NOTE 15. INCOME TAXES

Consolidated income before provision for income taxes consists of income earned primarily from international operations. The provision for current and deferred taxes for the years ended December 31, 1998, 1999 and 2000 consists of the following:

(U.S. dollars in thousands)	1998	1999	2000
Current			
Federal	$ 3,695	$ 3,030	$ 1,677
State	3,580	3,030	1,589
Foreign	72,317	56,165	36,503
	79,592	62,225	39,769
Deferred			
Federal	(10,712)	(19,008)	4,337
State	(48)	(215)	836
Foreign	947	(1,260)	(10,236)
Change in tax status	(6,939)	—	—
Provision for income taxes	**$ 62,840**	**$ 41,742**	**$ 34,706**

Prior to the reorganization of the initial companies to form the Company (the "Reorganization") and the NSI Acquisition described in Notes 3 and 7, the Subsidiaries elected to be taxed as S corporations whereby the income tax effects of the Subsidiaries' activities accrued directly to their stockholders; therefore, adoption of SFAS 109 required no establishment of deferred income taxes since no material differences between financial reporting and tax bases of assets and liabilities existed. Concurrent with the Company's Reorganization and the NSI Acquisition, the Company terminated the S corporation elections of its Subsidiaries. As a result, deferred income taxes under the provisions of SFAS 109 were established.

The principal components of deferred tax assets are as follows:

(U.S. dollars in thousands)	December 31, 1999	December 31, 2000
Deferred tax assets:		
Inventory differences	$ 12,224	$ 5,164
Foreign tax credit	40,503	60,278
Distributor stock options and employee stock awards	5,261	6,723
Capitalized legal and professional	2,570	1,427
Accrued expenses not deductible until paid	12,632	14,154
Withholding tax	8,897	2,142
Minimum tax credit	10,264	10,739
Net operating losses	11,017	7,096
Total deferred tax assets	103,368	107,723
Deferred tax liabilities:		
Foreign deferred tax	11,657	14,816
Exchange gains and losses	3,566	5,880
Cost of goods sold adjustment	—	3,220
Pharmanex intangibles step-up	21,116	18,880
Other	4,067	6,149
Total deferred tax liabilities	40,406	48,945
Valuation allowance	—	—
Deferred taxes, net	**$ 62,962**	**$ 58,778**

The consolidated statements of income include a pro forma presentation for income taxes, including the effect on minority interest, which would have been recorded if the Company's Subsidiaries had been taxed as C corporations for all periods presented. A reconciliation of the Company's pro forma effective tax rate for the year ended December 31, 1998 and the actual tax rate for the years ended December 31, 1999 and 2000 compared to the statutory U.S. Federal tax rate is as follows:

Year ended	December 31, 1998	December 31, 1999	December 31, 2000
Income taxes at statutory rate	35.00%	35.00%	35.00%
Foreign tax credit limitation (benefit)	4.40	(7.77)	—
Cumulative effect of change in tax status	(4.09)	—	—
Pharmanex in-process research and development	2.80	—	—
Non-deductible expenses	.83	1.72	1.92
Branch remittance gains and losses	(1.38)	3.78	(.03)
Other	(.56)	(.23)	(.89)
	37.00%	**32.50%**	**36.00%**

NOTE 16. EMPLOYEE BENEFIT PLAN

The Company has a 401(k) defined contribution plan which permits participating employees to defer up to a maximum of 15% of their compensation, subject to limitations established by the Internal Revenue Code. Employees who work a minimum of 1,000 hours per year, who have completed at least one year of service and who are 21 years of age or older are qualified to participate in the plan. The Company matches 100% of the first 2% and 50% of the next 2% of each participant's contributions to the plan. Participant contributions are immediately vested. Company contributions vest based on the participant's years of service at 25% per year over four years. The Company's contribution totaled $829,000, $910,000 and $979,000 for the years ended December 31, 1998, 1999 and 2000, respectively.

NOTE 17. DERIVATIVE FINANCIAL INSTRUMENTS

The Company's Subsidiaries enter into significant transactions with each other and third parties which may not be denominated in the respective Subsidiaries' functional currencies. The Company seeks to reduce its exposure to fluctuations in foreign exchange rates by creating offsetting positions through the use of foreign currency exchange contracts and through certain intercompany loans of foreign currency. The Company does not use such derivative financial instruments for trading or speculative purposes. The Company regularly monitors its foreign currency risks and periodically takes measures to reduce the impact of foreign exchange fluctuations on the Company's operating results. Gains and losses on foreign currency forward contracts and certain intercompany loans of foreign currency are recorded as other income and expense in the consolidated statements of income.

At December 31, 1999 and 2000, the Company held foreign currency forward contracts with notional amounts totaling approximately $31.1 million and $28.9 million, respectively, to hedge foreign currency items. These contracts do not qualify as hedging transactions and, accordingly, have been marked to market. The net gain on foreign currency forward contracts was $2.6 million for the year ended December 31, 1998, the net loss on foreign currency forward contracts was $0.3 million for the year ended December 31, 1999 and the net gain on foreign currency forward contracts was $4.5 million for the year ended December 31, 2000. These contracts at December 31, 2000 have maturities through July 2001.

NOTE 18. SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid for interest totaled $3,731,000, $5,714,000 and $4,194,000 for the years ended December 31, 1998, 1999 and 2000, respectively. Cash paid for income taxes totaled $77,271,000, $76,596,000 and $30,860,000 for the years ended December 31, 1998, 1999 and 2000, respectively.

NONCASH INVESTING AND FINANCING ACTIVITIES: For the year ended December 31, 1998, noncash investing and financing activities were as follows: (1) $37.6 million distribution to the stockholders of the Acquired Entities (Note 3). (2) Purchase of Acquired Entities for $70.0 million in Preferred Stock and $6.2 million in long-term notes payable. Net assets acquired totaled $90.4 million and assumed liabilities totaled $171.3 (Note 3). (3) $25.0 million in contingent consideration issued to the NSI Stockholders. $8.8 million of the contingent payment was recorded as an increase in intangible assets and $16.2 million of the contingent payment was recorded as a reduction of stockholders' equity (Notes 3 and 7). (4) Purchase of Pharmanex for $77.6 million in Class A common stock and $0.2 million in cash. Net assets acquired totaled $3.6 million and assumed liabilities totaled $34.0 million (Note 4).

For the year ended December 31, 1999, noncash investing and financing activities included the purchase of Big Planet for $29.2 million of which $14.6 million consisted of a note payable (Note 6).