of 2004, expenses related to its corporate-sponsored events increased by \$1.2 million to \$4.9 million, which related to additional costs associated with record attendance at its corporate-sponsored events in 2004 and the increased attendance at its corporate-sponsored events held in its international offices and expenses related to hosting the grand opening of its operations in South Korea.

### **Other Operating Costs**

Other operating costs include such costs as accounting, legal, consulting, depreciation, and non-cash charges associated with stock option activity. Other operating costs also include variable costs that directly correlate to net sales and operations including utilities, travel, professional fees, office expenses, printing-related expenses, clinical studies, off-site storage fees, and other miscellaneous operating expenses. For the three months ended September 30, 2004, other operating costs increased by \$3.5 million, or 57.3%, to \$9.6 million as compared to the same period in 2003. For the first nine months of 2004, other operating costs increased by \$5.9 million, or 31.2%, to \$24.9 million as compared to the same period in 2003. The dollar increase in other operating costs primarily consisted of increases in accounting, legal, consulting fees, and various other operating costs that directly correlated to the increase in net sales, partially offset by a decrease in depreciation and in the prior year recording non-cash accounting charges associated with variable accounting treatment related to certain stock options and warrants issued to former executives.

Other operating costs as a percentage of net sales slightly increased to 12.4% for the three months ended September 30, 2004 from 12.3% for the same period in 2003. For the nine months ended September 30, 2004, other operating costs as a percentage of net sales decreased to 11.8% for the nine months ended September 30, 2004 from 13.9% for the same period in 2003. The decrease in other operating costs as a percentage of net sales in 2004 was primarily due to an increase in net sales and a decrease in depreciation, partially offset by Mannatech incurring additional accounting, legal and consulting fees related to internal projects, including Sarbanes-Oxley readiness testing and internally developed software projects, and in the prior year recording non-cash accounting charges associated with variable accounting treatment related to certain stock options and warrants issued to former executives.

Accounting, legal, and consultant-related costs increased by \$1.1 million to \$2.1 million for the three months ended September 30, 2004 as compared to the same period in 2003. The dollar increase in 2004 was composed of the following:

- \$0.4 million related to accounting and consulting fees relating to Mannatech's compliance with Section 404 of the Sarbanes-Oxley Act of 2002;
- \$0.1 million related to non-capitalizable consulting fees for Mannatech's planned information technology internally-developed software projects;
- \$0.5 million related to legal and consulting fees for legal matters, regulatory matters, and opening operations in South Korea; and
- \$0.1 million related to consulting fees for clinical studies.

For the first nine months of 2004, accounting, legal and consultant-related costs increased by \$2.3 million to \$4.9 million as compared to the same period in 2003. The dollar increase in 2004 was composed of the following:

- \$1.0 million related to accounting and consulting fees related to Mannatech's compliance with Section 404 of the Sarbanes-Oxley Act of 2002;
- \$0.3 million related to consulting fees for Mannatech's planned information technology internally-developed software projects;
- \$0.7 million related to legal and consulting fees for legal matters, opening operations in South Korea, marketing projects, and regulatory matters; and
- \$0.3 million related to consulting fees for clinical studies.

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All other operating costs increased by \$2.5 million to \$6.8 million for the three months ended September 30, 2004 as compared to the same period in 2003. The overall increase in all other operating costs included increases in travel, utilities, insurance, equipment rental, royalties, and credit card fees, which largely correlated to the increase in net sales volume and opening operations in South Korea. For the first nine months of 2004, all other operating costs increased by \$5.3 million to \$18.0 million as compared to the same period in 2003, which largely correlated to the increase in net sales volume and beginning operations in South Korea.

These increases in operating costs described above were partially offset by a decrease in depreciation and non-cash accounting charges. For the three months ended September 30, 2004, depreciation decreased by \$0.1 million to \$0.7 million as compared to the same period in 2003. This decrease consisted of a decrease in depreciation related to assets that were placed in service in the prior years and fully depreciated by 2004, partially offset by an increase in depreciation expense related to \$3.4 million of additional property and equipment placed in service during the three months ended September 30, 2004. For the first nine months of 2004, depreciation decreased by \$0.5 million to \$2.0 million as compared to the same period in 2003. This decrease consisted of a decrease in depreciation expense related to assets that were placed in service in prior years and fully depreciated by 2004, partially offset by an increase in depreciation related to \$5.0 million of additional property and equipment placed in service during the first nine months of 2004. The additional assets relate to leasehold improvements for Mannatech's new office facilities in the United Kingdom and Japan, and its recent opening of operations in South Korea.

Non-cash accounting charges also decreased from the prior year. In the second quarter of 2003, Mannatech included a one-time non-cash charge of \$0.6 million related to the resignation of Mr. Robert Henry as Mannatech's former Chief Executive Officer in April 2003 and a \$0.5 million quarterly non-cash charge for variable accounting treatment related to certain stock options and warrants issued to three former executives who resigned in 2001. The \$0.6 million one-time charge related to extending the term of Mr. Henry's 266,667 stock options to the earlier of ten years from date of grant or one year after his death, as set forth in his Separation Agreement entered into in April 2003. The quarterly non-cash variable accounting treatment charge related to stock options and warrants issued in 2001 to former executives. The \$0.5 million non-cash variable accounting charge reflects the quarterly change of the fair market price of the stock options and warrants. The \$0.5 million charge in 2003 resulted from the increase in Mannatech's stock price from \$2.53 per share at March 31, 2003 to \$7.50 per share at June 30, 2003. In the third quarter of 2003, all but 500 of the stock options were exercised. The former executive has not exercised any of his stock warrants.

### **Severance Expenses**

Mannatech did not incur any severance expenses in 2004. For the third quarter of 2003, Mannatech accrued \$0.4 million related to severance expenses for Mr. Brad Wayment, its former Senior Vice President of Marketing and two additional marketing employees. The expenses included compensation and benefits, outplacement fees, and title to a leased vehicle.

For the first nine months of 2003, Mannatech recorded a total of \$1.8 million related to severance expenses for former employees, including the following:

- \$1.3 million of compensation related to the cancellation of Mr. Henry's employment agreement and expenses related to accrued vacation, health and life insurance, automobile costs, relocation fees, and outplacement fees that are payable to Mr. Henry through 2005.
- \$0.3 million of compensation related to a separation agreement with Mr. Wayment; and
- \$0.2 million of compensation related to the resignation of various other employees in 2003.

### **Interest Income**

Mannatech maintains interest-bearing accounts for its cash equivalents, restricted cash, and investments. For the three months ended September 30, 2004, interest income remained the same as compared to the same period in 2003. For the first nine months in 2004, interest income increased by \$0.2 million to \$0.4 million as compared to approximately \$0.2 million for the same period in 2003. The increase relates to an increase in the average balance held in cash, cash equivalents and investments during 2004 as compared to the same period in 2003.



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### ***Other Income (Expense), Net***

Other income (expense), net consists primarily of foreign currency transaction gains and losses and translation adjustments related to translating assets, liabilities, revenues, and expenses from its foreign operations to the United States dollar using current and weighted-average currency exchange rates. For the three months ended September 30, 2004, currency translation adjustments increased by \$0.4 million to \$0.2 million as compared to the same period in 2003. For the first nine months of 2004, currency translation adjustments increased by \$1.3 million to \$0.2 million as compared to the same period in 2003. These increases are primarily the result of the increase in operations from Mannatech's foreign subsidiaries and gains and losses resulting from a weakening of the United States dollar against its related foreign currencies during the three and nine months ended September 30, 2004 as compared to the same period in 2003. Mannatech does not engage in any financial hedging or derivative activity.

### ***Income Tax Expense***

Income taxes include both domestic and foreign taxes. In 2003, Mannatech's federal statutory tax rate was 35% in the United States, and its statutory tax rate was 30% in Australia, 19% in the United Kingdom, and 42% in Japan. In 2004, Mannatech's statutory tax rates for its operations have remained the same except that Mannatech expects a statutory tax rate in South Korea of approximately 27%. A portion of Mannatech's income from its international operations is subject to taxation in the countries in which it operates. Although Mannatech may receive foreign tax credits that would reduce the amount of taxes owed in the United States, Mannatech may not be able to fully utilize its foreign tax credits in the United States. At the beginning of 2004, Mannatech had net operating loss carryforwards from its Japanese operations, which was fully reserved due to the historically unprofitable operations in Japan and the limited carryforward period of 5 years. However, Mannatech's Japan operation has reported a profit for 2003 and 2004 and Mannatech expects a profit for 2005, therefore Mannatech now believes that its Japan net operating loss carryforward is more likely than not to be realized in the future. As a result in the third quarter of 2004, Mannatech has released its remaining valuation allowance of \$2.3 million associated with net operating losses from its Japanese operations. In addition, in the third quarter of 2004, Mannatech has incurred an operating loss for its South Korean operations since its startup in September 2004 and accordingly recognized a full valuation allowance of \$0.1 million related to its deferred tax assets of a like amount for its South Korean operations because as of September 30, 2004, Mannatech believes that the likelihood of realizing an income tax benefit in the future for its South Korean operations does not meet the more likely than not criteria for recognition.

For the third quarter of 2004, Mannatech's effective tax rate decreased to 24.3% from 31.5% for the same period in 2003. For the nine months ended September 30, 2004, Mannatech's effective tax rate decreased to 29.7% from 30.8% for the nine months ended September 30, 2003. Mannatech's effective tax rate decreased as a result of the elimination of its \$2.3 million valuation allowance related to its Japanese operations. However, in the future, Mannatech expects its effective tax rate to increase to approximately 35% and up to 38%.

### ***Net Income***

For the three months ended September 30, 2004, net income increased by \$3.9 million, or 137.0%, to \$6.8 million as compared to the same period in 2003. For the first nine months ended September 30, 2004, net income increased by \$10.0 million, or 183.4%, to \$15.5 million as compared to the same period in 2003. Mannatech believes the increase in its net income in 2004 is the result of the strong increase in net sales, which was largely due to the increase in the number of associates and members purchasing Mannatech's packs and products and its ability to control operating costs. The increase was partially offset by the increase in commissions due to the increase in net sales and the increase in the number of associates who qualified for Mannatech's 2004 annual travel incentive.

### **Liquidity and Capital Resources**

Mannatech currently holds \$45.7 million in cash, cash equivalents, and investments. Mannatech principally uses its cash from operations to fund its operating expenses, including commissions and incentives, capital expenditures, inventory purchases, and planned international expansion. Mannatech plans to continue to fund its business objectives, working capital, and operations along with any unanticipated shortfalls through its cash flows from operations rather than incurring long-term debt. However, Mannatech does maintain operating leases to fund the use of its computer hardware and to lease corporate office facilities, equipment, and automobiles. In February 2004, Mannatech entered into a \$1.0 million master operating lease line-of-credit. As of September 30, 2004, \$0.3 million of the lease line-of-credit had been utilized to lease computer hardware for its operations.

### **Cash and Cash Equivalents and Investments**

As of September 30, 2004, Mannatech strengthened its solid cash and investment position as it increased its cash and cash equivalents and investments by \$7.4 million, to \$45.7 million as compared to \$38.3 million on December 31, 2003. The increase in Mannatech's cash and cash equivalents and its investments are attributable to Mannatech's efforts to contain and scrutinize its operating expenses, partially offset by paying a combined cash dividend to its shareholders totaling \$5.3 million in the first and third quarters of 2004. Mannatech's Board of Directors plans to continue to assess its current and expected future financial position relative to the payment of any future cash dividends. Mannatech currently has no present plans to initiate any stock repurchase activity in the near future.

### **Working Capital**

Mannatech's working capital slightly increased by \$0.4 million to \$16.6 million at September 30, 2004 from \$16.2 million at December 31, 2003. Mannatech's increase in working capital at September 30, 2004 primarily related to an increase in inventory and prepaid expenses totaling \$6.6 million, which related to opening operations in South Korea and anticipated future sales growth. Mannatech's working capital also increased related to the releasing of the valuation allowance related to operations in Japan totaling \$2.3 million partially offset by and reducing deferred tax assets by \$0.8 million. This increase was partially offset by releasing restricted cash of \$1.7 million, which was used to purchase long term investments, accruing \$6.5 million in additional operating expenses and deferring \$0.3 million in additional revenue associated with net sales increases.

Mannatech's cash flows consist of the following:

<u>Provided by (used in):</u>	<b>For the nine months ended September 30,</b>	
	<b>2003</b>	<b>2004</b>
	<b>(in millions)</b>	
Operating activities	\$ 10.5	\$ 16.6
Investing activities	\$ (14.7)	\$ (11.3)
Financing activities	\$ (1.4)	\$ (4.8)

### **Operating Activities**

For the first nine months of 2004, Mannatech's operating activities provided \$16.6 million in cash compared to cash provided by operating activities of \$10.5 million in the same period in 2003. For the first nine months of 2004, net earnings adjusted for noncash activities provided cash of \$16.8 million compared to \$10.1 million in the first nine months of 2003, which is largely contributable to the 53.8% increase in net sales and 183.4% increase in net income.

Mannatech's working capital accounts, which include receivables, inventories, prepaid expenses, payables, deferred revenues, accrued commissions and incentives, and expenses for operations plus its long term assets for the first nine months of 2004 provided \$0.6 million in working capital and long term assets as compared to using \$0.2 million in working capital and long term assets in the same period in 2003. For the first nine months of 2004, working capital accounts increased primarily because of an \$8.1 million increase in accrued operating expenses and taxes, which was partially offset by an increase in inventories of \$5.0 million and an increase of \$2.8 million in accounts receivable, prepaids, and other long term assets of \$2.2 million, which was associated with an increase in net sales and opening operations in South Korea. Operating activities also increased as a result of a \$0.4 million increase in deferred revenue related to an increase in net sales. For the first nine months of 2003, working capital accounts increased primarily because of a \$2.9 million increase in deferred revenues and a decrease in inventory of \$0.3 million. This increase was partially offset by a \$2.8 million increase in accounts receivable, prepaids, and other assets, which primarily related to an increase in insurance premiums and an increase in deposits related to operating leases.

Operating activities also used cash to pay accrued severance costs of approximately \$0.8 million to former executives during the first nine months of 2004, as compared to accruing \$1.8 million of severance costs during the first nine months of 2003, for the resignation of certain former executives, which was partially offset by paying approximately \$1.2 million of accrued severance costs to former executives during the first nine months of 2003. Mannatech expects that its net cash provided by operating activities for the remainder of 2004 and for 2005 will be sufficient to fund its current operations, its information technology projects, and its plans for international expansion into Taiwan.

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### ***Investing Activities***

In the first nine months of 2004, Mannatech's investing activities used a total of \$11.3 million in cash compared to using \$14.7 million in cash for the same period in 2003. Mannatech's investing activities included purchasing investments, restricting cash from future use, and purchasing capital assets.

In the first nine months of 2004, Mannatech used \$5.0 million of its cash to purchase higher yielding investments and released \$2.1 million of its restricted cash, which was also used to purchase higher yielding long-term investments. In addition, in the first nine months of 2004, Mannatech restricted cash of \$1.2 million as long-term collateral. The \$1.2 million of restricted cash was composed of \$0.4 million for a payment due related to Mannatech's 2004 travel incentive cruise for its associates, \$0.5 million associated with obtaining additional surety bonds in Canada, and \$0.3 million related to holding time deposits as collateral for its building leases in Australia and South Korea. In contrast, in the first nine months of 2003, Mannatech used \$12.0 million of its cash to purchase investments and restricted cash of \$2.1 million as collateral for a lease line-of-credit.

Investing activities also include purchases of property and equipment. In the first nine months of 2004, investing activities included \$5.0 million in purchases of office furniture, leasehold improvements, computer hardware and software, and capitalizing internally-developed costs associated with developing computer software. In the first nine months of 2003, Mannatech purchased \$0.8 million of property and equipment, primarily related to purchasing computer hardware and software. The increase in property and equipment related to the internal development of computer software and opening operations in South Korea.

Over the next 16 months, Mannatech plans to complete and implement its information technology projects, including its re-architecture project involving a new global back-office system. Mannatech intends to spend between \$8.0 million to \$10.0 million on all of its information technology projects through 2005, of which \$6.0 million to \$8.0 million is expected to be capitalized as internal development of computer software, including certain payroll and consulting costs relating to the programming and implementation of its computer software. In addition, for the remainder of 2004 and for all of 2005, Mannatech plans to purchase up to \$2.0 to \$3.0 million in other property and equipment related to corporate leasehold improvements and planned international expansion into Taiwan.

### ***Financing Activities***

In the first nine months of 2004, Mannatech's financing activities used \$4.8 million in cash as compared to providing \$1.4 million of cash for the same period in 2003. During the first nine months of 2004, Mannatech used cash to pay its shareholders cash dividends of \$5.3 million, which was partially offset by receiving cash proceeds from stock options exercised of approximately \$0.4 million. In the first nine months of 2003, Mannatech received cash proceeds from stock option activity of \$0.2 million, which was partially offset by using \$0.1 million of cash to repay its note payable and capital lease-obligations.

### ***General Liquidity and Cash Flows***

Historically, Mannatech has generated positive cash flows from its operations and believes that its existing liquidity and cash flows from operations, including cash and investments totaling \$45.7 million should be adequate to fund expected business operations, payment of any future dividends, plans for international expansion, and costs associated with the internally developed software systems for its new back-office, web redesign, and expansion into Taiwan for the next 12 to 24 months. Mannatech also believes its existing liquidity and cash flows will be adequate for its operations over the next 12 to 24 months as most of its operating expenses are variable in nature. However, if Mannatech's operations begin to decline, its existing capital resources or cash flows could become insufficient to meet its current business plans, projections, and existing capital requirements. If Mannatech's existing capital resources become insufficient, it would be required to raise additional funds, which may not be available on favorable terms, if at all.

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Mannatech is required to fund certain commitments and obligations, which as of September 30, 2004 are as follows:

- funding the remaining payments related to severance agreements with former executives. Under the terms of a separation agreement for Robert Henry related to the remaining aggregate payments due of approximately \$0.5 million;
- funding an estimated \$2.7 million of royalty payments to Dr. McAnalley for future royalties associated with his ten-year royalty agreement;
- funding the non-compete payments related to the renewal of the non-compete agreement with Dr. Reg. McDaniel, a former employee, totaling \$0.1 million, which is payable in monthly installments of \$25,000 through January, 2005; and
- funding a three year purchase agreement and a five year purchase agreement for raw material purchases of \$12.0 million.

Mannatech has no present commitments or agreements with respect to acquisitions or purchases of any manufacturing facilities. Since 1994, Mannatech has maintained a purchase commitment with its supplier of Manapol<sup>®</sup>. In 2003, the purchase commitment was modified to include purchases by its manufacturers, as well as from Mannatech. The purchase commitment requires Mannatech and its manufacturers to collectively purchase a minimum of \$0.3 million per month through November 2004. Presently Mannatech's manufacturers' monthly purchases of Manapol<sup>®</sup> have met or exceeded the monthly commitment of \$0.3 million. Mannatech's projected purchases for the remainder of 2004 are expected to meet the required minimum monthly purchase commitment obligation. Mannatech is in the process of renewing this purchase agreement with this supplier with substantially the same terms.

Mannatech plans to continue to open additional operations in new foreign markets. Mannatech expanded into South Korea in September 2004 and plans to open its Taiwan operations in the first half of 2005. The expansion into Taiwan is estimated to cost between \$2.0 million and \$3.0 million in the aggregate, of which approximately \$1.0 million will relate to property and equipment purchased and internally developed that will be depreciated over the life of the assets or lease term.

During early 2004, Mannatech approved several large scale information technology projects that are expected to increase functionality, improve the efficiency and effectiveness of operations and internal controls, and expand its reporting capabilities. Mannatech has revised its projected the total costs outlay to complete these projects to be between \$12.0 million and \$14.0 million through January 2006, of which Mannatech anticipates capitalizing payroll, contracting, and consulting fees related to these information technology projects in the range of \$8.0 million to \$10.0 million. In the first quarter of 2004, Mannatech capitalized \$0.1 million, in the second quarter of 2004, Mannatech capitalized approximately \$0.4 million, and in the third quarter Mannatech capitalized approximately \$1.3 million of payroll, contracting, and outside consulting fees related to its information technology projects. In late June 2004, Mannatech signed an agreement with PeopleSoft to purchase an off-the-shelf ERP system for approximately \$1.0 million and will configure this ERP system over the next 16 months to meet its financial and operational needs. This project is called Mannatech's global re-architecture or Global View project and will be implemented in its operations in each country in two stages. The first stage, called phase 1, includes implementing a multi-faceted financial system in January 2005 and phase 2 includes implementing a sales and customer support system, distribution system, and data management system in January 2006.

In June 2004, Mannatech agreed to indemnify four of its executive officers, Stephen Fenstermacher, Bettina Simon, Jack Crowley, and Ron Norman, who were appointed to the Board of Directors of Mannatech's subsidiary – Mannatech Korea Ltd. Regulations in South Korea required each board member to personally guarantee the operations of Mannatech Korea Ltd. As a result, Mannatech, Incorporated agreed to indemnify each of these four officers for any liability incurred related to their personal guarantees.

**Recent Financial Accounting Standards Board Statements**

**FIN 46R.** In December 2003, FASB issued a revised Interpretation No.46 (“FIN 46R”), “Consolidation of Variable Interest Entities, and Interpretation of Accounting Research Bulletin No. 51,” which replaces the original interpretation issued in January 2003. FIN 46R requires certain entities to be consolidated by enterprises that lack majority voting interest when equity investors of those entities have insignificant capital at risk or lack voting rights, the obligation to absorb expected losses, or the right to receive expected returns. Entities identified with these characteristics are called variable interest entities and the interests enterprises have in these entities are called variable interest. These interests are derived from certain guarantees, leases, loans, or other arrangements that result in certain risks and rewards, which are disproportionate to the voting interests in such entities. The adoption of FIN 46R as of March 31, 2004 did not have a material effect on Mannatech’s consolidated financial condition, results of operations, or cash flows.

**Forward-Looking Statements**

Certain disclosure and analysis included in this report includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995, which are subject to various risks and uncertainties. Opinions, forecasts, projections, guidance, or other statements, other than statements of historical fact are considered forward-looking statements and reflect the current views of Mannatech about future events and financial performance. These forward-looking statements are subject to certain events, risks, and uncertainties that may be outside Mannatech’s control. Some of these forward-looking statements include statements regarding:

- plans for growth and expected operating costs for the remainder of 2004;
- existing capital resources, cash flows, and the operating lease line-of-credit being adequate to fund Mannatech’s future cash needs;
- future plans related to Mannatech’s budgets, future capital requirements, market share growth, and anticipated capital projects and obligations;
- plans for information technology projects including capitalizing a significant amount of internal salaries and outside consulting fees;
- the realization of Mannatech’s deferred tax assets;
- the expected future cash flows of Mannatech’s assets exceeding the net book value of such assets;
- the impact of future market changes due to exposure to foreign currency translations from Mannatech’s business;
- the impact of Mannatech’s product development strategy;
- plans to introduce new products and reformulation of existing products;
- Mannatech’s ability to offer innovative incentives in the future;
- no significant impact of recent accounting pronouncements on Mannatech’s financial condition, results of operations, or cash flows;
- plans for any future dividends;
- the outcome of regulatory and litigation matters;
- the possibility of certain policies, procedures, and internal processes minimizes Mannatech’s exposure to market risk; and
- other assumptions described in this report underlying such forward-looking statements.

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Actual results and developments could materially differ from those expressed in or implied by such statements due to a number of factors, including:

- those described in the context of such forward-looking statements;
- changes in inventory costs;
- the future impact of any changes to Mannatech's global career and compensation plan or incentives;
- the ability to attract and retain independent associates and members;
- timely development and acceptance of new products and refinements of existing products;
- changes in sales mix;
- the markets for Mannatech's domestic and international operations;
- changes in global statutory tax rates;
- the impact of new competition and competitive products and pricing;
- the political, social and economic climate in which Mannatech conducts its operations; and
- the risk factors described in other documents and reports filed by Mannatech with the United States Securities and Exchange Commission, including its 2003 annual report filed on Form 10-K on March 14, 2004.

Forward-looking statements generally can be identified by the use of or phrases or terminology such as "may," "will," "should," "could," "expects," "plans," "hopes," "intends," "anticipates," "believes," "estimates," "approximates," "predicts," "potential," "projects," "in the future," or "continues" or other similar words or the negative of such terms and other comparable terminology. Similarly, descriptions of Mannatech's objectives, plans, strategies, targets or beliefs contained herein are also considered forward-looking statements. Readers are cautioned when considering these forward-looking statements to keep in mind these risks and uncertainties and any other cautionary statements in this report, as all of the forward-looking statements contained herein are as of the date of this report.

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

Mannatech does not engage in trading market risk sensitive instruments and does not purchase investments as hedges or for purposes “other than trading” that are likely to expose it to certain types of market risk, including interest rate, commodity price, or equity price risk. Although Mannatech has some investments, there has been no material change in its exposure to interest rate risk. Mannatech has not issued any debt instruments, entered into any forward or futures contracts, purchased any options, or entered into any swaps.

Mannatech is exposed to certain other market risks, including changes in currency exchange rates as measured against the United States dollar. The value of the United States dollar may affect Mannatech’s financial results. Changes in exchange rates could positively or negatively affect its financial results, as expressed in United States dollars. When the United States dollar strengthens against currencies in which products are sold or weakens against currencies in which Mannatech incurs costs, net sales and costs could be adversely affected.

Mannatech believes inflation has not had a material impact on its operations or profitability. Mannatech expanded into Canada in 1996, into Australia in 1998, into the United Kingdom in 1999, into Japan in 2000, into New Zealand in 2002, and into South Korea in September 2004. Mannatech’s New Zealand operation is serviced through its Australian operations. Mannatech plans to expand into Taiwan in the first half of 2005. Revenues and expenses in foreign markets are currently translated using historical and weighted-average currency exchange rates.

Mannatech maintains policies, procedures, and internal processes that it believes help monitor any significant market risks. Mannatech currently does not use any financial instruments to manage its exposure to such risks. The sensitivity of earnings and cash flows to variability in currency exchange rates is assessed by applying an appropriate range of potential rate fluctuations to Mannatech’s assets, obligations, and projected transactions denominated in foreign currencies. Mannatech cautions that it cannot predict with any certainty its future exposure to such currency exchange rate fluctuations or the impact, if any, such fluctuations may have on its future business, product pricing, consolidated financial condition, results of operations, or cash flows. However to combat such risk, Mannatech closely monitors current fluctuations for exposure to such market risk. The foreign currencies in which Mannatech currently has exposure to foreign currency exchange rate risk include the currencies of Canada, Australia, the United Kingdom, Japan, New Zealand, South Korea, and Taiwan. The low and high currency exchange rates to the United States dollar, for each of these countries, for the nine months ended September 30, 2004 are as follows:

<u>Country/Currency</u>	<u>Low</u>	<u>High</u>
Australia/Dollar	\$0.683100	\$0.798600
Canada/Dollar	\$0.716600	\$0.787600
Japan/Yen	\$0.008736	\$0.009640
New Zealand/Dollar	\$0.597000	\$0.709700
South Korea/Won	\$0.000836	\$0.000886
Taiwan/Dollar	\$0.029230	\$0.030500
United Kingdom/British Pound	\$1.755200	\$1.904000

### Item 4. Controls and Procedures

Mannatech’s management, with the participation of its Chairman of the Board and Chief Executive Officer (its principal executive officer) and its Chief Financial Officer (its principal financial officer) have concluded, based on their evaluation as of the end of the period covered by this report, that its disclosure controls and procedures are effective to ensure that information required to be disclosed by Mannatech in the reports filed or submitted by it under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by Mannatech in such reports is accumulated and communicated to its management, including its principal executive officer and financial officer, as appropriate to allow timely decisions regarding required disclosure.

There were no significant changes in Mannatech’s internal controls during the third quarter of 2004 that have materially affected or that are reasonably likely to materially affect its internal controls over financial reporting.

## PART II - OTHER INFORMATION

### Item 1. Legal Proceedings

On June 11, 2004, the Australian Therapeutic Goods Administration notified Mannatech of a complaint that an Australian associate had made certain therapeutic claims to promote its products. In response to this complaint, Mannatech conducted an investigation and terminated this associate's account. In November 2004, the Australian Therapeutic Goods Administration indicated its agreement to the action proposed by Mannatech, including Mannatech's plans for ongoing education and compliance training for its associates over the next three years. However, the Australian Therapeutic Goods Administration will continue to monitor Mannatech's activities.

On January 1, 2004, the Canadian Natural Health Product Regulations came into force, which applies to all Natural Health Products sold in Canada. The Natural Health Product Regulations require companies selling Natural Health Products in Canada to obtain a product license prior to sale. Regulatory compliance action in connection with products on the market prior to January 1, 2004 is subject to the priority classification of the product ingredients. As a result, companies selling products containing priority one ingredients were required to submit an application for a product license by June 30, 2004 and company's selling products containing priority two ingredients are required to submit an application for a product license by December 31, 2004. Mannatech did not file a license application for its products containing priority one ingredients by June 30, 2004 and accordingly must await receipt of its product license for its products before resuming sale of these products in Canada. As of November 1, 2004, Mannatech had submitted product license applications for all of its products containing priority one ingredients and expects to have product license applications submitted for all of its products containing priority two ingredients prior to December 31, 2004. In the meantime, Mannatech products remain available for personal consumption by Canadian consumers in accordance with Health Canada's Importation of Human Use Drugs for Personal Use Enforcement Directive. In addition, Mannatech is also reformulating certain of its products in order to prospectively comply with these new regulations in Canada and has recorded an inventory reserve of \$0.1 million as of September 30, 2004 relating to any products, which it may not be able to sell in the future. Mannatech believes this will not have a significant impact on its overall consolidated sales or operations and does not expect it to significantly restrict its ability to continue its operations in Canada.

There have been no other material changes in, or additions to, the legal proceedings previously reported in Mannatech's Annual Report on Form 10-K (File No. 000-24657) for 2003 as filed with the United States Securities and Exchange Commission on March 14, 2004 and in its Form 10-Q (File No. 000-24657) for the second quarter of 2004, filed with the United States Securities and Exchange Commission on August 9, 2004.

### Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities

On June 30, 2004, the Company's Board of Directors authorized a stock repurchase program to purchase up to 1.3 million shares of the Company's outstanding common stock. The Company has not formalized or adopted any stock repurchase program and currently has no present plans to initiate any repurchase activity in the near future. As of November 1, 2004, the Company had not repurchased any of its common stock in the open market or through any private sales.

### Item 3. Defaults Upon Senior Securities

Not applicable.

### Item 4. Submission of Matters to a Vote of Security Holders

None.

### Item 5. Other Information

Effective August 2, 2004, Mr. J. Stanley Fredrick resigned from Mannatech's Audit Committee as a non-voting member. On October 6, 2004, Mannatech's Board of Directors appointed Don A. Buchholz as an independent director to its Board of Directors.



**Item 6. Exhibits and Reports on Form 8-K**

**(a) Exhibits required by Item 601 of Regulation S-K**

- 3.1 Amended and Restated Articles of Incorporation of Mannatech dated May 19, 1998, incorporated herein by reference to Exhibit 3.1 in Mannatech's Form S-1 (File No. 333-63133) filed with the Commission on October 28, 1998.
- 3.2 Fourth Amended and Restated Bylaws of Mannatech dated August 8, 2001, incorporated herein by reference to Exhibit 99.1 in Mannatech's Form 8-K (File No. 000-24657) filed with the Commission on August 22, 2001.
- 4.1 Specimen Certificate representing Mannatech's common stock, par value \$0.0001 per share, incorporated herein by reference to Exhibit 4.1 in Mannatech's Amendment No. 1 to Form S-1 (File No. 333-63133) filed with the Commission on October 28, 1998.
- 10.1\* Purchase Agreement with Marinova Pty. Limited, dated August 11, 2004.
- 31.1\* Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, of the Chief Executive Officer of Mannatech.
- 31.2\* Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, of the Chief Financial Officer of Mannatech
- 32.1\* Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of the Chief Executive Officer of Mannatech.
- 32.2\* Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of the Chief Financial Officer of Mannatech.

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\* filed herewith.

**(b) Reports on Form 8-K.**

Mannatech filed a Form 8-K on August 10, 2004 announcing its financial and operating results for the second quarter of 2004. Mannatech also filed a Form 8-K on October 12, 2004 announcing the appointment of Mr. Don Buchholz as a new independent director to its Board of Directors.

**SIGNATURES**

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

**November 9, 2004**

**MANNATECH, INCORPORATED**

/S/ SAMUEL L. CASTER

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**Samuel L. Caster**

Chief Executive Officer and Chairman of the Board  
(principal executive officer)

**November 9, 2004**

/S/ STEPHEN D. FENSTERMACHER

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**Stephen D. Fenstermacher**

Senior Vice President and Chief Financial Officer  
(principal financial officer)

**INDEX TO EXHIBITS**

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\* filed herewith.

**PURCHASE AGREEMENT**

This Agreement made and entered into this 11th day of August, 2004 by and between Mannatech™ Incorporated (“Buyer”), a Texas (USA) corporation with its principle place of business located at 600 S. Royal Lane, Suite 200, Coppel, Texas 75019 and Marinova Pty. Limited (“Seller”) with its principle place of business located at Level 7, 39 Murray Street, Hobart, TAS 7000 Australia, hereinafter collectively referred to as the “Parties”.

**RECITALS**

**WHEREAS**, Buyer develops and sells proprietary nutritional supplements and topical products through a network marketing system throughout the United States, Canada, Australia, New Zealand, the United Kingdom and Japan by distributors referred to as Independent Associates (“Associates”);

**WHEREAS**, Seller desires to sell the Products (as defined below) exclusively to Buyer within the Territory (as defined below) and during the Term (as defined below), and Buyer desires to be the exclusive Buyer of the Products within the Territory and during the Term of bioactive fractions from the brown seaweed, *Undaria pinnatifida* (“Product”);

**WHEREAS**, Seller has represented that it presently has the ability to harvest, manufacture, store and deliver the Product in the quantities as specified herein in Exhibit A and in accordance with the quality control and Product specifications that Buyer and Seller will agree upon, attached hereto.

**NOW, THEREFORE**, in consideration of the foregoing premises and the mutual covenants and agreements hereinafter contained, and for good and valuable consideration the receipt and sufficiency of which is hereby acknowledged, the Parties agree as follows:

**1. Definitions.**

As used in this Agreement, the following terms shall have the meanings set forth below:

- 1.1 “Effective Date” means the date of authorization by the Board of Directors of Buyer.
- 1.2 “Product” means the bioactive fractions of Galacto Fucan Sulphate (GFS™) glyconutrient harvested, purified and packaged from *Undaria pinnatifida* with specifications agreed upon between the Seller and Buyer suitable for use in the proprietary nutritional supplements and topical products of Buyer.
- 1.3 “Primary Term” shall refer to the Term as set forth in Section 2.2, hereinbelow.
- 1.4 “Secondary Term” shall refer to a 365 day period commencing on, and on each anniversary of the Effective Date after the end of the Primary Term.
- 1.5 “Territory” means: worldwide

**2. Effective Date and Term.**

- 2.1 **Pre-Payment.** Buyer to make a prepayment of four hundred and fifty thousand United States Dollars, (\$450,000 U.S.D.), which shall be charged against the first year (2005) purchase requirement, in five (5) monthly payments of ninety thousand (\$90,000 U.S.D. per month) commencing on August 15, 2004. In exchange for the Pre-Payment, Seller agrees as follows:
  - 2.1.1 **Inspection of Manufacturing and Storage Facilities.** Buyer will send, and Seller agrees to permit Buyer’s designated representatives, to visit, inspect and approve during business hours the harvest, manufacture, storage any and all required facilities used to harvest, process, manufacture and/or store the Product.
  - 2.1.2 **Agreement on Specifications.** The Seller and Buyer shall work together to develop the Product, the Product specifications and the quality control requirements for the Product, for use in Buyer’s proprietary nutritional supplement products, including without limitations: concentration, appearance, mouth feel, smell, texture, dissolution, availability as a nutritional effective amount of the one or more glyconutrients, microbiology, method of manufacture, stability, toxin levels (if any), and the like.

- 2.2 **Term.** The Term of this Agreement shall be for five (5) years (“Primary Term”), unless earlier terminated as set forth herein.
- 2.3 **Renewal.** Upon the expiration of the Primary Term specified in Section 2.2, this Agreement may be renewed for successive periods of one (1) year (“Secondary Term”), unless either Party gives written notice of non-renewal to the other Party at least sixty (60) days before the then-current expiration date, in which case this Agreement will terminate as of the end of the second month after the written notice of non-renewal was given.
- 2.4 **Expansion of Territory.** The expansion of the Territory to include other parts of the world may be negotiated between Seller and Buyer.
- 2.5 **Effective Date of this Agreement.** This Agreement shall become binding as to Buyer for execution, delivery and performance on the date of authorization of this Agreement by the Board of Directors of Buyer.
- 2.6 **End of Term Notice.** At least thirty (30) days prior to the end of the Term, Buyer and Seller will mutually agree in writing on the quantity and price of the Product to be sold by Seller and purchased by Buyer hereunder during such additional one-year period. At least sixty (60) days prior to the end of the Term, Seller and Buyer shall commence good faith negotiations to determine and agree upon such quantity and price for such additional one-year period. If Buyer and Seller are unable to so agree on such quantity and price, this Agreement shall terminate effective at the end of the then-current Term. Nothing contained in this Paragraph shall be deemed to: (i) obligate Buyer and Seller to agree upon such quantity and price; (ii) obligate a party to negotiate with the other party regarding such quantity and price if such other party is then in breach of or in default under this Agreement; or (iii) limit the rights of Buyer and Seller under Paragraph 13 hereof.

### 3. **Product.**

- 3.1 **Product.** Seller shall sell Product to Buyer that shall meet or exceed the Product specifications agreed upon between the Parties and as shall be modified in writing from time to time by the Buyer.
- 3.2 **Validation of Claims.** Contemporaneously with such development of the Product, Seller shall provide to Buyer all required scientific data to substantiate product claims (if any). Seller and Buyer shall cooperate in all aspects as contemplated hereunder to ensure that the Product(s) comport with any and all regulatory guidelines in place by governmental authorities during the term of this Agreement.
- 3.3 **Specifications.**
  - 3.3.1 **Initial Specifications.** As consideration for the Pre-payment, the Seller shall use its best efforts to develop a Product that meets the Buyer’s requirements for its proprietary nutritional supplements and topical products. Buyer agrees to work with the Seller on the initial Product specifications.
  - 3.3.2 **Product to Meet or Exceed Specifications.** The Product shall meet or exceed the specifications as provided by Buyer to Seller, from time to time (the “Specifications”). Such Specifications to be provided to Buyer by Seller and may be amended by Buyer and Seller only by mutual written consent, from time to time, subject to variance within ranges of contents and other factors. From time to time, Buyer and Seller shall agree on updated specifications including particle size and packaging preferences. Upon agreement on the specifications, packaging and powder specifications shall be included in the price set forth in Exhibit A.
  - 3.3.3 **Specification Documentation.** Seller shall also provide formulation documentation for those countries outside of the United States in which Buyer conducts business and sells the Product. Such documentation shall include, but is not necessarily limited to, raw material specifications, certificates of analysis, manufacturing processing (e.g., to determine whether specific raw materials are allowable), and amounts of ingredients (e.g., to determine whether the ingredient in the formulation is within upper and lower limits allowable in the specified country).

**4. Quality Control.**

- 4.1 Quality Control Costs. Seller shall bear all responsibility for product and quality control, including, without limitation, costs, testing, written and electronic documentation and compliance with Product specifications and quality control requirements that Seller and Buyer will agree upon for all Products, and as shall be provided by Buyer to Seller from time to time.
- 4.2 Quality Control Representations. Seller represents and warrants that it has established procedures for the manufacture and supply of the Products. Seller agrees that all Products manufactured, packaged, labeled, supplied and delivered to Buyer (or its designee), will be manufactured in a professional, clean, safe and sanitary manner, in accordance with good manufacturing practices and the specifications established provided by Buyer to Seller from time to time.
- 4.3 Buyer Right to Inspect. Buyer has the right to inspect and test all Product as contemplated herein, to the extent practicable, at all places and times, including the period of manufacture, and in any event prior to acceptance thereof. Buyer shall perform inspections and tests for quality assurance in a manner that will not unduly delay the production of the Product.
- 4.4 Replacement of Nonconforming Product. Buyer may require repair, reformulation or replacement of nonconforming Product, those constituting, without limitation of the foregoing, unacceptable formulation(s), scientific validation, safety, efficacy, shelf life and nonconformity with applicable governmental regulations. Buyer reserves the right to run adequate tests to determine whether the Product conforms to the specifications as contemplated hereby. Use of a portion of the Product shall not constitute acceptance thereof.
- 4.5 Records and Audit. Appropriate records maintained by Seller with respect to the supply of Product shall be available at all reasonable times for inspection and verification by Buyer or any of its designated agents or representatives. Buyer reserves the right, at any time, to examine Seller's books and records related to the Product at Buyer's expense, and Seller shall cooperate with any person making such examination on behalf of Buyer.

**5. Orders, Price and Payment.**

- 5.1 Minimums. The Seller has agreed to sell to Buyer and Buyer has agreed to purchase from Seller the minimums at the price set forth in Exhibit A (the "Purchase Price") during each year of the Term. The Seller agrees to produce and sell such minimums to the Buyer. Unless otherwise provided herein, the Purchase Price does not include any foreign, federal, state or local sales, value added, use or other taxes, all of which shall be borne by Buyer.
- 5.2 Payment. Seller shall submit invoices to Buyer for the balance due on the Products when quantities of the Products are available for shipment to Buyer. Seller's invoices are due on receipt (net 45) to be paid in United States Dollars (U.S.D.) to the bank account nominated by the Seller.
- 5.3 Supply Requirements. Buyer shall provide written supply requirements to Seller for each ensuing twelve (12) month period no later than July 1 of each year.
- 5.4 Price. The price per kilogram of 10% GFS shall be as set forth in Exhibit A. As set forth in Section 2.2, the price for 10% GFS for any Secondary Term shall be reviewed and subject to good faith negotiations upon termination of the Primary Term.

**6. Delivery & Shipment.**

- 6.1 Delivery. Delivery dates and quantities of the Products shall be as set forth in Purchase Order(s), but at least quarterly. Seller shall provide Buyer with sufficient quantity for Seller's batch processing, as acknowledged and approved by Seller. All quantities of the Products purchased by Buyer hereunder shall be shipped to the Point of Delivery as set forth in Exhibit A.
- 6.2 Seller Responsibilities. Seller shall be responsible for all shipping, delivery, transportation, insurance, brokerage, handling, import duty, export fees, any taxes, any governmental charges, regulatory fees, demurrage, and other costs that Seller may incur in delivering the Products to Buyer's Dock from Seller's place of manufacture or distribution center. Seller shall be responsible for all customs costs and proceedings at Seller's sole expense.
- 6.3 Seller Supplies. Seller shall hold back sufficient stock of Product to ensure continuous supply to meet Buyer's requirements.
- 6.4 Buyer Responsibilities. Risk of loss associated with the shipments shall pass to Buyer when Seller delivers the shipments to a commercial carrier, if any, at the Point of Delivery.

- 6.5 **Transfer of Title.** Title to Product shall not transfer to Buyer until the following conditions have been met: (1) the Product has cleared all customs, including without limitation, Australian and United States customs; (2) the Product is delivered to Buyer at the location set forth in Exhibit A; (3) the Product has been inspected by Buyer; (4) the entire lot of the Product meets or exceeds the agreed upon specifications; and (5) the entire lot of the Product has been approved by Buyer. Upon acceptance, Buyer shall be able to use or sell the Product without limitation.
- 6.6 **Cancellation by Buyer.** Upon written notice to Seller, Buyer may cancel any order, in whole or in part, that Seller has previously accepted but not yet shipped to Buyer.

7. **Exclusivity.**

- 7.1 **Buyer Exclusivity.** Buyer shall have an exclusive for all GFS product ranges (all concentrations) provided the Minimums set forth in Section 5.1 are met. Seller shall not directly or indirectly develop, manufacture or market an “equivalent or derivative product” for any other multi-level marketing, direct-sales or similar company or any other form of retail distribution using the Product for a period of three (3) years, after the third year Buyer shall maintain exclusivity if Buyer purchases a minimum of 20,000 kilograms. For the purpose of this Agreement, “equivalent or derivative product” means any product formulated by Seller that substantially replicates the Product as to the combination of specific ingredients, nutrients, and functional features.
- 7.2 **Seller Negotiations.** Upon execution of this Agreement, Seller shall terminate any and all current dealings, business, negotiations and the like, with any and all other companies intending to market any other products containing GFS in the nutritional and dietary supplement fields and Buyer shall have an exclusive worldwide right to market the Product.

8. **Intellectual Property.**

- 8.1 **Marks.** The Parties recognize that the name and/or respective marks of the other are valuable, valid and that all goodwill associated with use of such names and marks shall inure to the benefit of the respective mark owner, whether the mark is registered, pending or protected under common law or any equivalent thereof. Buyer shall have the right to terminate this Agreement immediately in the event that Seller acts in a manner which would negatively impact the reputation or goodwill of Buyer and/or of its name or marks (“Buyer Marks”) and/or would infringe or dilute the value of Buyer’s marks or which is not in compliance with applicable law in the United States or any other country in which Buyer conducts business as the case may be.
- 8.2 **Seller Representations.** Seller represents and warrants that the Product does not infringe the intellectual property of any third-party.
- 8.3 **Seller Acquisition of Additional Rights.** In the event that third-party intellectual property is needed, Seller shall use best efforts to identify and secure any additional approvals or permissions required in connection with the production, manufacture, use or exploitation of the Product, at Seller’s sole expense.
- 8.4 **Notice of Infringement by One or Both Parties.** Each Party shall promptly notify the other of its knowledge of any potential claim of infringement, whether threatened or not, of any intellectual property, including, without limitation, patents, trademarks and copyrights, owned or under the control of a third party. Each Party has the right, but not the obligation, to take reasonable legal action necessary against such infringement of third party intellectual property related to the Product. Each Party agrees to render such reasonable assistance as the enforcing Party may request at the expense of the enforcing Party. Seller shall be solely responsible for all costs of defense for any claim of infringement, including without limitations, attorney’s fees, court costs, travel and related expenses, expert fees, and the like.

**9. Confidential Information.**

- 9.1 Buyer's Confidential Information. Seller recognizes and acknowledges that Buyer has invested and continues to invest in protecting Buyer's Intellectual Property and the validity and enforceability thereof, which are valuable assets belonging to Buyer and as such are the sole property of Buyer (hereinafter referred to as "Buyer Confidential Information"). Prior to and during the performance of this Agreement, Seller may have or had access to certain Buyer Confidential Information. Seller shall not at any time, during or after the performance of this Agreement, in any manner, either directly or indirectly, use, divulge, disclose, or communicate to any person, firm or corporation, any confidential information of any kind, nature, or description concerning any matters affecting or relating to the business of Buyer or Buyer Confidential Information. Buyer Confidential Information, whether in written, electronic or other form includes but is not limited to: trade name(s), trademarks, copyrights, patents, patent applications, invention disclosures, research and development, marketing plans, identity of and related information regarding its Associates, product formulations and other proprietary product information and any information relating to the management/operations of Buyer; Buyer genealogies (being the information held by Buyer in connection with any current or former Associate of Buyer) related to its Associates including without limitation its relationship with each of its Associates, the Associate's name, upline and downline, charts, data reports, proprietary product information which may from time-to-time be made known to Seller, the names or practices of any of Buyer's customers or Associates; Buyer's marketing methods and related data; the names of Buyer's vendors or suppliers; costs of materials; costs of its products generally, the prices Buyer obtains or has obtained or at which it sells or has sold its products or services; manufacturing and sales costs; lists or other written records used in Buyer's business; compensation paid to its Associates, details of training methods, new products or new uses for old products, merchandising or sales techniques, contracts and licenses, business systems, computer programs, or any other confidential information of, about, or concerning the business of Buyer; its manner of operation or other confidential data of any kind, nature or description and the like.
- 9.2 Use of Buyer's Confidential Information. Seller shall only use Buyer Confidential Information in conjunction with this agreement and shall return copies of any written, electronic Buyer or other Confidential Information in Seller's possession to Buyer forthwith upon written demand or upon termination of this Sale and License Agreement for whatever reason.
- 9.3 Notwithstanding anything to the contrary contained in this Agreement:
- 9.3.1 Seller shall have no obligation to maintain in confidence or return to Buyer any information: (i) that was known to Seller prior to its disclosure to Seller by Buyer or any of its current or former Associates and that did not become known to Seller through disclosure by a person who was then known actually by Seller to have obtained such information or made such disclosure in violation of any obligation to Buyer; (ii) that is now in or hereafter enters the public domain other than due to a breach by Seller of this section 10; (iii) that is disclosed to Seller by a third party who is not actually known by Seller to have obtained or disclosed such information in violation of any obligation to Buyer; or (iv) that is independently developed by Seller without the aid, application or use of any Buyer Confidential Information disclosed to Seller; and
- 9.3.2 Seller may make any disclosure of Buyer Confidential Information: (i) that is necessary or appropriate to make in order to carry out its obligations under any written agreement with Buyer; (ii) that it is required or permitted to make pursuant to any written consent of or written agreement with Buyer; or (iii) that it is required to make by law by a court, tribunal or otherwise with competent and enforceable jurisdiction.
- 9.4 Confidentiality of Seller's Agents, Consultants and Contractors. Seller agrees that all its consultants and contractors having access to Buyer Confidential Information, shall be subject to the same confidentiality obligations as the principals, it's agents and assigns pursuant and shall enter into written secrecy agreements in support of such obligations. Insofar as this is not reasonably practicable, Supplier shall take all reasonable steps to ensure that any such agents, consultants and contractors are made aware of such confidentiality obligations. Seller shall be jointly and severably responsible for any and all breaches of confidentiality by any such consultants and contractors.



- 9.5 **Seller's Confidential Information.** Buyer recognizes and acknowledges that Seller's trade name(s), trademarks, copyrights, patents, marketing plans, product formulations, know-how, compounds, products, processes, designs, production methods and techniques and other proprietary product information and any information relating to the management/operations of Seller are valuable assets and confidential information belonging to Seller and as such are the sole property of Seller and may constitute trade secrets of Seller. Prior to and during the performance of this Agreement, Buyer may have or had access to certain confidential information pertaining to Seller. Buyer agrees that it will not at any time, during or after the performance of this Agreement, in any manner, either directly or indirectly, use, divulge, disclose, or communicate to any person, firm or corporation, any confidential information of any kind, nature, or description concerning any matters affecting or relating to the business of Seller (hereinafter referred to as "Seller Confidential Information"). Seller Confidential Information includes but is not limited to: the names or practices of any of Seller's customers; Seller's marketing methods and related data; the names of Seller's vendors or suppliers; costs of materials; costs of its products generally, the prices Seller obtains or has obtained or at which it sells or has sold its products or services; manufacturing and sales costs; lists or other written records used in Seller's business; compensation paid to its Associates, details of training methods, new products or new uses for old products, merchandising or sales techniques, contracts and licenses, business systems, computer programs, or any other confidential information of, about, or concerning the business of Seller; its manner of operation or other confidential data of any kind, nature or description.
- 9.6 **Use of Seller's Confidential Information.** Buyer agrees to use the Seller Confidential Information only for Seller business and return copies of any written Seller Confidential Information in its possession to Seller forthwith upon written demand and upon termination of this Agreement for whatever reason.
- 9.7 Notwithstanding anything to the contrary contained in this Agreement,
- 9.7.1 Buyer shall have no obligation to maintain in confidence or return to Seller any information: (i) that was known to Buyer prior to its disclosure to Buyer by Seller that did not become known to Buyer through disclosure by a person who was then known actually by Buyer to have obtained such information or made such disclosure in violation of any obligation to Seller; (ii) that is now in or hereafter enters the public domain other than due to a breach by Buyer of this section 10; (iii) that is disclosed to Buyer by a third party who is not actually known by Buyer to have obtained or disclosed such information in violation of any obligation to Seller; or (iv) that is independently developed by Buyer without the aid, application or use of any Seller Confidential information disclosed to Buyer; and
- 9.7.2 Buyer may make any disclosure of Seller Confidential Information: (i) that it is necessary or appropriate to make in order to carry out its obligations under any written agreement with Seller; (ii) that it is required or permitted to make pursuant to any written consent of or written agreement with Seller; or (iii) that it is required by law to make.

**10. Indemnification.**

- 10.1 **SELLER HEREBY AGREES TO INDEMNIFY, SAVE AND HOLD BUYER HARMLESS IN RESPECT OF ALL CAUSES OF ACTION, LIABILITIES, COSTS, CHARGES AND EXPENSES, LOSS AND DAMAGE (INCLUDING CONSEQUENTIAL LOSS) SUFFERED OR INCURRED BY BUYER (INCLUDING LEGAL FEES) ARISING FROM ANY WILLFUL OR GROSSLY NEGLIGENT ACT OR OMISSION OF SELLER OR ITS EMPLOYEES, SERVANTS AND AGENTS AND ARISING FROM CONTRAVENTION BY SELLER OF ANY OF ITS EMPLOYEES, SERVANTS, AND AGENTS OF ANY OF THE TERMS AND CONDITIONS IMPOSED ON SELLER PURSUANT TO THIS AGREEMENT. THIS SECTION WILL NOT BE CONSTRUED TO LIMIT OR EXCLUDE ANY OTHER CLAIMS OR REMEDIES THAT BUYER MAY ASSERT UNDER THIS AGREEMENT OR BY LAW.**

10.2 **SELLER HEREBY AGREES TO INDEMNIFY, SAVE AND HOLD BUYER HARMLESS IN RESPECT OF ALL CAUSES OF ACTION, LIABILITIES, COSTS, CHARGES AND EXPENSES, LOSS AND DAMAGE (INCLUDING CONSEQUENTIAL LOSS) SUFFERED OR INCURRED BY BUYER (INCLUDING LEGAL FEES) ARISING FROM THE INFRINGEMENT OF ANY AND ALL THIRD PARTY INTELLECTUAL PROPERTY.**

**11. Representations and Warranties.**

The following representations and warranties are made by Seller and are true and correct and shall remain true and correct during the term of this Agreement and have been made to induce Buyer to enter into this Agreement.

- 11.1 Production. Seller warrants that the Products conform to the specifications, quality control and to be free from contaminants within standard limits for each of the Territories. If Buyer is asked to provide a warranty as to shelf-life, such warranty shall only be made upon successful testing as to shelf life and shall in any event not exceed a twelve (12) month period.
- 11.2 Organization. Each of Buyer and Seller is a corporation duly organized, validly existing and in good standing under the laws of its state of incorporation as to the United States or as to the region in which it does business and has full power and authority to carry on its business as now being conducted.
- 11.3 Seller Authorization and Agreement. The execution, delivery and performance of this Agreement by Seller and Buyer have been authorized by all necessary corporate action, except as required by Section 2.5. The consummation of the transactions contemplated by this Agreement will not result in the breach of, or constitute a default under, any indenture, mortgage, note, agreement or other financing agreement to which Seller or Buyer is a party or to which the properties or rights of the Seller or Buyer are subject and will not be in violation of the rights of any other party
- 11.4 No Consent. No consent of any party and no consent, license, approval or authorization of, or exemption by, or registration or declaration with, any governmental authority, bureau or agency is required in connection with the execution, delivery, validity or enforceability of this Agreement with respect to Seller and the consummation of the transactions contemplated hereby.
- 11.5 Insurance. The Seller warrants that it has in place the following insurances and that if requested by the Buyer, satisfactory and acceptable evidence of such policies will be provided. The Seller agrees to nominate the Buyer and its subsidiaries as interested parties on each of the relevant policies within 30 days if such request is made.
- 11.5.1 General and Public Liability. AUD\$5,000,000 Combined Single Limit for Bodily Injury and Property Damage, including Product Liability applicable to Australia and New Zealand.
- 11.5.2 Auto Liability. AUD\$30,000,000 Combined Single Limit for Bodily Injury and Property Damage. Policy shall include owned and blanket non-owned vehicles and hired coverage.
- 11.5.3 Worker's Compensation. Seller shall have and keep at all times a full statutory policy.
- 11.5.4 Commercial Umbrella Liability. If requested, the Buyer will assist the Seller in obtaining other insurances as considered necessary, including Public and Product Liability coverage in countries other than Australia and New Zealand.
- 11.6 Validity and Enforceability. This Agreement is valid and enforceable against Seller and Buyer in accordance with its terms, except as enforcement may be limited by applicable bankruptcy, insolvency or other laws affecting the rights of creditors generally. The execution, delivery and performance of this Agreement does not violate any law or rule or regulation or give rise to a cause of action in favor of any person which will result in any liability to any of the Parties.

- 11.7 **No Breach.** Neither the execution and delivery of this Agreement, nor the consummation of the transactions contemplated hereby will: (i) violate any provision of the Articles of Incorporation or By-Laws of either the Buyer or Seller; (ii) violate, conflict with or result in the breach or termination of, or otherwise give any other contracting party the right to terminate or constitute a default (by way of substitution, novation or otherwise) under the terms of any mortgage, lease, bond, indenture, agreement, franchise or other instrument or obligation to which either Seller or Buyer is a party or by which it may be bound or by which any of the property or assets of either Seller or Buyer may be bound or materially affected; (iii) result in the creation of any lien, charge or encumbrance upon the assets or properties of either the Seller or Buyer as it relates to its business or the pending businesses of either Party; (iv) violate any judgment, order, injunction, decree or award of any court, arbitrator, administrative agency or governmental body against, or binding upon either Seller or Buyer or upon the property, assets or business of Seller or Buyer; or (v) constitute a violation by either Seller or Buyer of any law or regulation of any jurisdiction as such law or regulation relates to it or to the property or business of Seller or Buyer, as applicable.
- 11.8 **Compliance with Laws.** The business and operations of each Party and any of their other affiliates and subsidiaries, if any, have not been, and are not, conducted in violation of any applicable judgment, order, injunction, award, tariff or decree. Neither Seller nor Buyer has received notice of, nor have any knowledge of or any reasonable grounds to know after due inquiry that its business and its operations have not been and are not conducted in violation of any Federal, state or local law, ordinance, regulations, or any other requirement of any governmental body, court or arbitrator applicable to either Party or pursuant to which either the Seller or Buyer conducts its business and operations. Both Parties have all permits, licenses, orders, authorizations or approvals of any Federal, state, local or foreign governmental or regulatory body to carry on its business in the places and in the manner now and heretofore conducted, and all such licenses, authorizations any permits are in full force and effect. Neither Party has received notice of nor has any knowledge of or any reasonable grounds to know after due inquiry that its business and operations have not and are not conducted in material violation of any such licenses, authorizations and permits, and no proceeding is pending or threatened to revoke or limit any such license, authorizations or permits.
- 11.9 **Suppliers and Customers.** Each Party hereby represents and warrants that its relationship with its suppliers and customers is generally good. No material customer or supplier has cancelled or otherwise terminated, or threatened to cancel or otherwise terminate its relationship with either Party or has actually notified that it will decrease its services or supplies to either Party.

## 12. **Termination.**

- 12.1 **Termination by Seller.** Seller will have just cause to terminate this Agreement immediately upon written notice to Buyer or to refuse to renew this Agreement, without judicial or administrative notice or resolution, upon the occurrence of any termination event specified below:
- 12.1.1 **Breach.** Buyer or any of its employees (i) breaches any obligation under the terms of this Agreement or (ii) breaches any other obligation under this Agreement and fails to cure the breach within 90 days after Seller demands its cure in writing.
- 12.1.2 **Normal Business.** Buyer ceases to conduct business in the normal course, becomes insolvent, enters into suspension of payments, moratorium, reorganization or bankruptcy, makes a general assignment for the benefit of creditors, admits in writing its inability to pay debts as they mature, suffers or permits the appointment of a receiver for its business or assets, or avails itself of or becomes subject to any other judicial or administrative proceeding that relates to insolvency or protection of creditors' rights.
- 12.2 **Termination by Buyer.** Buyer will have just cause to terminate this Agreement immediately upon written notice to Seller or to refuse to renew this Agreement, without judicial or administrative notice or resolution, upon the occurrence of any termination event specified below or elsewhere in this Agreement:
- 12.2.1 **Failure to Agree on Specifications.** This Agreement shall terminate immediately if the Buyer and Seller fail to agree to the specifications or quality control requirements for the Product, such agreement shall not be unreasonably withheld.

- 12.2.2 **Breach.** Seller or any of its employees breaches any obligation under this Agreement and fails to cure the breach to Buyer's satisfaction within ninety (90) days after Buyer demands its cure in writing.
- 12.2.3 **Normal Business.** Seller ceases to conduct business in the normal course, becomes insolvent, enters into suspension of payments, moratorium, reorganization or bankruptcy, makes a general assignment for the benefit of creditors, admits in writing its inability to pay debts as they mature, suffers or permits the appointment of a receiver for its business or assets, or avails itself of or becomes subject to any other judicial or administrative proceeding that relates to insolvency or protection of creditors' rights.
- 12.2.4 **Failure to Meet Quality Control Standards.** The Products fail to meet the Quality Control Standards provided by Buyer to Seller in the form of product specifications or as Buyer may provide to Seller from time to time. Seller shall have fifteen (15) days to cure any breach.
- 12.2.5 **Illegality.** If, in the Buyer's sole discretion, continued use of the Product would result in harm to its consumers, give rise to a regulatory investigation or is otherwise determined to be illegal or unsafe for human consumption anywhere in the Territory.
- 12.2.6 **Insolvency.** The institution by Seller of insolvency, receivership or bankruptcy proceedings or any other material proceedings for the settlement of its debts, including, without limitation, a reorganization, a compromise, an arrangement or assignment for the benefit of its creditors; the institution of such proceedings against the Seller and Seller has failed to resolve in its favor within twenty (20) calendar days after appropriate services of process.
- 12.2.7 **General Assignment.** The Seller makes a general assignment for the benefit of creditors, Seller's dissolution or ceasing to do business in the normal course; Seller has a substantial part of its assets seized.
- 12.2.8 **Fair Trade Practices.** The Seller shall at all times comply with international fair trade practices. Buyer shall have the right to terminate this Agreement upon seven (7) days prior written notice to Seller or representative in the event that Seller, its officers, executives, partners, directors, principals, employees, attorneys or agents, does any of the following: (i) engages in illegal, immoral, or criminal conduct resulting in a criminal indictment with a substantial likelihood of conviction; (ii) misrepresents or conceals anything in its background that could be detrimental to the value of Buyer's goodwill, name, reputation or stock; (iii) engages in conduct contrary to the best interests of Buyer; (iv) engages in conduct that offends the sensitivities of a portion of the population, including, without limitations, use of child labor, acts contrary to international standards for the treatment of employees or the environment, abrogates the rights of employees to congregate and the like; or (v) engages in any conduct, whether intentional or not, that may bring Buyer or its Associated into public disrepute.
- 12.2.9 **Termination Due to Regulatory Requirements.** Buyer may terminate this Agreement in the event that government regulatory requirements, state or federal, or Buyer's specifications, including but not limited to quality assurance, good manufacturing practices and legality for sale, are not met regarding product and manufacturing, such determination at its sole discretion.
- 12.2.10 **Termination for Failure to Meet Buyer's Production Requirements.** Buyer may terminate this Agreement if Seller is unable to meet the Buyer's minimum production requirements or if Seller is unable to meet the Buyer's reasonable future requirements.

### **13. Consequences of Termination.**

- 13.1 **Termination Obligations.** Without waiving any rights or remedies a party may have hereunder, upon the expiration or termination of this Agreement, all rights granted to either party hereunder will immediately cease, and the parties will: (i) promptly comply with the termination obligations specified below; and (ii) otherwise cooperate with the other party to terminate relations in an orderly manner.
- 13.2 **Payments.** Buyer shall pay Seller all due and outstanding amounts owed up to the date of Termination. There shall be no liquidated, consequential or incidental damages or payments due of any kind.

**14. Notice.**

Any notice or other communications between the Parties hereto shall be sufficiently given if sent by international delivery or by telecopy, if to Buyer addressed to it at 600 South Royal Lane, Suite 200 Coppell, Texas 75019, or if to Seller addressed to it at Level 7, 39 Murray Street, Hobart, TAS 7000 Australia or to other such addresses hereafter designated in writing by one party to the other. Such notice or other communications shall, if sent by telecopy, be deemed to be given upon receipt of the confirmation of its proper transmission and if outside the hours of 9:00 a.m. to 5:00 p.m. on any business day in the jurisdiction of the addressee, shall be deemed to be given at 9:00 a.m. on the next business day. Notices sent by international delivery shall be deemed to be received (3) days after the date of forwarding the same. For the purposes of this Agreement, "business day" shall refer to a day in which trading banks are open for business.

**15. Attorney's Fees.**

In the event any party hereto shall institute an action, including arbitration pursuant to Section 19 of this Agreement, to enforce any rights hereunder, the prevailing party in such action shall be entitled, in addition to any other relief granted, to reasonable attorneys' fees and costs.

**16. Severability.**

Any portion of this Agreement which may be prohibited or unenforceable in any applicable jurisdiction shall, as to such jurisdiction, be ineffective to the extent of such prohibition or unenforceability, but shall not invalidate the remaining portions of such provisions or the other provisions hereof or affect any such provisions or portion thereof in any other jurisdiction.

**17. Modification.**

This Agreement and the Exhibits attached hereto may be revised from time to time and can be modified by mutual written agreement of the Parties.

**18. Waivers.**

Any failure by any of the Parties to comply with any of the obligations, agreements or conditions set forth in this Agreement may be waived by the other party, but any such waiver will not be deemed a waiver of any other obligations, agreement or conditions contained herein.

**19. Arbitration.**

Any controversy or claim arising out of or relating to this Agreement or the existence, validity, breach or termination thereof, whether during or after its term, will be finally settled by compulsory arbitration in accordance with the Commercial Arbitration Rules and Supplementary Procedures for Commercial Arbitration of the American Arbitration Association ("AAA"); provided, however, that in the event of any such controversy or claim: (i) neither party will initiate arbitration within the first thirty (30) days after the aggrieved party first notifies the other party of the controversy or claim; and (ii) during such thirty (30) day period, the chief executive officers of both parties convene at least once in Dallas, Texas, to endeavor in good faith to amicably resolve the controversy or claim.

To initiate arbitration, either party will file the appropriate notice at the appropriate Regional Office of the AAA. The arbitration proceeding will take place during a period not exceeding three (3) days. The arbitration panel will consist of three (3) arbitrators, one arbitrator appointed by each party and a third neutral arbitrator appointed by the AAA. Any communication between a party and any arbitrator will be directed to the AAA for transmittal to the arbitrator.

The arbitral award will be the exclusive remedy of the parties for all claims, counterclaims, issues or accountings presented or plead to the arbitrators. The award will (i) be granted and paid in U.S. Dollars exclusive of any tax, deduction or offset and (ii) include interest from the date of breach or other violation of the Agreement until the award is fully paid, computed at the then-prevailing LIBOR rate. Judgment upon the arbitral award may be entered in any court that has jurisdiction thereof. Any additional costs, fees or expenses incurred in enforcing the arbitral award will be charged against the party that resists its enforcement.

20. **Counterparts.**  
This Agreement may be executed in one or more counterparts, each of which will be deemed an original but all of which together will constitute one and the same document.
21. **Compliance.**  
Each party will comply with all laws relating to the performance of this Agreement including federal and state laws, rules and regulations and represents and warrants that execution of this Agreement and performance of its obligations under this Agreement does not and will not breach any other agreement to which it is or will be a party, including but not limited to any agreements with its customers or third-parties.
22. **No Agency.**  
Neither party shall purport or shall be deemed an agent, employee, partner, or joint venture with the other party.
23. **Governing Law.**  
The Parties hereto agree that this Agreement shall be enforced and governed by the laws of the State of Texas without regard to the conflicts of law principals. Each party consents to personal jurisdiction in Dallas County, Texas, for any action to enforce arbitration including any further rules provided for emergency or extraordinary relief, as to this Agreement.
24. **Authority.**  
The Parties represent that they have full capacity and authority to grant all rights and assume all obligations they have granted and assumed under this Agreement.
25. **Assignment.**  
This Agreement and the rights hereunder may not be assigned by any party (except by operation of law) without prior written consent of the other party, but, subject to the foregoing limitation, this Agreement shall be binding and inure to the benefit of the respective successors, assigns, and legal representatives of the Parties.
26. **Force Majeure.**  
Neither party shall be liable for any failure, inability or delay to perform hereunder, if such failure, inability or delay is due to war, strike or other labor stoppage or slowdown, flood, fire, explosion or accident, transportation stoppage, materials shortage, government law, order or regulation or energy allocation or shortage; in which case Buyer shall under no circumstances be relieved of the obligation to pay amounts then due to Seller. If delay or failure caused by such force majeure condition shall continue for more than ninety (90) days, either party shall have the right, at its sole discretion, to terminate this Agreement, by giving notice to the other of its election to terminate. For the purposes of this Agreement, the term “force majeure” shall mean any event beyond the control of the parties, including, without limitation, fire, flood, riots, strikes, epidemics, war (declared or undeclared and including the continuation, expansion or new outbreak of any war or conflict now in effect), terrorist acts, export controls, embargoes, changes in government and governmental actions or decrees, including without limitations regulatory interventions, regulatory approvals and the like.
27. **Captions.**  
The headings of the sections in this Agreement are intended solely for convenience of reference and are not intended and shall not be deemed for any purpose whatsoever to modify or explain or place constriction upon any of the provisions of this Agreement.
28. **Incorporation of Recitals.**  
The recitals of this Agreement shall be construed and interpreted as comprising an essential portion of this Agreement.
29. **Schedules and Attachments.**  
The schedules and attachments attached to or to be attached to this Agreement shall form an integral part of the same.

**30. Non-Competition.**

During the term of this Agreement, neither Seller, nor any of its sub-distributors, sales representatives, their agents, assigns, executives or anyone in privity therewith, shall serve as manufacturer, distributor, marketing or sales representative in connection with any product that is directly or indirectly competitive with the product or products that Buyer is distributing, promoting, or selling on behalf of Buyer without first obtaining Buyer's written consent.

**31. Independent Judgment.**

The Parties acknowledge that: (a) they have read this Agreement; (b) they understand the terms and conditions of this Agreement; (c) they have had the opportunity to seek legal counsel and advice; (d) they are of equal bargaining power; and (e) they have relied on their own judgment in entering into this Agreement, as such, none of the sections, paragraphs or clauses contained herein may be construed to the disadvantage of a party because that party was responsible for its preparation.

**32. Publicity of Agreement.**

This Agreement is confidential. Neither party shall engage in any type of publicity in any way connected with this Agreement without the other party's prior written approval, which approval shall not be unreasonably withheld. However, approval to disclose is hereby given by both parties to the extent required for compliance with any governmental rule, regulation or other requirement. In the event of any disclosure, the publishing party shall furnish a copy of such disclosure to the other party.

**33. Entire Agreement.**

Subject to the Buyer agreeing to product and quality control specifications, this Agreement constitutes the entire agreement between the Parties hereto pertaining to the subject matter hereof and supersedes all prior and contemporaneous agreements and understanding of the Parties, and there are no representations, warranties, or other agreements between the Parties in connection with the subject matter hereof except as specifically set forth herein. No supplement, modification, amendment, waiver or termination of this Agreement shall be binding unless executed in writing by the Parties hereto. In the event of any inconsistency between the terms of the Purchase Order and this Agreement, the terms of this Agreement shall prevail.

IN WITNESS WHEREOF, the parties have duly executed this Agreement on the date first written above.

**Mannatech™ Incorporated**

By: /s/ Sam Caster  
Sam Caster

Date: August 11, 2004

Its: Chairman and Chief Executive Officer

**Marinova Pty Limited**

By: /s/ Paul Garrott  
Paul Garrott

Date: August 12, 2004

Its: Managing Director

EXHIBIT "A"

PRODUCT AMOUNT AND PRICE

**I) Yearly Minimum Purchase Amount and Price, Primary Term:**

For each of the first three years of this Agreement (2005, 2006, 2007) Buyer shall purchase 20,000 kilograms of 10% GFS product at the price set forth below (depending on the method of freight) for use in dietary supplements based on agreed upon specifications.

Alternatively, in each of the first three years (2005, 2006, 2007) the Buyer may purchase a combination of 10% to 75% GFS, the total monetary value of which will be at least equal to the monetary value of 20,000 kilos of 10% GFS.

The purchase price for 75% GFS shall be determined by mutual agreement between the Buyer and Seller for use in dietary supplements based on agreed upon specifications.

<u>Year</u>	<u>Minimum Purchase Kilograms</u>	<u>USD Price per Kilogram Sea Freight (Point of Delivery: Los Angeles) (10% GFS)</u>	<u>USD Price per Kilogram Air Freight (Point of Delivery: Dallas) (10% GFS)</u>
2005	20,000	\$198.50	\$200.50
2006	20,000	\$176.00	\$178.00
2007	20,000	\$176.00	\$178.00
2008	none	\$176.00	\$178.00
2009	none	\$176.00	\$178.00



**Certification of  
Chief Executive Officer  
of Mannatech, Incorporated**

This certification is provided pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, and accompanies the annual report on Form 10-Q for the quarter ended September 30, 2004 of Mannatech, Incorporated.

I, Samuel L. Caster, the Chief Executive Officer of the registrant, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Mannatech, Incorporated;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 9, 2004

*/s/ Samuel L. Caster*

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Samuel L. Caster  
Chief Executive Officer

**Certification of  
Chief Financial Officer  
of Mannatech, Incorporated**

This certification is provided pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, and accompanies the annual report on Form 10-Q for the quarter ended September 30, 2004 of Mannatech, Incorporated.

I, Stephen D. Fenstermacher, the Chief Financial Officer of the registrant, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Mannatech, Incorporated;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 9, 2004

*/s/ Stephen D. Fenstermacher*

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Stephen D. Fenstermacher  
Chief Financial Officer

**Certification of  
Chief Executive Officer  
of Mannatech, Incorporated**

This certification is provided pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and accompanies the quarterly report on Form 10-Q (the "**Form 10-Q**") for the quarter ended September 30, 2004 of Mannatech, Incorporated (the "Issuer").

I, Samuel L. Caster, the Chief Executive Officer of the Issuer, certify that to the best of my knowledge:

- (i) the Form 10-Q fully complies with the requirements of section 13(a) or section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)); and
- (ii) the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Issuer.

Dated: November 9, 2004

*/s/ Samuel L. Caster*

\_\_\_\_\_  
Samuel L. Caster  
Chief Executive Officer

Subscribed and sworn to before me  
This 9<sup>th</sup> day of November, 2004

*/s/ Christina Dutton*

\_\_\_\_\_  
Name: Christina Dutton  
Title: Notary Public, State of Texas

My commission expires: March 19, 2006

*(A signed original of this written statement required by Section 906 has been provided to Mannatech, Incorporated  
will be furnished to the Securities and Exchange Commission or its staff upon request.)*

**Certification of  
Chief Financial Officer  
of Mannatech, Incorporated**

This certification is provided pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and accompanies the quarterly report on Form 10-Q (the "**Form 10-Q**") for the quarter ended September 30, 2004 of Mannatech, Incorporated (the "Issuer").

I, Stephen D. Fenstermacher, the Chief Financial Officer of the Issuer, certify that to the best of my knowledge:

- (i) the Form 10-Q fully complies with the requirements of section 13(a) or section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)); and
- (ii) the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Issuer.

Dated: November 9, 2004

*/s/ Stephen D. Fenstermacher*

\_\_\_\_\_  
Stephen D. Fenstermacher  
Chief Financial Officer

Subscribed and sworn to before me  
This 9<sup>th</sup> day of November, 2004

*/s/ Christina Dutton*

\_\_\_\_\_  
Name: Christina Dutton  
Title: Notary Public, State of Texas

My commission expires: March 19, 2006

*(A signed original of this written statement required by Section 906 has been provided to Mannatech, Incorporated  
will be furnished to the Securities and Exchange Commission or its staff upon request.)*