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NATURAL HEALTH TRENDS CORP
Form 10KSB
April 13, 2004

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-KSB

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934.

Or

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934.

For the fiscal year ended December 31, 2003

Commission file number 0-011228

NATURAL HEALTH TRENDS CORP.
(Name of Small Business Issuer in Its Charter)

Florida
(State or Other Jurisdiction of
Incorporation or Organization)

59-2705336
(I.R.S. Employer
Identification No.)

12901 Hutton Drive, Dallas, Texas
(Address of principal executive office)

75234
(Zip Code)

Issuer's Telephone Number, Including Area Code: (972) 241-4080

Securities registered pursuant to Section 12(g) of the Exchange Act:

Common Stock, par value \$.001
(Title of Class)

Check whether the issuer: (1) filed all reports required to be filed by
Section 13 or 15(d) of the Exchange Act during the past 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

Check if there is no disclosure of delinquent filers in response to Item
405 of Regulation S-B contained in this Form, and no disclosure will be
contained, to the best of registrant's knowledge, in definitive proxy or
information statements incorporated by reference in Part III of this Form 10-KSB
or any amendment to this Form 10-KSB.

Issuer's revenues for its most recent fiscal year: \$62,885,830

The aggregate market value of the voting stock held by non-affiliates of
the Issuer as of March 31, 2004 was approximately \$97,919,000 (based upon a
closing price of \$18.27 per share).

The number of shares of the Common Stock of the issuer outstanding as of
March 31, 2004 was 5,446,409.

DOCUMENTS INCORPORATED BY REFERENCE:

Part III incorporates certain information by reference from the
Registrant's Definitive Proxy Statement for the Registrant's Annual Meeting to

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be held during the second quarter of 2004.

Natural Health Trends Corp.
Form 10-KSB
2003 Annual Report

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements contained in this Annual Report on Form 10-KSB constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements included in this Annual Report, other than statements of historical facts, regarding our strategy, future operations,

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financial position, estimated revenues, projected costs, prospects, plans and objectives are forward-looking statements. When used in this Annual Report, the words "will," "believe," "anticipate," "intend," "estimate," "expect," "project" and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. We cannot guarantee future results, levels of activity, performance or achievements, and you should not place undue reliance on our forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including the risks described in Part I - Risk Factors, and elsewhere in this Annual Report. Our forward-looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures or strategic investments. In addition, any forward-looking statements represent our expectation only as of the day this Annual Report was first filed with the SEC and should not be relied on as representing our expectations as of any subsequent date. While we may elect to update forward-looking statements at some point in the future, we specifically disclaim any obligation to do so, even if our expectations change.

Although we believe that the expectations reflected in any of our forward-looking statements are reasonable, actual results could differ materially from those projected or assumed in any of our forward-looking statements. Our future financial condition and results of operations, as well as any forward-looking statements, are subject to change and to inherent risks and uncertainties, such as those disclosed in this Annual Report. Important factors that could cause our actual results, performance and achievements, or industry results to differ materially from estimates or projections contained in forward-looking statements include, among others, the following:

- . our relationship with our distributors;
- . our need to continually recruit new distributors;
- . our internal controls and accounting methods may require further modification;
- . regulatory matters governing our products and network marketing system;
- . adverse publicity associated with our products or network marketing organizations;
- . product liability claims;
- . our reliance on outside manufacturers;
- . risks associated with operating internationally, including foreign exchange risks;
- . product concentration;
- . dependence on increased penetration of existing markets;
- . the competitive nature of our business; and
- . our ability to generate sufficient cash to operate and expand our business.

Market data and other statistical information used throughout this report is based on independent industry publications, government publications, reports by market research firms or other published independent sources and on our good faith estimates, which are derived from our review of internal surveys and independent sources. Although we believe that these sources are reliable, we have not independently verified the information and cannot guarantee its accuracy or completeness.

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PART I

ITEM 1. BUSINESS.

We are Natural Health Trends Corp. ("NHTC" or "the Company"), an international network marketing organization. We control subsidiaries that

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distribute products through three separate direct selling networks that promote health, wellness and vitality. Lexxus International, Inc., our majority-owned subsidiary and other Lexxus subsidiaries (collectively, "Lexxus") sell certain cosmetic products as well as "quality of life" products, which constituted approximately ninety-six percent (96%) of our consolidated revenues in 2003. eKaire.com, Inc., our wholly-owned subsidiary ("eKaire"), distributes nutritional supplements aimed at general health and wellness. In 2003, we commenced the operations of I Luv My Pet, Inc., ("ILMP"), our wholly owned subsidiary that distributes nutritional supplements for dogs and cats. Lexxus commenced operations in January 2001 and has experienced tremendous growth, as we are currently conducting business in at least 30 countries through approximately 80,000 active distributors. While eKaire's business is significantly smaller, it has been in business since 2000 and is doing business in four countries through approximately 4,400 active distributors. Sales from ILMP were negligible since it commenced operations during the fourth quarter of 2003.

Total net sales for fiscal 2003 increased to approximately \$62.9 million from approximately \$37.0 million for fiscal 2002, an increase of approximately 70%. Income before discontinued operations for fiscal 2003 increased to approximately \$5.4 million from a loss of approximately \$261,000 for fiscal 2002. Net income for fiscal 2003 increased to approximately \$5.4 million from \$2.1 million for fiscal 2002, an increase of approximately 157%.

Through our subsidiaries, Lexxus, eKaire and ILMP, we seek to be a leader in the network marketing industry serving the health and wellness marketplace by driving our products into as many venues and into as many markets as possible through our multi-level marketing operations. Our objectives are to enrich the lives of the users of our products while enabling distributors to benefit financially from the sale of our products.

In March 2003, in order to enhance the price of our Common Stock and to enable us to better use our capital stock to compensate management and motivate employees, as well as consideration for future acquisition transactions, our stockholders approved and we effected a 1-for-100 reverse stock split with respect to our outstanding shares of Common Stock. As a result, on March 19, 2003, the number of outstanding shares of Common Stock declined from 462,873,100 to 4,628,731 and the closing price per share increased from \$0.01 on March 18, 2003 to \$1.50 on March 19, 2003, as reported on the OTC Bulletin Board. In addition, the trading symbol for the shares of our Common Stock changed from "NHTC" to "NHLC". All share references in this annual report will give effect to the reverse stock split. On March 31, 2004, the closing price per share as reported on the OTC Bulletin Board was \$18.27.

We maintain executive offices at 12901 Hutton Drive, Dallas, Texas 75234 and our telephone number is (972) 241-4080. Our website is located at www.naturalhealthtrends.com, but the information provided there should not be considered part of this Annual Report on Form 10-KSB.

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Recent Developments

Restatement of Previously Issued Financial Statements:

During the quarters ended September 30 and December 31, 2003, the Company re-evaluated its financial statements for the years ended December 31, 2002 and 2001, the quarterly periods included in such years and the quarterly periods ended March 31, June 30 and September 30, 2003. As a result of such review, the Company determined that it inadvertently applied the incorrect accounting treatment with respect to the following items (the "Restatement Items"):

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- (i) revenue recognition with respect to administrative enrollment fees;
- (ii) revenue cut-off between 2002 and 2003;
- (iii) accounts receivable reconciliation to supporting documents;
- (iv) reserves established for product returns and refunds;
- (v) the gain recorded in connection with the sale of a subsidiary in 2001;
- (vi) income tax provisions; and
- (vii) stock option based compensation.

Consequently, the Company is amending and restating its financial statements for each quarter in 2001, 2002 and 2003 as well as for the years ended December 31, 2001 and 2002.

In connection with the review of the Company's financial statements, the Company has revised its accounting treatment for administrative enrollment and membership fees received from distributors in accordance with the principles contained in Staff Accounting Bulletin No. 104, "Revenue Recognition", ("SAB 104") and related guidance. The Company determined that under SAB 104, such fees actually received and recorded as current sales in prior quarters should have been deferred and recognized as revenue on a straight-line basis over the twelve-month term of the membership. The restatement resulted in net sales for the year ended December 31, 2002 being decreased by approximately \$1,336,000. The restatement in net sales resulted in a corresponding adjustment to cost of sales for direct costs paid to a third party associated with the administrative enrollment fees received from distributors. Compared to amounts previously reported, the restatement decreased cost of sales by approximately \$336,000 for the year ended December 31, 2002.

The Company also reviewed its revenue cut-off as of the beginning of 2003. It was noted that approximately \$1,008,000 of sales originally recorded in 2002 were not actually shipped until early 2003. The restatement resulted in net sales for the quarter ended December 31, 2002 being decreased by \$1,008,000 and net sales for the quarter ended March 31, 2003 being increased by the same amount. The restatement also resulted in distributor commissions for the quarter ended December 31, 2002 being decreased by \$459,000 and distributor commissions for the quarter ended March 31, 2003 being increased by the same amount.

Also in connection with its review, the Company determined that its accounts receivable as of March 31 and June 30, 2003 did not reconcile in total to supporting details for such transactions. The restatement resulted in net sales being decreased by \$140,000 and \$260,000 as of March 31 and June 30, 2003, respectively.

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The Company had not recorded a reserve for distributor returns and refunds as of September 30, 2003 and for prior periods. Based upon analysis of the Company's historical returns and refund trends by country, it was determined that the reserves for returns and refunds for prior periods were required and should be recorded. The restatement resulted in net sales for the year ended December 31, 2002 being decreased by approximately \$350,000, with corresponding adjustments to cost of sales for the estimated cost of products returned.

In 2001, the Company sold all of the outstanding common stock in Kaire Nutraceuticals, Inc. ("Kaire"), a Delaware corporation and wholly-owned subsidiary of the Company, to an unrelated third party. The gain on the sale of Kaire was approximately \$3.1 million, a portion of which was previously deferred. The Company subsequently recognized into income approximately \$1.9 million from the transaction over the period from the fourth quarter of 2001 through the second quarter of 2003. Based upon a review of the transaction, the Company now believes the gain on sale of Kaire should have been recognized only

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in 2001 and 2002 and not in 2003. For the year ended December 31, 2002, the Company is now recognizing \$2,400,000 of gain on the sale of Kaire as Discontinued Operations and is reducing its Other Income by \$800,000.

The Company disclosed in its Annual Report on Form 10-KSB for the year ended December 31, 2002 that it had a net operating loss carry forward at December 31, 2002 of approximately \$6,000,000, subject to certain limitations. Consequently, the Company made no provision for income taxes for any period in 2002 or 2001. Upon further review, it has been determined that the available net operating loss was not expected to be sufficient to offset all of the domestic and foreign taxable income in 2002 or 2001 and that an estimated tax provision in the amount of \$300,000 was necessary for the year ended December 31, 2002.

The Company has determined that the stock options (the "Options") granted in January 2001 and October 2002 to senior executive officers of the Company should be accounted for as variable stock options due to the provision in the stock option plan that allowed the holder to exercise the stock option in an immaculate cashless fashion. The cashless exercise feature allows option holders to use the "in the money" value of the options (or the spread between the exercise price and the fair market price of the underlying shares as of the exercise date) as payment for all, or a portion, of the exercise price of an option. The Options were amended in November 2002 to require the option holder to obtain Company approval before the Option holder could use the cashless exercise feature. Subsequent to the modification, fixed option accounting will be applied to the options. Under variable accounting, changes in the intrinsic value of the stock option result in recording a charge or credit to stock based compensation expense. For the year ended December 31, 2002, the restatement resulted in \$1,434,000 being charged to stock option based compensation expense.

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The following table presents amounts from operations as previously reported and as restated (in thousands, except for per share data):

	Year Ended December	
	December 31, 2002	
	As Previously Reported	As Restated
Net sales	\$ 39,662	\$ 36,968
Cost of sales	7,391	6,985
Gross profit	32,271	29,983
Operating expenses	28,770	29,745
Income from operations	3,501	238
Other income (expense)	601	33
Income from continuing operations before taxes and minority interest	4,102	271
Income tax expense	-	(300)
Minority interest, net of taxes	-	(232)

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Income (loss) before discontinued operations	4,102	(261)
Gain from discontinued operations, net of taxes	-	2,400
Net income	4,102	2,139
Preferred stock dividends	70	70
Net income available to common stockholders	\$ 4,032	\$ 2,069
Basic income per common share:		
Continuing operations	\$ 1.29	\$ (0.11)
Discontinued operations	-	0.77
Net income	\$ 1.29	\$ 0.66
Diluted income per common share:		
Continuing operations	\$ 1.24	\$ (0.11)
Discontinued operations	-	0.77
Net income	\$ 1.24	\$ 0.66
Weighted average shares outstanding:		
Basic	3,118	3,118
Diluted	3,247	3,118

The adjustments in net sales, cost of sales, commission expense, stock based compensation expense, other income and income taxes resulted in a net decrease in income before discontinued operations of approximately \$4,363,000 from the amounts previously reported for the year ended December 31, 2002. Net income available to stockholders decreased by approximately \$1,963,000 from the amounts previously reported. Restated basic and diluted income per share from continuing operations decreased by \$1.40 and \$1.35, respectively, from the amounts previously reported for the year ended December 31, 2002. Net income for basic and diluted income per share decreased by \$0.63 and \$0.58, respectively, from the amounts previously reported for the year ended December 31, 2002. The cumulative effect of the restatements for 2001 and 2002 resulted in a net increase in accumulated deficit of approximately \$3,520,000 as of December 31, 2002.

Our Industry

We are engaged in the network marketing business, which is also referred to as multi-level marketing. This type of organizational structure and approach to marketing and sales has

proven to be extremely successful for several other multi-level marketing companies such as Amway Corp., Mary Kay, Inc., Nu Skin Enterprises and Herbalife. Generally, network marketing is based upon an organizational structure where independent distributors of a company's products are compensated for sales made directly to consumers. But, even more significantly, distributors are compensated for sales generated by distributors recruited by that distributor and all subsequent distributors recruited by their "down line" network of distributors. This can be very lucrative for individual distributors who develop extensive networks of distributors that sell company products as well as recruit additional distributors.

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According to information contained on the Direct Selling Association's website, network marketing is one of the fastest growing segments for the distribution of products on a worldwide basis. The Direct Selling Association reports that over 47 million individuals are now involved in direct selling worldwide (of which network marketing is a major segment), and that those involved in direct selling generate \$85 billion in annual sales around the world. In the United States, the direct selling channel has generated sales of approximately \$28.7 billion of goods and services in 2002, making the United States the largest direct selling market in the world.

We are presently marketing and selling lifestyle enhancement products through our Lexxus subsidiaries, nutraceutical products through our wholly owned eKaire subsidiary and pet nutraceuticals through our wholly owned ILMP subsidiary. It is important to note that once a sizeable network of distributors is established, alternative products and services can be offered to those distributors for sale to consumers and additional distributors. The successful introduction of new products can dramatically increase sales and profits for both distributors and the multi-level marketing organization.

Our Products

Lexxus

We offer several Lexxus branded lifestyle enhancement products:

. Skindulgence(TM) is a skin care system marketed as a "30-Minute Non-Surgical FaceLift" designed to create a more youthful appearance by helping to tone and firm facial muscles, by helping to diminish fine lines and wrinkles and by helping to improve skin tone and color. The facelift masque is coupled with a cleanser and moisturizer. It is currently Lexxus' fastest growing product accounting for approximately 49% of Lexxus' revenues in 2003.

. Alura(TM) is an intimacy creme designed to increase the sexual satisfaction of women and accounted for approximately 34% of Lexxus' revenues in 2003.

. LexLips(TM) is a lip enhancing gloss for women, designed to create the effect of fuller lips and to help reduce fine lines and wrinkles around the mouth.

. La Vie(TM) is a dietary supplement described as a non-alcoholic red wine. It is marketed as an energizing supplement containing aloe.

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. 180 DEG. Life System Carb-Blocker(TM) is marketed as a weight management product based upon over 30 years of research.

. Lexxus Premium Noni(TM) is a 100% organic dietary supplement drink, developed to help support the natural, optimum cell functions of the body.

Alura(TM) and Skindulgence(TM) are trademarks of Lexxus.

eKaire

We offer eKaire branded products, which are organized into five broad categories: reviving products; energizing products; enhancing products; optimizing products and renewing products.

Reviving Products

The eKaire reviving product line consists primarily of nutritional

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supplements based on antioxidants including Maritime Prime with Pycnogenol(R) and EnzoKaire Complete.

- . Maritime Prime with Pycnogenol(R) is a dietary supplement that contains Pycnogenol(R) which is designed to help maintain healthy circulation by strengthening capillary walls by protecting against free radical damage caused by stress, pollution and chemical additives, and by improving skin and collagen texture, elasticity and smoothness. Pycnogenol(R) is a patented extract from the bark of the Maritime Prime trees grown in southwestern France.
- . EnzoKaire Complete is a dietary supplement containing Enzogenol(TM), which is a natural antioxidant, intended to provide protection for cells against the effects of free radicals. It also increases energy and endurance, and slows the aging process. Enzogenol(TM) is derived from the bark of the New Zealand pine tree, Pinus radiata.

Most of the products in this product line are based on proprietary formulations in several combinations containing natural products including Pycnogenol (R) and Enzogenol(TM).

Energizing Products

The Kaire energizing product line consists primarily of natural stimulants designed to enhance and increase vitality and endurance both mentally and physically. Products in this category include Ginkgo Shield and Momentum.

- . Ginkgo Shield is intended to assist in mental alertness and to enhance the functioning of the circulatory system.
- . Momentum is intended to help increase and balance energy levels.

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Enhancing Products

The Kaire enhancing product line is designed to support an individual's overall health and includes such products as Immunol, Colloidal SilverKaire, Synerzyme, Osteo Formula, and Pro GSH 90 Plus.

- . Immunol is a shark liver oil based capsule, which is intended to aid the human immune system.
- . Colloidal Silverkaire is a solution of silver particles electro-magnetically suspended in deionized water that is intended to provide dietary support for the immune system.
- . Synerzyme is a combination of naturally occurring enzymes and trace minerals that is intended to enhance the efficacy of enzymes that assist the body with the breakdown and assimilation of various foods and fats.
- . Osteo Formula is a dietary supplement that contains calcium, which is intended to aid in bone strength and overall skeletal system health.
- . Pro GSH 90 Plus, a Whey Protein product, is a pharmaceutical-grade milk serum protein isolate designed to enhance the immune system.

Optimizing Products

The Kaire optimizing product line provides many of the basic vitamins and nutrients, which are missing in the typical adult diet, through products such as MSM Complex, Bio10 and Celltonic Plus(TM).

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- . MSM Complex is intended to support an increased production of collagen and elastin fibers and increases cell permeability.
- . Bio10 is a live source of all 12 lactobacillus bacteria, which is supposed to help improve digestion, and the process and absorption of nutrients.
- . Celltonic Plus(TM) is an organic mineral solution containing over 72 minerals and trace elements within an electrolyte drink designed to strengthen cells and aid in the natural healing process.

Renewing Products

The Kaire renewing product line consists of moisturizing products designed to soothe and refresh the skin. These products include Aloe Gel and DermaKaire with Pycnogenol(R).

- . Aloe Gel is a topical creme that soothes and refreshes the skin.
- . DermaKaire with Pycnogenol is a moisturizing, whole-leaf Aloe product combined with a powerful antioxidant intended to maintain healthy-looking skin.

Pycnogenol (R) and Enzogenol(TM) are trademarks of suppliers of eKaire.

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I Luv My Pet

We formed ILMP in August 2003, which currently operates only in the United States and Canada. ILMP offers quality of life products for pets. Billions of dollars are spent each year in the U.S. alone on pets and pet supplies, indicating the buyers' love for animals and the appreciation for their companionship and love. ILMP currently offers dog and cat nutritional supplements, and is researching additional cutting-edge products to expand the product offerings. In 2004, the Company intends to focus on developing the ILMP product line and network of distributors.

Sourcing of Products

We purchase finished goods from selected manufacturers and sell them directly to our distributors for their resale or personal consumption. All of our products are produced or provided by unaffiliated third-party suppliers located in the United States. We are heavily dependent upon two primary suppliers, one of which supplies our Skindulgence(TM) product line and the other of which supplies our Alura(TM) product line. We believe that, in the event we were unable to source products from these suppliers or the other important suppliers of our other products, we could replace these products or substitute similar ingredients in order to meet the product needs of our distributors.

For other products, we place orders for finished goods and manufacturing services to meet the demand of the market. These orders are based on price quotations and other terms obtained from selected manufacturers.

Research and Development

We believe that our ability to introduce new products increases our distributors' visibility and competitiveness within the marketplace. The executive management of NHTC and Lexxus devote a significant portion of their time in new product review and evaluation. In addition, we rely upon independent research consultants and our vendor's research and development staff for product

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research, development and formulation. We have incurred minimal research and development costs in the years ended December 31, 2003 and 2002.

Marketing and Distribution

Lexus, eKaire and ILMP are set up as direct selling companies using a network of distributors to sell products. Our distributors are independent contractors who purchase products directly from the respective subsidiary via the Internet for resale to retail consumers or for personal consumption. Distributors may elect to work on a full-time or a part-time basis. The growth of a distributor's business depends largely upon their ability to recruit a down-line and the popularity of our products in the marketplace.

Currently, we have distributors located in all fifty states, as well as the District of Columbia, Puerto Rico, Canada, Australia, New Zealand, Taiwan, Hong Kong, Singapore, Philippines, South Korea, Brazil, India and sixteen countries in eastern Europe, including Russia,

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in order to maximize our direct selling efforts. As of December 31, 2003, we have a physical presence in six of the top 20 direct selling markets in the world. We intend to pursue additional foreign markets in 2004.

To become a Lexus distributor, a person must accept an agreement (posted on our Lexus International website) to comply with our policies and procedures and to pay a nominal \$100 annual enrollment fee. To be considered "active", the distributor must order a minimum of \$100 of products each year. Lexus currently has approximately 80,000 active distributors.

To become an eKaire distributor, a person must sign an agreement (posted on our eKaire website) to comply with our policies and procedures. To be considered "active", the distributor must order a minimum of \$50 of products each year. eKaire currently has approximately 4,400 active distributors and customers.

To become an ILMP distributor, a person must accept an agreement (posted on our ILMP website) to comply with our policies and procedures and to pay a nominal \$49.50 annual enrollment fee. To be considered "active", the distributor must order a minimum of \$49.50 of products each year.

We pay commissions to qualified distributors based on sales volumes for each commission period. We believe, based upon our knowledge of our competitor's compensation plans, that we offer one of the highest commission payouts in the direct selling industry. We also believe that the uniqueness and efficacy of our products, combined with a high commission rate, creates a highly desirable business opportunity and work environment for our distributors. See "Compensation Plans".

Distributors generally pay for products by credit card in connection with orders placed through their own Internet page at www.mylexxus.com, www.mykaire.com or www.iluvmypet.com prior to shipment. Accordingly, we carry minimal accounts receivable and credit losses are historically nominal.

We regularly sponsor promotional meetings and participate in motivational training events in key cities around the world. These events are designed to inform prospective and existing distributors about both existing and new product lines as well as selling techniques. Distributors typically share their direct selling experiences, their individual selling styles and their recruiting methods at these promotional or training events. Prospective distributors are educated about the structure, dynamics and benefits of the

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network marketing industry. We are continually developing or updating our marketing strategies and programs to motivate our distributors. These programs are designed to increase distributors' monthly product sales and the recruiting of new distributors in their down-lines.

Sponsorship

We rely on our distributors to recruit and sponsor new distributors and to purchase our products. While we provide product samples, brochures and other sales materials, distributors are

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primarily responsible for recruiting and educating their new distributors with respect to products, the compensation plan and how to build a successful distributorship network.

The sponsoring of new distributors creates multiple levels in a network marketing structure. The persons that a distributor sponsors within the network are referred to as "downline" or "sponsored" distributors. If downline distributors also sponsor new distributors, they create additional levels within the structure, but their downline distributors remain in the same downline network as their original sponsoring distributor.

Sponsoring activities are not required of distributors and we do not pay any commissions for sponsoring new distributors. However, because of the financial incentives provided to those who succeed in building a distributor network that consumes and resells products, we believe that many of our distributors attempt, with varying degrees of effort and success, to sponsor additional distributors. Because they are seeking new opportunities for income, people are often attracted to become distributors after using our products and becoming regular customers or after attending introductory seminars. Once a person becomes a distributor, he or she is able to purchase products directly from us at wholesale prices via the Internet. The distributor is also entitled to sponsor other distributors in order to build a network of distributors and product users.

Compensation Plans

We believe that one of our key competitive advantages within the direct selling industry is our distributor compensation plan. Under our compensation plan, distributors are paid consolidated weekly commissions in the distributor's home country, in their local currency, for their own product sales and for product sales in that distributor's downline distributor network across all geographic markets. This "seamless" compensation plan enables a distributor located in one country to sponsor other distributors located in other countries where we do business.

Based upon management's knowledge of our competitors' distributor compensation plans, we believe that our compensation plan is among the most financially rewarding plans offered to distributors by any network marketing company. Currently, there are two fundamental ways in which our distributors can earn commissions:

- . Through retail markups on sales of products purchased by distributors at wholesale prices; and
- . Through a series of commissions paid on product sales.

Each of our products carries a specified number of sales volume points. Commissions are based on total personal and group sales volume points per sales

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period. Sales volume points are essentially based upon a percentage of a product's wholesale cost. As the distributor's business expands from successfully sponsoring other distributors who in turn expand their own businesses by sponsoring other distributors, the distributor receives yet higher commissions. In determining commissions, the number of levels of downline distributors included within the distributor's commissionable group increases as the number of distributorships directly below the distributor increases.

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Distributor Support

We are committed to providing a high level of support services tailored to the needs of our distributors in each marketplace we are serving. We attempt to meet the needs and build the loyalty of distributors by providing personalized distributor services and by maintaining a generous product return policy. See "Product Warranties and Returns". Because the majority of our distributors are working on a part-time basis and have only a limited number of hours each week to concentrate on their business, we believe that maximizing a distributor's efforts by providing effective distributor support has been, and will continue to be, important to our success.

Through training meetings, annual conventions, web-based messages, distributor focus groups, regular telephone conference calls and other personal contacts with distributors, we seek to understand and satisfy the needs of our distributors. Via our websites, we provide product fulfillment and tracking services that result in user-friendly and timely product distribution. Most of our offices maintain meeting rooms, which our distributors may utilize for training and sponsoring activities. Because of our efficient distribution system, we do not believe that most of our distributors maintain a significant inventory of our products.

To help maintain communication with our distributors, we offer the following support programs:

Touchtalk and Fax on Demand

Touchtalk is an automated telephone system that distributors can call 24 hours a day, 7 days a week, to receive reports on the sales activity of their organization and listen to selected messages on special offers, marketing program updates and product information. Certain information is also available via facsimile transmission to the distributor.

Teleconferences

Lexus, eKaire and ILMP hold teleconferences with company management and associate field leadership on various subjects such as technical product discussions, distributor organization building and management techniques.

Internet

We maintain websites at www.naturalhealthtrendscorp.com, www.ekaire.com, www.kaire.com, www.lexxusinternational.com, www.mylexxus.com, www.mykaire.com and www.iluvmypet.com. On each website, the user can read company news, learn more about various products, sign up to be a distributor, place orders, and track the fulfillment and delivery of their order.

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Product Literature

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We offer a variety of literature to distributors, including product catalogs, informational brochures, pamphlets and posters for individual products.

Toll Free Access

eKaire offers a toll free number, to place orders and to sponsor new distributors, but Lexxus offers these services only through its websites. Both eKaire and Lexxus offer "live" consumer support where a customer service representative can address general questions or concerns. ILMP currently offers customer support only via e-mail.

Broadcast Fax/Broadcast E-mail

Announcements about Lexxus, eKaire and ILMP are sent via facsimile and/or e-mail to all active distributors.

Technology and Internet Initiatives

We believe that the internet has become increasingly important to our business as more consumers communicate online and purchase products over the Internet as opposed to traditional retail and direct sales channels. As a result, we have committed significant resources to our e-commerce capabilities and the abilities of our distributors to take advantage of the Internet. Substantially all of our sales during 2003 occurred via the Internet. eKaire has a personalized website for its distributors to purchase products via the Internet at www.mykaire.com. Lexxus offers a global web page that allows a distributor to have a personalized website at www.mylexxus.com through which he or she can sell products in 30 global markets. In addition, ILMP has a personalized website for its distributors to purchase products via the Internet at www.iluvmpet.com.

Rules Affecting Distributors

We monitor regulations in each country in which we do business as well as the activity of distributors to ensure that our distributors comply with local laws. Our distributor policies and procedures establish the rules that distributors must follow in each country. We also monitor distributor activity in an attempt to provide our distributors with a "level playing field" so that one distributor may not be disadvantaged by the activities of another. We require our distributors to present products and business opportunities in an ethical and professional manner. Distributors further agree that their presentations to customers must be consistent with, and limited to, the product claims and representations made in our literature. Even though sponsoring activities can be conducted in many countries, our distributors may not conduct marketing activities outside of those countries in which we currently conduct business.

We require that we produce or pre-approve all sales aids used by distributors such as videotapes, audiotapes, brochures and promotional clothing. Further, distributors may not use any form of media advertising to promote products unless it is pre-approved by the Company. Products may be promoted only by personal contact or by literature produced or approved by us.

Distributors are not entitled to use our trademarks or other intellectual property without our prior consent.

Our compliance department systematically reviews reports of alleged

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distributor misbehavior. If we determine that a distributor has violated our distributor policies or procedures, we may terminate the distributor's rights completely. Alternatively, we may impose sanctions such as warnings, probation, withdrawal or denial of an award, suspension of privileges of the distributorship, fines, withholding commissions until specified conditions are satisfied or other appropriate injunctive relief. Our distributors are independent contractors who may resign/terminate their distributorship at any time without notice.

Competition

We compete with a significant number of other retailers that are engaged in similar lines of business, including sellers of health-related products and other direct sellers. Many of the competitors have greater name recognition and financial resources than us as well as many more distributors. The two most well known and established of the direct sellers are Mary Kay, Inc. and Amway Corp., each with over three million distributors worldwide. Other non-direct selling retailers with which we compete include retail pharmacies and health stores, such as General Nutrition Centers, and internet based companies, such as VitaminShoppe.com and drugstore.com. The market for nutritional supplements is rapidly growing and is highly competitive. The direct selling channel tends to sell products at a higher price compared to traditional retailers, which poses a degree of competitive risk. There is no assurance that we will continue to compete effectively against retail stores, internet based retailers or other direct sellers.

Seasonality

We believe that the recruitment of distributors and the general sales volume fluctuates on a pattern opposite of traditional retail sales. When retail stores have negligible or no sales growth, multi-level marketing sales tend to increase. Since most of our distributors operate as a home-based business, distributors tend to take "typical" vacations such as during summer and winter holidays, thus, decreasing our sales volume during such vacation periods.

Intellectual Property

In November 2001, the inventor of our Alura(TM) product, from whom we have a license to distribute Alura(TM), was awarded a patent for the formulation of that product.

Most of the eKaire, Lexxus and ILMP products are packaged under a "private label" arrangement. We have applied for trademark registration for names, logos and various product names in several countries into which eKaire and Lexxus are doing business or considering expanding into. We currently have approximately three trademark registrations in the United States and three trademark applications pending with the United States Patent and Trademark Office. Our registered trademarks expire or become renewable from 2007 to 2008 and we rely on common law trademark rights to protect our unregistered trademarks. These common law

trademark rights do not provide us with the same level of protection as afforded by a United States federal registration trademark. Common law trademark rights are limited to the geographic area in which the trademark is actually utilized, while a United States federal registration of a trademark enables the registrant to discontinue the unauthorized use of the trademark by a third party anywhere in the United States even if the registrant has never used the trademark in the geographic area where the trademark is being used, provided, however, that the unauthorized third party user has not, prior to the registration date, perfected

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its common law rights in the trademark within that geographic area.

Government Regulation

Direct Selling Activities

Direct selling activities are regulated by various federal, state and local governmental agencies in the United States and foreign countries. These laws and regulations are generally intended to prevent fraudulent or deceptive schemes often referred to as "pyramid" schemes, that compensate participants for recruiting additional participants irrespective of product sales, use high pressure recruiting methods and/or do not involve legitimate products. The laws and regulations in our current markets often:

- . impose cancellation/product return, inventory buy backs and cooling off rights for consumers and distributors;
- . require us or our distributors to register with governmental agencies;
- . impose reporting requirements; and
- . impose upon us requirements, such as requiring distributors to maintain levels of retail sales to qualify to receive commissions, to ensure that distributors are being compensated for sales of products and not for recruiting new distributors.

The laws and regulations governing direct selling are modified from time to time to address concern of regulators. For example, in South Korea new regulations were adopted that, among other things, restrict multi-level marketing companies from imposing certain personal sales quota to obtain or maintain distributorship or favorable compensation rates, modify product return requirements so that product must be returned within a shorter period of time, and require the companies to show sufficient insurance or guarantee to reimburse customers and/or distributors for cancelled or unfilled orders. We have had to make some modifications to our compensation plan and policies in order to be in compliance with some of these rules.

Based on research conducted in opening our existing markets, the nature and scope of inquiries from government regulatory authorities, and our history of operations in such markets to date, we believe that our methods of distribution are in compliance in all material respects with the laws and regulations relating to direct selling activities of the countries in which we currently operate. Even though we believe that laws governing direct selling are generally becoming more permissive, many countries currently have laws in place that would prohibit us

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from conducting business in such markets. There can be no assurance that we will be allowed to continue to conduct business in each of our existing markets that we currently service or any new market we may enter in the future.

Regulation of Our Products

Our products and related promotional and marketing activities are subject to extensive governmental regulation by numerous domestic and foreign governmental agencies and authorities, including the FDA, the FTC, the Consumer Product Safety Commission, the United States Department of Agriculture, State Attorneys General and other state regulatory agencies, and similar government agencies in each country in which we operate. For example, in Taiwan, all

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"medicated" cosmetic and pharmaceutical products require registration. These regulations can limit our ability to import products into new markets and can delay introductions of new products into existing markets as we comply with the registration and approval process for our products.

Some of our products are strictly regulated in some of the markets in which we operate. These markets have varied regulations that apply to and distinguish nutritional health supplements from "drugs" or "pharmaceutical products." For example, the FDA of the United States under the Federal Food, Drug and Cosmetic Act regulates our products. The Federal Food, Drug and Cosmetic Act has been amended several times with respect to nutritional supplements, most recently by the Nutrition Labeling and Education Act and the Dietary Supplement Health and Education Act. The Dietary Supplement Health and Education Act establishes rules for determining whether a product is a dietary supplement. Under this statute, dietary supplements are regulated more like foods than drugs, are not subject to the food additive provisions of the law, and are generally not required to obtain regulatory approval prior to being introduced to the market. None of this limits, however, the FDA's power to remove an unsafe substance from the market. In the event a product, or an ingredient in a product, is classified as a drug or pharmaceutical product in any market, we will generally not be able to distribute that product in that market through our distribution channel because of strict restrictions applicable to drug and pharmaceutical products.

Most of our existing major markets also regulate product claims and advertising regarding the types of claims and representations that can be made regarding the efficacy of products, particularly dietary supplements. Accordingly, these regulations can limit our ability and that of our distributors to inform consumers of the full benefits of our products. For example, in the United States, we are unable to make any claim that any of our nutritional supplements will diagnose, cure, mitigate, treat or prevent disease. The Dietary Supplement Health and Education Act, however, permits only substantiated, truthful and non-misleading statements of nutritional support to be made in labeling, such as statements describing general well-being resulting from consumption of a dietary ingredient or the role of a nutrient or dietary ingredient in affecting or maintaining a structure or a function of the body. In addition, all product claims must be substantiated.

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Other Regulatory Issues

As a company incorporated in the United States and operating through subsidiaries in foreign jurisdictions, we are subject to foreign exchange control and transfer pricing laws that regulate the flow of funds between our subsidiaries and us for product purchases, management services and contractual obligations such as the payment of distributor commissions.

Product Warranties and Returns

Lexxus

The Lexxus refund policies and procedures closely follow industry and country standards which vary greatly by country. For example, in the United States, the Direct Marketing Association recommends that network marketers permit returns during the twelve-month period following the sale while in Hong Kong the return policy is as short as 14 days following the sale. We have conformed our return policies to comply with local laws or the recommendation of the local direct marketing association. In most cases, distributors may return unopened product that is in resalable condition for a partial refund. Lexxus must be notified of the return in writing and such written requests will be

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considered a termination notice of the distributorship.

eKaire

eKaire product warranties and refund policies are similar to those of other companies in the industry. If a distributor is not satisfied with the product then he/she can return the product to eKaire for a full refund within ninety (90) days of the first time the product was purchased. A distributor may return or exchange products that are unopened and in resalable condition thirty (30) days after the date of purchase.

ILMP

If a distributor is not satisfied with the product then he/she can return the product to ILMP within thirty (30) days of the date of the first purchase of a product for a full refund (less shipping and handling). A distributor may return or exchange products that are unopened and in resalable condition thirty (30) days after the date of subsequent purchases.

Management Information Systems

We utilize third parties to process all distributor orders and to calculate distributor commission payments. Both Lexxus and ILMP use Marketvision Communications Corp. to maintain their web-based system to process orders, to communicate volume and commissions to its distributors.

The eKaire commission system provides each associate with a detailed monthly accounting of all sales and recruiting activity. These statements eliminate the need for substantial record keeping on behalf of the distributor.

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Insurance

NHTC currently carries general liability insurance in the amount of \$1,000,000 per occurrence and \$2,000,000 in the aggregate as well as international and other insurance coverages. However, we do not carry product liability insurance, but believe that we are covered by the insurance maintained by our principal suppliers. There can be no assurance, however, that product liability insurance will be available, and if available, that it will be sufficient to cover potential claims or that an adequate level of coverage will be available in the future at a reasonable cost, if at all. A successful product liability claim could have a material adverse affect on our business, financial condition and results of operations.

Employees

The combined total of employees for our company, including the employees of our foreign subsidiaries is 148 at December 31, 2003, including 36 management, 7 administrative assistants, 16 warehouse employees, and 89 "general operations" employees, which includes employees in customer service and administrative roles. 142 employees are full-time and 6 are considered part-time. None of the employees are represented by a union, and we believe that our employee relations are good.

Corporate History

In January 2002, we incorporated MyLexxus Europe AG, a corporation organized under the laws of Switzerland and our majority-owned subsidiary ("MyLexxus Europe"). This company managed the sales of product into sixteen eastern European countries, including Russia. In November 2003, the operations

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of MyLexxus Europe AG were discontinued and new business activities were commenced in a new company, KGC Networks Pte. Ltd. ("KGC"), a corporation organized under the laws of Singapore. Effective as of November 17, 2003, we own 51% of the outstanding capital stock of KGC. The operations of KGC have been included in the consolidated statement of operations since inception.

In March 2002, we incorporated Lexxus International Co., Ltd., a corporation organized under the laws of Hong Kong and our wholly-owned subsidiary ("Lexxus Hong Kong") which does business in Hong Kong. The operations of Lexxus Hong Kong have been included in the consolidated statement of operations since inception.

In April 2002, we incorporated MyLexxus Personal Care International (India) Pvt. Ltd., a corporation organized under the laws of India and our majority-owned subsidiary ("MyLexxus India") which does business in India. The operations of MyLexxus India have been included in the consolidated statement of operations since inception.

In June 2002, we incorporated Lexxus Marketing Pte. Ltd., a corporation organized under the laws of Singapore and our majority-owned subsidiary ("Lexxus Singapore"), which does business in Singapore. The operations of Lexxus Singapore have been included in the consolidated statement of operations since inception.

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In November 2002, we incorporated Lexxus International Network Marketing, Inc., a corporation organized under the laws of the Philippines and our majority-owned subsidiary ("Lexxus Philippines"), which does business in the Philippines. The operations of Lexxus Philippines have been included in the consolidated statement of operations since inception.

In June 2003, we incorporated Lexxus Korea Co., Ltd. (South Korea), a corporation organized under the laws of South Korea and our wholly-owned subsidiary ("Lexxus Korea"), which does business in South Korea. The operations of Lexxus Korea have been included in the consolidated statement of operations since inception.

In August 2003, we incorporated I Luv My Pet, Inc. ("ILMP") as a wholly-owned subsidiary. ILMP is in the business of selling pet nutraceuticals. The operations of ILMP have been included in the consolidated statement of operations since inception.

Risk Factors

In addition to other information in this Annual Report, the following important factors should be carefully considered in evaluating the Company and its business because such factors currently have a significant impact on the Company's business, prospects, financial condition and results of operations.

Risks Related to Our Business:

Our Failure To Maintain and Expand Our Distributor Relationships Could Adversely Affect Our Business. We distribute our products through independent distributors, and we depend upon them directly for all of our sales. Accordingly, our success depends in significant part upon our ability to attract, retain and motivate a large base of distributors. Our multi-level marketing organization is headed by a relatively small number of key "master" distributors responsible for a significant percentage of total sales, including, in some cases, sales in several different countries. The loss of a significant number of distributors, including any "master" distributors, could materially

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and adversely affect sales of our products and could impair our ability to attract new distributors. Moreover, the replacement of distributors could be difficult because, in our efforts to attract and retain distributors, we compete with other network marketing organizations, including those in the personal care and cosmetic product industries. Our distributors may terminate their services with us at any time and, in fact, like many network-marketing organizations, we have a high rate of attrition.

If The Number Or Productivity Of Independent Distributors Does Not Increase, Our Revenue Will Not Increase. To increase revenue, we must increase the number and/or the productivity of our distributors. We can provide no assurances that distributor numbers will increase or remain constant or that their productivity will increase. We experienced a 113% and 33% increase in active distributors during 2003 and 2002, respectively. The number of active distributors may not increase and could decline in the future. Distributors may terminate their services at any time, and, like most direct selling companies, we experience a high turnover among distributors from year to year. We cannot accurately predict any fluctuation in the number and productivity of distributors because we primarily rely upon existing distributors to sponsor

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and train new distributors and to motivate new and existing distributors. Operating results could be adversely affected if our existing and new business opportunities and products do not generate sufficient economic incentive or interest to retain existing distributors and to attract new distributors.

As We Continue To Expand Into Foreign Markets Our Business Becomes Increasingly Subject To Political And Economic Risks. Changes In These Markets Could Adversely Affect Our Business. We commenced operations in Canada, Australia, New Zealand and Taiwan in 2001, Europe and Russia, Hong Kong, India, Singapore and the Philippines in 2002 and South Korea in 2003. In 2004, we anticipate commencing operations in Mexico. We believe that our ability to achieve future growth is dependent in part on our ability to continue our international expansion efforts. However, there can be no assurance that we will be able to grow in our existing international markets, enter new international markets on a timely basis, or that new markets will be profitable. We must overcome significant regulatory and legal barriers before we can begin marketing in any foreign market. Also, before marketing commences it is difficult to assess the extent to which our products and sales techniques will be accepted or successful in any given country. In addition to significant regulatory barriers, we may also encounter problems conducting operations in new markets with different cultures and legal systems from those encountered elsewhere. We may be required to reformulate certain of our products before commencing sales in a given country. Once we have entered a market, we must adhere to the regulatory and legal requirements of that market. No assurance can be given that we will be able to successfully reformulate our products in any of our current or potential international markets to meet local regulatory requirements or attract local customers. The failure to do so would have a material adverse effect on our business, financial condition, and results of operations. There can be no assurance that we will be able to obtain and retain necessary permits and approvals or that we will have sufficient capital to finance our expansion efforts in a timely manner. In many market areas, other network marketing companies already have significant market penetration, the effect of which could be to desensitize the local distributor population to a new opportunity, or to make it more difficult for us to recruit qualified distributors. There can be no assurance that, even if we are able to commence operations in foreign countries, there will be a sufficiently large population of persons inclined to participate in a network marketing system, such as ours. We believe our future success will depend in part on our ability to seamlessly integrate our distributor compensation plan across all markets in which our products are sold. There can

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be no assurance that we will be able to further develop and maintain a seamless compensation program.

An Increase In The Amount Of Compensation Paid To Distributors Would Reduce Profitability. A significant expense is the payment of compensation to our distributors. We compensate our distributors by paying commissions, bonuses, and certain awards and prizes. Management closely monitors the amount of compensation to distributors paid as a percentage of net sales and may need to adjust our compensation plan to prevent distributor compensation from having a significant adverse effect on earnings. There can be no assurance that these changes or future changes to our compensation plan or product pricing will be successful in maintaining the level of distributor compensation expense as a percentage of net sales. Furthermore, these changes may make it difficult to recruit and retain qualified and motivated distributors. An

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increase in compensation payments to distributors as a percentage of net sales would reduce our profitability.

Internal Controls and Accounting Methods May Require Further Modification. The Company has recently modified certain of its accounting policies and made other adjustments to the accounting for past transactions, which resulted in the restatement of the Company's financial statements for each quarter in 2001, 2002, and 2003 as well as for the years ended December 31, 2001 and 2002. See the discussion of the Restatement of Previously Issued Financial Statements on page 3. In connection with the restatement of its financial statements and the audit of the Company's financial statements for the year ended December 31, 2003, the Company has been informed by its independent auditors that many of the restatement items are the result of material weaknesses in the Company's internal controls and procedures. The Company believes that it has implemented new controls and procedures and plans to implement additional controls and procedures sufficient to accurately report our financial performance on a timely basis in the foreseeable future. If we are unable to implement these additional controls and procedures, we may not be able to accurately report our financial performance on a timely basis and our business and stock price would be adversely affected. In addition, we may be unable to achieve Section 404 certification as mandated by the Sarbanes-Oxley Act.

We Rely On And Are Subject To Risks Associated With Our Reliance Upon Information Technology Systems. Our success is dependent on the accuracy, reliability, and proper use of sophisticated and dependable information processing systems and management information technology. Our information technology systems are designed and selected in order to facilitate order entry and customer billing, maintain distributor records, accurately track purchases and compensation payments, manage accounting and finance operations, generate reports, and provide customer service and technical support. Any interruption in these systems could have a material adverse effect on our business, financial condition, and results of operations.

Taxation And Transfer Pricing Considerations Affect Our Foreign Operations. Our principal domicile is the United States. Under tax treaties, we are eligible to receive foreign tax credits in the United States for taxes actually paid abroad. As our operations expand outside the United States, taxes paid to foreign taxing authorities may exceed amounts of the credits available to us, resulting in the payment of a higher overall effective tax rate on our worldwide operations. We have adopted transfer pricing agreements with our subsidiaries to regulate intercompany transfers, which agreements are subject to transfer pricing laws that regulate the flow of funds between the subsidiaries and the parent corporation for product purchases, management services, and contractual obligations, such as the payment of distributor compensation. If the United

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States Internal Revenue Service or the taxing authorities of any other jurisdiction were to successfully challenge these agreements or require changes in our transfer pricing practices, we could be required to pay higher taxes and our earnings would be adversely affected. We believe that we operate in compliance with all applicable transfer pricing laws. However, there can be no assurance that we will continue to be found to be operating in compliance with transfer pricing laws, or that those laws will not be modified, which, as a result, may require changes in our operating procedures.

Our Lexxus Subsidiaries Have a Limited Operating History Which May Not be Indicative of Future Performance. Although our Lexxus subsidiaries accounted for approximately 96% of

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our total revenues during fiscal 2003, it has only been operating since January 2001, and therefore, is in the early stage of its development. Our business and prospects must be considered in light of the risk, expense and difficulties frequently encountered by companies in an early stage of development, particularly companies in new and rapidly evolving international markets. If we are unable to effectively allocate our resources and help grow our Lexxus subsidiary, our stock price may be adversely affected and we may be unable to execute our strategy of expanding our network of distributors. Our business depends upon the performance of our Lexxus subsidiaries and, due to its relatively short operating history, past performance may not be indicative of future results.

Regulatory Matters Governing Our Industry Could Have A Significant Negative Effect On Our Business. In both our United States and foreign markets, we are affected by extensive laws, governmental regulations, administrative determinations, court decisions and similar constraints. Such laws, regulations and other constraints may exist at the federal, state or local levels in the United States and at all levels of government in foreign jurisdictions.

Product Regulations.

The formulation, manufacturing, packaging, labeling, distribution, importation, sale and storage of certain of our products are subject to extensive regulation by various federal agencies, including the Food and Drug Administration ("FDA"), the Federal Trade Commission (the "FTC"), the Consumer Product Safety Commission and the United States Department of Agriculture and by various agencies of the states, localities and foreign countries in which our products are manufactured, distributed and sold. Failure by our distributors or us to comply with those regulations could lead to the imposition of significant penalties or claims and could materially and adversely affect our business. In addition, the adoption of new regulations or changes in the interpretations of existing regulations may result in significant compliance costs or discontinuation of product sales and may adversely affect the marketing of our products, resulting in significant loss of sales revenues.

Product Claims, Advertising And Distributor Activities.

Our failure to comply with FTC or state regulations, or with regulations in foreign markets that cover our product claims and advertising, including direct claims and advertising by us, as well as claims and advertising by distributors for which we may be held responsible, may result in enforcement actions and imposition of penalties or otherwise materially and adversely affect the distribution and sale of our products. Distributor activities in our existing markets that violate applicable governmental laws or regulations could result in governmental or private actions against us in markets where we operate. Given the size of our distributor force, we cannot assure that our distributors will comply with applicable legal requirements.

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Network Marketing System.

Our network marketing system is subject to a number of federal and state regulations administered by the FTC and various state agencies as well as regulations in foreign markets administered by foreign agencies. Regulations applicable to network marketing organizations generally are directed at ensuring that product sales ultimately are made to consumers and that advancement within the organizations is based on sales of the organizations' products rather than investments in the organizations or other non-retail sales related criteria. We are subject to the

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risk that, in one or more markets, our marketing system could be found not to be in compliance with applicable regulations. The failure of our network marketing system to comply with such regulations could have a material adverse effect on our business in a particular market or in general.

We are also subject to the risk of private party challenges to the legality of our network marketing system. The regulatory requirements concerning network-marketing systems do not include "bright line" rules and are inherently fact-based. An adverse judicial determination with respect to our network marketing system, or in proceedings not involving us directly but which challenge the legality of other multi-level marketing systems, could have a material adverse effect on our business.

Transfer Pricing And Similar Regulations.

In many countries, including the United States, we are subject to transfer pricing and other tax regulations designed to ensure that appropriate levels of income are reported as earned by our United States or local entities and are taxed accordingly. In addition, our operations are subject to regulations designed to ensure that appropriate levels of customs duties are assessed on the importation of our products.

Taxation Relating To Distributors.

Our distributors are subject to taxation, and in some instances legislation or governmental agencies impose an obligation on us to collect the taxes, such as value added taxes, and to maintain appropriate records. In addition, we are subject to the risk in some jurisdictions of being responsible for social security and similar taxes with respect to our distributors.

Other Regulations.

We are also subject to a variety of other regulations in various foreign markets, including regulations pertaining to employment and severance pay requirements, import/export regulations and antitrust issues. Our failure to comply, or assertions that we fail to comply, with these regulations could have a material adverse effect on our business in a particular market or in general.

To the extent we decide to commence or expand operations in additional countries, government regulations in those countries may prevent or delay entry into or expansion of operations in those markets. In addition, our ability to sustain satisfactory levels of sales in our markets is dependent in significant part on our ability to introduce additional products into the markets. However, government regulations in both our domestic and international markets can delay or prevent the introduction, or require the reformulation or withdrawal, of some of our products.

Currency Exchange Rate Fluctuations Could Lower Our Revenue And Net Income. In 2003, we recognized approximately 83% of our revenue in non-United States markets. We purchase all inventory in the United States in United States dollars. In preparing our consolidated financial statements, we translate revenue and expenses in foreign countries from their local currencies into

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United States dollars using the average exchange rates for the period. The effect of the translation of the Company's foreign operations are included in accumulated other comprehensive income within stockholder's equity and such do not impact the statement of

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operations. Given our inability to predict the degree of exchange rate fluctuations, we cannot estimate the effect these fluctuations may have upon future reported results, product pricing or our overall financial condition. Further, to date we have not attempted to reduce our exposure to short-term exchange rate fluctuations by using foreign currency exchange contracts.

If We Are Unable To Expand Operations In Any Of The New Markets We Have Currently Targeted, We May Have Difficulty Achieving Our Long-Term Objectives. A significant percentage of our revenue growth over the past three years has been attributable to our expansion into new markets. For example, the revenue growth we experienced in 2002 and 2003 was due in part to our successful expansion of operations into Hong Kong, Russia and South Korea. Moreover, our growth over the next several years depends on our ability to successfully introduce our products and our distribution system into new markets. We could face regulatory difficulties in accessing these new markets. If we are unable to successfully expand our operations into these new markets, our opportunities to grow our business may be limited, and as a result, we may not be able to achieve our long-term objectives.

Adverse Publicity Concerning Our Business, Marketing Plan Or Products Could Harm Our Business And Reputation. The size of our distribution force and the results of our operations can be particularly impacted by adverse publicity regarding us, the legality of our distributor network, our products or the actions of our distributors. Specifically, we are susceptible to adverse publicity concerning:

- . The legality of network marketing;
- . The safety of the ingredients found in our products or our competitor's products;
- . Regulatory investigations of us, our competitors and our respective products;
- . The actions of our current or former distributors; and
- . Public perceptions of direct selling businesses in general.

In addition, in the past certain network marketing companies have experienced negative publicity in connection with regulatory investigations and inquiries that has harmed the network marketing industry in general. We, or one or more of our network-marketing competitors, may receive negative publicity in the future and it may harm our business and reputation.

Although Our Distributors Are Independent Contractors, Improper Distributor Actions That Violate Laws Or Regulations Could Harm Our Business. Distributor activities that violate governmental laws or regulations could result in governmental actions against us in markets where we operate. Our distributors are not employees and act independently of us. Some of our distributors may be doing business in countries without proper registration or authority to do so. We implement strict policies and procedures to ensure our distributors comply with applicable legal requirements. However, given the size and diversity of our distributor force, we experience problems with distributors from time to time. Distributors often desire to enter a market before we have received approval to do business in order to gain an advantage in the marketplace. Improper distributor activity in new geographic markets could result in adverse publicity and can be particularly harmful to our ability to ultimately enter these markets.

Failure Of New Products To Gain Distributor And Market Acceptance Could Harm Our Business. An important component of our business is our ability to develop new products that create enthusiasm among our distributor force. If we fail to introduce new products on a timely basis, our distributor productivity could be harmed. In addition, if any new products fail to gain market acceptance, are restricted by regulatory requirements, or have quality problems, this would harm our results of operations. Factors that could affect our ability to continue to introduce new products include, among others, limited capital resources, government regulations, proprietary protections of competitors that may limit our ability to offer comparable products and any failure to anticipate changes in consumer tastes and buying preferences.

The Loss Of Key High-Level Distributors Could Negatively Impact Our Distributor Growth And Our Revenue. For Lexxus and eKaire, we have approximately 84,400 total active distributors and 3,100 total senior level distributors. These senior level distributors, together with their extensive networks of downline distributors, account for substantially all of our revenue. As a result, the loss of a senior level distributor or a group of leading distributors in the distributor's network of downline distributors whether by their own choice or through disciplinary actions by us for violations of our policies and procedures could negatively impact our distributor growth and our revenue.

Increases In Duties On Our Imported Products In Our Non-United States Markets Could Reduce Our Revenue And Harm Our Competitive Position. Historically, we have imported most of our products into the countries in which they are ultimately sold. These countries impose various legal restrictions on imports and typically impose duties on our products. In any given country, regulators may increase duties on imports and, as a result, reduce our profitability and harm our competitive position relative to locally produced goods. In some countries government regulations may prevent importation of our products altogether or require us to locally manufacture or source a significant portion of our products.

System Failures Could Harm Our Business. Because of our diverse geographic operations and our seamless distributor compensation plan, our business is highly dependent on efficiently functioning information technology systems provided by Marketvision Communications Corp. The Marketvision systems and operations are vulnerable to damage or interruption from fires, earthquakes, telecommunications failures, computer viruses and worms, software defects and other events. They are also subject to break-ins, sabotage, acts of vandalism and similar misconduct. Despite precautions implemented by the staff of Marketvision, problems could result in interruptions in services and materially and adversely affect our business, financial condition and results of operations.

Because Of Our Dependence Upon Consumer Perceptions, Adverse Publicity Associated With Harmful Effects Resulting From The Consumption Of Our Products, Or Any Similar Products Distributed By Other Companies, Could Have A Material Adverse Effect On Us. Because we are highly dependent upon consumers' perception of the safety and quality of our products as well as similar products distributed by other companies, we could be adversely affected if any of our products or any similar products distributed by other companies prove to be, or are asserted to be, harmful to consumers. Also, because of our dependence upon consumer perceptions, any adverse publicity associated with illness or other adverse effects resulting from

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consumers' use or misuse of our products or any similar products distributed by other companies could have a material adverse impact on us. Adverse publicity could also negatively affect our ability to attract, motivate and retain distributors.

We Do Not Have Product Liability Insurance And Product Liability Claims Could Hurt Our Business. Currently, we do not have product liability insurance, although the insurance carried by our suppliers may cover certain product liability claims against us. Nevertheless, we do not conduct or sponsor clinical studies of our products. As a marketer of nutraceuticals, cosmetic lotions and other products that are ingested by consumers or applied to their bodies, we may become subjected to various product liability claims, including that: (i) our products contain contaminants; (ii) our products include inadequate instructions as to their uses; or (iii) our products include inadequate warnings concerning side effects and interactions with other substances. Especially since we do not have direct product liability insurance, it is possible that product liability claims and the resulting adverse publicity could negatively affect our business. If our suppliers' product liability insurance fails to cover product liability claims, or such claims exceed the amount of coverage provided by such policies, we could be required to pay substantial monetary damages which could materially harm our business, financial condition and results of operations. As a result, we may become required to pay higher premiums and accept higher deductibles in order to secure adequate insurance coverage in the future.

We Do Not Manufacture Our Own Products So We Must Rely On Independent Third Parties For The Manufacture And Supply Of Our Products. All of our products are manufactured by outside third parties. There is no assurance that these outside manufacturers will continue to reliably supply products to us at the level of quality we require. In the event any of our third-party manufacturers were to become unable or unwilling to continue to provide the products in required volumes and quality levels, we would be required to identify and obtain acceptable replacement manufacturing sources. There is no assurance that we will be able to obtain alternative manufacturing sources on a timely basis. An extended interruption in the supply of our products could result in a substantial loss of sales. In addition, any actual or perceived degradation of product quality as a result of our reliance on third party manufacturers may have an adverse effect on sales or result in increased product returns and buybacks.

A Large Portion Of Our Sales Is Concentrated In A Small Number Of Countries. Our earnings in future periods may be susceptible to various risks because of the concentration of our sales in a small number of countries. Of the thirty countries in which we operated as of December 31, 2003, the United States, Canada, Hong Kong, Russia, South Korea and Taiwan, accounted for approximately 96% of our total sales for the year ended December 31, 2003. As a result, our future performance is dependent upon government regulation, economic conditions and consumer demand for our products in these six countries.

Two Of Our Products Constitute A Significant Portion Of Our Sales. Our Skindulgence(TM) and Alura(TM) products constitute a significant portion of our retail sales, accounting for approximately 49% and 34%, respectively, of our total sales in fiscal 2003. If demand for either of these products decreases significantly, government regulation restricts the sale of these products, we are unable to adequately source or deliver these products, or we cease offering

either of these products for any reason without a suitable replacement, our business, financial condition and results of operations could be materially and adversely effected.

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Our Ability To Grow In The Future Will Be More Dependent On Increased Penetration Of Existing Markets Than New Market Openings, Relative To Past Years; As A Result, Our Business Will Be Adversely Affected If We Are Unable To Successfully Increase Existing Market Penetration. During the past two years Lexxus has expanded principally by entering into new markets and introducing new products. Because we have already succeeded in entering into many of the most attractive markets for our products and distribution system, an increasingly important part of our strategy for continued growth is to increase the number and range of our products available in our existing markets. In addition, our future growth will depend upon improved training and other activities that enhance distributor retention in our existing markets. We cannot assure that our efforts to increase our market penetration in our existing markets will be successful.

We May Not Properly Manage Our Growth. Our success has been, and will continue to be, significantly dependent on our ability to manage rapid growth through expansions and enhancements of our worldwide personnel and management, order processing and fulfillment, inventory and shipping systems and other aspects of operations. As we continue to expand our operations, the ability to manage this growth will represent an increasing challenge and our failure to properly manage this growth may materially and adversely affect our results of operation.

The High Level Of Competition In Our Industry Could Adversely Affect Our Business. The business of marketing nutraceutical and lifestyle enhancement products is highly competitive. This market segment includes numerous manufacturers, distributors, marketers, and retailers that actively compete for the business of consumers both in the United States and abroad. The market is highly sensitive to the introduction of new products, which may rapidly capture a significant share of the market. Although we are the exclusive distributor of the Alura(TM) product in the network marketing segment, we cannot be sure that another company will not replicate, or market similar products. Sales of similar products by competitors may materially and adversely affect our business, financial condition and results of operations.

We are subject to significant competition for the recruitment of distributors from other network marketing organizations, including those that market similar products as well as other types of products. Most of our competitors are substantially larger than we are, offer a wider array of products, have far greater financial resources and many more active distributors than we have. Our ability to remain competitive depends, in significant part, on our success in recruiting and retaining distributors through an attractive compensation plan and other incentives. We believe that our compensation and incentive programs provide our distributors with significant earning potential. However, we cannot be sure that our programs for recruitment and retention of distributors will be successful.

Terrorist Attacks Or Acts Of War May Seriously Harm Our Business. Terrorist attacks or acts of war may cause damage or disruption to our company, our employees, our facilities and our customers, which could impact our revenues, expenses and financial condition. The terrorist

attacks that took place in the United States on September 11, 2001 were unprecedented events that have created many economic and political uncertainties, some of which may materially and adversely affect our business, results of operations, and financial condition. The potential for future terrorist attacks, the national and international responses to terrorist attacks, and other acts of war or hostility have created many economic and political uncertainties, which could materially and adversely affect our business, results of operations, and financial condition in ways that we

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currently cannot predict.

A General Economic Downturn May Reduce Our Revenues. Worldwide economic conditions may adversely affect demand for our products. Consumer purchases of our products may decline during recessionary periods and also may decline at other times when disposable income is lower.

Loss Of Key Personnel Could Adversely Affect Our Business. Our future success depends to a significant degree on the skills, experience and efforts of Mark D. Woodburn, our President and Chief Financial Officer, and Terry LaCore, the Chief Executive Officer of Lexxus. The loss of the services of either Mr. Woodburn or Mr. LaCore could have a material adverse effect on our business, results of operations and financial condition. We also depend on the ability of our executive officers and other members of senior management to work effectively as a team. The loss of one or more of our executive officers and other members of senior management could have a material adverse effect on our business, results of operations and financial condition.

We May Be Unable To Protect Our Proprietary Technology Rights. Our success depends to a significant degree upon the protection of the Marketvision licensed software and other proprietary technology rights. We rely on trade secret, copyright and trademark laws and confidentiality agreements with employees and third parties, all of which offer only limited protection. Moreover, the laws of other countries in which we market our products may afford little or no effective protection of our proprietary technology. The reverse engineering unauthorized copying or other misappropriation of our proprietary technology could enable third parties to benefit from our technology without paying us for it. This could have a material adverse effect on our business, operating results and financial condition. If we resort to legal proceedings to enforce our intellectual property rights, the proceedings could be burdensome and expensive and could involve a high degree of risk.

Our Use Of The "Alura" or "Lexxus" Trademarks May Infringe The Trademark Rights Of Other Companies. Our use of "Alura" or "Lexxus" as well as the use of other names, may result in costly litigation, divert management's attention and resources, cause product shipment delays or require us to pay damages and/or to enter into royalty or license agreements to continue to use a product name. We may be required to stop using the name "Alura" or "Lexxus". Any of these events could have a material adverse effect on our business, operating results and financial condition.

Risks Related To Our Common Stock:

Disappointing Quarterly Revenue Or Operating Results Could Cause The Price Of Our Common Stock To Fall. Our quarterly revenue and operating results are difficult to predict and

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may fluctuate significantly from quarter to quarter. If our quarterly revenue or operating results fall below the expectations of investors or securities analysts, the price of our common stock could fall substantially.

Our Common Stock Is Particularly Subject To Volatility Because Of The Industry That We Are In. The stock market in general has experienced extreme price and volume fluctuations. In addition, the market prices of securities of network marketing companies, have been extremely volatile, and have experienced fluctuations that have often been unrelated or disproportionate to the operating performance of such companies. These broad market fluctuations could adversely affect the market price of our common stock.

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Future Sales By the Company or Existing Security Holders Could Depress The Market Price Of Our Common Stock. If the Company or our existing stockholders sell a large number of shares of our common stock, the market price of the common stock could decline significantly. Further, even the perception in the public market that the Company or our existing stockholders might sell shares of common stock could depress the market price of the common stock.

There Are Risks Associated With Our Stock Trading On The NASD OTC Bulletin Board Rather Than A National Exchange. There are significant consequences associated with our stock trading on the NASD OTC Bulletin Board rather than a national exchange such as NASDAQ. The effects of not being able to list our securities on a national exchange include:

- . Limited release of the market prices of our securities;
- . Limited news coverage of us;
- . Limited interest by investors in our securities;
- . Volatility of our stock price due to low trading volume;
- . Increased difficulty in selling our securities in certain states due to "blue sky" restrictions; and
- . Limited ability to issue additional securities or to secure additional financing.

There is No Assurance That An Active Public Trading Market Will Continue. There was an extremely limited public trading market for our common stock. Commencing in the fourth quarter of 2003, a more active trading market for our shares developed and the price of our shares of common stock increased considerably. There can be no assurances that an active public trading market for our common stock will be sustained. If for any reason an active public trading market does not continue, purchasers of the shares of our common stock may have difficulty in selling their securities should they desire to do so and the price of our common stock may decline.

ITEM 2. PROPERTIES.

NHTC and Lexxus lease an aggregate of approximately 16,000 square feet of office and warehouse space in Dallas, Texas. The original lease term is 38 months, expiring in September 2004, and the current rent is approximately \$153,000 per year. Additional warehousing for Lexxus is located in Hollister, Missouri where Lexxus utilizes approximately 1,500 square feet

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of warehouse space. The lease term is on a month-to-month basis at a rent of \$18,000 per year. The Canadian office and warehouse of Lexxus and eKaire leases office space in Langley, British Columbia, totaling approximately 5,000 square feet. The lease term is 36 months, expiring on January 2007 and the current rent is approximately \$22,000 per year.

Kaire Australia, Kaire New Zealand, Lexxus Australia and Lexxus New Zealand lease office space and warehouse facilities of approximately 2,500 square feet in Queensland, Australia. The lease term is 60 months, expiring in January 2007, and the current rent is approximately \$32,000 per year.

In February 2002, Lexxus Hong Kong entered into a 42-month agreement for approximately 5,400 square feet of office space at a current rate of approximately \$183,000 per year.

In March 2002, Lexxus Taiwan entered into a 24-month agreement for approximately 10,000 square feet of office space located in Kaohsiung, Taiwan at a current rate of approximately \$56,000 per year. This lease was extended effective March 1, 2004 for an additional six months. In May 2002, Lexxus Taiwan

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entered into a 36-month agreement for approximately 4,500 square feet of office space located in Taipei, Taiwan at a current rate of approximately \$86,000 per year.

In August 2002, Lexxus India entered into a 60-month agreement for 2,665 square feet of office space located in Hyderabad, India at a current rate of approximately \$13,000 per year.

In September 2002, Lexxus Singapore entered into a 36-month agreement for 4,155 square feet of office space at a current rate of approximately \$155,000 per year.

In January 2003, Lexxus Philippines entered into a 24-month agreement for approximately 6,400 square feet of office space located in Manila at a current rate of approximately \$49,000 per year.

In April 2003, Lexxus South Korea entered into a 12-month agreement for approximately 4,100 square feet of office space located in Seoul at a current rate of approximately \$266,000 per year.

We believe that such properties are suitable and adequate for our current operating needs.

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ITEM 3. LEGAL PROCEEDINGS.

On April 10, 2003, Bobby R. Porter and wife, Betty R. Porter, filed suit against Lexxus International, Inc. and Alex Arnold (an employee of Lexxus International, Inc.) in the 170th District Court of McLennan County, Texas asserting misrepresentations made by the former owners of NuEworld.com Commerce, Inc. ("NuEworld") pertaining to a stock investment made by the plaintiffs in June 2000. The plaintiffs are seeking the sum of \$40,000, court costs and other relief. The Company acquired certain assets of NuEworld in January 2003. The Company filed a motion to transfer venue in April 2003 and intends to vigorously defend itself in this case.

In February 2004, the Company received notice from a plaintiff in an action in Florida state court styled Haimes v. Natural Health Trends Corp. that plaintiff was seeking to recover attorney's fees from the Company in the amount of approximately \$85,000 in connection with a judgment that the plaintiff previously had taken against the Company and the Company had paid in full. While the Company disputes such charges, they have entered into preliminary settlement negotiations with the plaintiff.

From time to time, NHTC is involved in legal proceedings incidental to the course of its business. NHTC believes that pending actions, both individually and in the aggregate, will not have a material adverse effect on the financial condition, results of operations, cash flows or prospects.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

During the last quarter of 2003, NHTC did not submit any matter to the vote of the shareholders.

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PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

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NHTC's Common Stock is currently quoted on the NASD Over the Counter Bulletin Board ("OTCBB") under the symbol "NHLC". The following table sets forth the range of high and low closing bid prices on a quarterly basis as reported by the OTCBB for the fiscal years 2002 and 2003.

2002		
Quarter	High Bid(\$)	Low Bid(\$)
-----	-----	-----
First Quarter	4.00	2.00
Second Quarter	2.00	1.00
Third Quarter	3.00	1.00
Fourth Quarter	3.00	1.00

2003		
Quarter	High Bid(\$)	Low Bid(\$)
-----	-----	-----
First Quarter *	2.00	1.00
Second Quarter	6.30	1.60
Third Quarter	11.40	5.63
Fourth Quarter	11.10	4.80

The OTCBB quotations reflect inter-dealer prices, without retail mark-ups, markdowns or commissions, and may not represent actual transactions. On March 31, 2004, the closing price of our shares of Common Stock as reported on the OTCBB was \$18.27.

* In March 2003, we effected a 1-for-100 reverse stock split with respect to the outstanding shares of our Common Stock.

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Holders

As of February 19, 2004, NHTC had approximately 400 holders of record of our Common Stock and approximately 3,400 beneficial owners of Common Stock.

Dividends

We have not paid any cash dividends on our Common Stock to date and do not anticipate declaring or paying any cash dividends in the foreseeable future. In addition, future-financing arrangements, if any, may preclude or otherwise restrict the payment of dividends.

Securities authorized for issuance under equity compensation plans.

The following table summarizes the Company's Equity Compensation Plans as of December 31, 2003:

Equity Compensation Plan Information

(b)
Weighted-

(c)

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Plan category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equi compensation plans (excluding securities reflected in column (a))
Equity compensation plans or arrangements approved by security holders	1,225,000 (1)	--	1,225,000 (1)
Equity compensation plans or arrangements not approved by security holders	1,334,919 (2)	\$ 1.21	--
Total	2,559,919	--	1,225,000

(1) Includes 1,225,000 shares of our Common Stock reserved under our 2002 Stock Option Plan, as amended, for future issuance which was approved by our stockholders in May 2003 and 310,000 of which have been granted as of March 31, 2004.

(2) Includes (i) options exercisable for 570,000 shares of Common Stock issued to the LaCore and Woodburn Partnership, (ii) options exercisable for 570,000 shares of Common Stock issued to Mr. LaCore, (iii) options exercisable for 30,000 shares of Common Stock issued to Benchmark Consulting Group (which was subsequently assigned to the LaCore and Woodburn Partnership), (iv) options exercisable for 30,000 shares of Common Stock issued to Mr. LaCore, (v) options exercisable for 120,000 shares of Common Stock issued to certain members of the Company's board of directors, (vi) options exercisable for 13,419 shares of Common Stock issued to two unrelated parties, and (vii) options exercisable for 1,500 shares of Common Stock to an employee.

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Recent Sales of Unregistered Securities

During the year ended December 31, 2003, the Company issued the following unregistered securities:

In January 2003, the Company issued pursuant to Section 4(2) of the Securities Act of 1933, as amended, 18,500 shares of Common Stock to a law firm for legal services previously performed of approximately \$34,000.

In January 2003, the Company issued pursuant to Section 4(2) of the Securities Act of 1933, as amended, 10,000 shares of Common Stock to a consulting firm for consulting services of approximately \$19,000.

In March 2003, the Company issued pursuant to Section 4(2) of the Securities Act of 1933, as amended, 360,000 shares of our Common Stock valued at approximately \$433,000 to NuEworld.com Commerce, Inc. pursuant to a database purchase agreement. In the purchase, the shares were discounted approximately 35% from their market value of \$1.85 per share due to certain trading restrictions.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION.

The following discussion is intended to assist in the understanding of NHTC's consolidated financial position and its results of operations for each of the two years ended December 31, 2003 and 2002. This discussion should be read in conjunction with Item 7. - Financial Statements, beginning on page F-1 of this report and with other financial information included elsewhere in this report. Unless stated otherwise, all financial information presented below, throughout this report, and in the consolidated financial statements and related notes includes NHTC and all of its subsidiaries on a consolidated basis.

Company Overview

NHTC is an international network marketing organization. NHTC controls subsidiaries that distribute products through three separate direct selling networks that promote health, wellness and vitality. Lexxus International, Inc., a majority-owned subsidiary and other Lexxus subsidiaries (collectively, "Lexxus") sell certain cosmetic products as well as "quality of life" products, which constitute approximately ninety-six percent (96%) of consolidated revenues in 2003. eKaire.com, Inc., ("eKaire"), a wholly-owned subsidiary, distributes nutritional supplements aimed at general health and wellness. I Luv My Pet, Inc., ("ILMP"), a wholly-owned subsidiary, distributes nutritional supplements for dogs and cats.

NHTC operates its Lexxus, eKaire and ILMP direct selling operations as a single segment and primarily sells its products through a network of approximately 85,000 active distributors. NHTC aggregates the Lexxus and eKaire operating segments because it believes it operates as a single reportable segment selling its products in similar distribution channels in each of its operations. Operations of ILMP are not material for the year ended December 31, 2003 since it commenced in the fourth quarter of 2003.

As of March 29, 2004, NHTC purchased the common stock owned by the minority shareholders of Lexxus International, Inc. (representing the 49% interest in Lexxus not owned by the Company) in exchange for 100,000 shares of restricted NHTC common stock. During 2004, the Company intends to continue to pursue acquiring the minority ownership of most of its majority owned subsidiaries. Effective on March 31, 2004, the Company acquired Marketvision Communications Corp. ("Marketvision"). Marketvision is the exclusive developer and service provider of the direct selling software used by the Company since mid-2001.

NHTC's management reviews its financial information in each country primarily by total net sales. Each of NHTC's operations sells primarily the same products and possesses similar economic characteristics, such as similar gross margins. For the year ended December 31, 2003, NHTC's foreign operations accounted for approximately 83% of its consolidated net sales, whereas in the same period in 2002, its foreign operations accounted for approximately 64% of its consolidated net sales.

Net Sales. NHTC derives its revenue from sales of its products, sales of its starter and renewal administrative enrollment packs, and from shipping fees. Substantially all of its product sales are to independent distributors at published wholesale prices. NHTC believes the vast

majority of its product sales are for personal consumption; however, NHTC cannot distinguish its personal consumption sales from its other sales because it has

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no involvement in its products after delivery other than usual and customary product returns.

The number of active distributors for NHTC's products has increased from approximately 30,000 to approximately 85,000 since 2001. NHTC attributes the increase in the number of active distributors and the resulting improvement over the past three years in its net sales to the following:

- . relatively high commissions paid under the distributor compensation plan. Management believes the NHTC compensation plan is among the most financially rewarding plans offered by any network marketing company;
- . expansion into international markets including eastern Europe and Russia, Hong Kong, India, Singapore, the Philippines, and South Korea in 2002 and 2003; and
- . introduction of certain new products, including the 180DEG. Life System Carb-Blocker(TM) and Lexxus Premium Noni(TM).

NHTC believes its future success on increasing its net sales is dependent on the following factors:

- . continuing its product development strategy, which includes continuing to enhance its existing proprietary products and introducing new products, such as the recent launch of its 180DEG. Life System Carb-Blocker(TM);
- . continuing its planned international expansion; and
- . continuing to attract and retain distributors who routinely purchase its products by introducing new incentives and refining existing commissions and incentives.

Cost of sales consists of products purchased from third-party manufacturers, costs of promotional materials sold to NHTC's distributors, freight, provisions for slow moving or obsolete inventories and the cost of NHTC's third party service provider. NHTC's inventory turnover ratio improved from 2.2 in 2002 to 3.7 in 2003.

NHTC's sales mix can be influenced by the following:

- . changes in commission and incentive programs;
- . changes in its sales prices;
- . changes in consumer demand;
- . changes in competitors' products;
- . changes in economic conditions;

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- . changes in regulations;
- . introduction of new products; and
- . discontinuation of existing products.

Distributor commissions are dependent on the sales mix and typically

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range between 43% to 46% of net sales. Commissions are paid to NHTC's independent distributors in accordance with its global compensation plan based on commissionable net sales, which consist of finished products. NHTC's commission and incentive program calculates commissions and incentives based on the following criteria:

- . a distributor's placement and position within NHTC's overall global commission plan;
- . the volume of a distributor's direct and indirect commissionable sales; and
- . a distributor's achievement of certain sales levels.

Foreign exchange. NHTC is exposed to certain market risks, including changes in currency exchange rates as measured against the United States dollar. The value of the United States dollar may affect NHTC's financial results. Changes in exchange rates could positively or negatively affect its financial results, as expressed in United States dollars. The effect of the translation of the Company's foreign operations are included in accumulated other comprehensive income within stockholder's equity and such do not impact the statement of operations. For the years ended December 31, 2003 and 2002, changes in currency exchange rates did not have a material adverse impact on the Company.

Effect of inflation. NHTC believes inflation has not had a material impact on its operations or profitability.

Critical Accounting Policies and Estimates

In response to SEC Release No. 33-8040, "Cautionary Advice Regarding Disclosure About Critical Accounting Policies" and SEC Release Number 33-8056, "Commission Statement about Management's Discussion and Analysis of Financial Condition and Results of Operations," NHTC has identified certain policies that are important to the portrayal of its consolidated financial condition and consolidated results of operations. These policies require the application of significant judgment by NHTC's management. NHTC periodically analyzes the need for certain estimates, including the need for such items as reserves for inventory valuation, impairment of long-lived assets, revenue recognition, sales returns, and contingencies. NHTC bases any estimates needed on its historical experience, industry standards, and various other assumptions that may be reasonable under the circumstances. NHTC 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 NHTC could experience an adverse effect on its consolidated financial condition, changes in financial condition, and results of operations. NHTC's critical accounting policies at December 31, 2003 include the following:

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Inventory Valuation

NHTC's inventory carrying value is reviewed and compared to the net realizable value of its inventory and any inventory value in excess of net realizable value is written down. In addition, NHTC reviews its inventory for obsolescence and any inventory identified as obsolete is reserved or written off. NHTC'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.

Asset Impairment

NHTC reviews the book value of its property and equipment and other long-term assets whenever an event or change in circumstances indicates that the

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net book value of an asset or group of assets may be unrecoverable. NHTC's impairment review includes a comparison of future projected cash flows (undiscounted and without interest charges) generated by the asset or group of assets with its associated carrying value. NHTC 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, NHTC would have to recognize an impairment loss to the extent the net book value of an asset exceeds its fair value. At December 31, 2003, the net book value of NHTC's property and equipment and long-term assets was approximately \$883,000 and \$509,000, respectively.

Allowance for Sales Returns

The Company maintains an allowance for sales returns and refunds based on the return practices and policies by country and our historical experience. The allowance for sales returns may need to be adjusted if actual sales returns differ from estimates.

Tax Valuation Allowance

NHTC 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. At December 31, 2003, the Company had net deferred assets of approximately \$2.5 million. The Company has established a valuation allowance for the full amount of such net deferred tax assets at December 31, 2003, as management of the Company has not been able to determine that it is more likely than not that the deferred tax assets will be realized. However, should the Company's trend of taxable income continue, it may be necessary, as early as fiscal 2004, to release a portion or all of the valuation allowance.

Revenue Recognition and Deferred Costs

Product sales are recognized when shipped. NHTC defers revenue received from the sale of its starter and renewal administrative packs due to the twelve-month term of the membership. Such fees actually received are recognized as revenue on a straight-line basis over the twelve-month term of the membership. In addition, NHTC defers and recognizes to cost of sales on a straight line basis the actual cost paid to a third party associated with the administrative enrollment fees received from distributors. Although NHTC has no immediate plans to significantly change the terms or conditions of the starter or renewal memberships, any changes in the future could result in additional revenue deferrals or could cause NHTC to recognize its deferred revenue over a longer period of time.

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Restatement of Previously Issued Financial Statements

During the quarters ended September 30 and December 31, 2003, the Company re-evaluated its financial statements for the years ended December 31, 2002 and 2001, the quarterly periods included in such years and the quarterly periods ended March 31, June 30 and September 30, 2003. As a result of such review, the Company determined that it inadvertently applied the incorrect accounting treatment with respect to the following items:

- (i) revenue recognition with respect to administrative enrollment fees;
- (ii) revenue cut-off between 2002 and 2003;
- (iii) accounts receivable reconciliation to supporting documents;
- (iv) reserves established for product returns and refunds;
- (v) the gain recorded in connection with the sale of a subsidiary in 2001;
- (vi) income tax provisions; and
- (vii) stock option based compensation.

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Consequently, the Company is amending and restating its financial statements for each quarter in 2001, 2002 and 2003 as well as for the years ended December 31, 2001 and 2002.

In connection with the review of the Company's financial statements, the Company has revised its accounting treatment for administrative enrollment and membership fees received from distributors in accordance with the principles contained in Staff Accounting Bulletin No. 104, "Revenue Recognition", ("SAB 104") and related guidance. The Company determined that under SAB 104, such fees actually received and recorded as current sales in prior quarters should have been deferred and recognized as revenue on a straight-line basis over the twelve-month term of the membership. The restatement resulted in net sales for the year ended December 31, 2002 being decreased by approximately \$1,336,000. The restatement in net sales resulted in a corresponding adjustment to cost of sales for direct costs paid to a third party associated with the administrative enrollment fees received from distributors. Compared to amounts previously reported, the restatement decreased cost of sales by approximately \$336,000 for the year ended December 31, 2002.

The Company also reviewed its revenue cut-off as of the beginning of 2003. It was noted that approximately \$1,008,000 of sales originally recorded in 2002 were not actually shipped until early 2003. The restatement resulted in net sales for the quarter ended December 31, 2002 being decreased by \$1,008,000 and net sales for the quarter ended March 31, 2003 being increased by the same amount. The restatement also resulted in distributor commissions for the quarter ended December 31, 2002 being decreased by \$459,000 and distributor commissions for the quarter ended March 31, 2003 being increased by the same amount.

Also in connection with its review, the Company determined that its accounts receivable as of March 31 and June 30, 2003 did not reconcile in total to supporting details for such transactions. The restatement resulted in net sales being decreased by \$140,000 and \$260,000 as of March 31 and June 30, 2003, respectively.

The Company had not recorded a reserve for distributor returns and refunds as of September 30, 2003 and for prior periods. Based upon analysis of the Company's historical returns and refund trends by country, it was determined that the reserves for returns and refunds for prior periods were required and should be recorded. The restatement resulted in net sales for

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the year ended December 31, 2002 being decreased by approximately \$350,000, with corresponding adjustments to cost of sales for the estimated cost of products returned.

In 2001, the Company sold all of the outstanding common stock in Kaire Nutraceuticals, Inc. ("Kaire"), a Delaware corporation and wholly-owned subsidiary of the Company, to an unrelated third party. The gain on the sale of Kaire was approximately \$3.1 million, a portion of which was previously deferred. The Company subsequently recognized into income approximately \$1.9 million from the transaction over the period from the fourth quarter of 2001 through the second quarter of 2003. Based upon a review of the transaction, the Company now believes the gain on sale of Kaire should have been recognized only in 2001 and 2002 and not in 2003. For the year ended December 31, 2002, the Company is now recognizing \$2,400,000 of gain on the sale of Kaire as Discontinued Operations and is reducing its Other Income by \$800,000.

The Company disclosed in its Annual Report on Form 10-KSB for the year ended December 31, 2002 that it had a net operating loss carry forward at December 31, 2002 of approximately \$6,000,000, subject to certain limitations.

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Consequently, the Company made no provision for income taxes for any period in 2002 or 2001. Upon further review, it has been determined that the available net operating loss was not expected to be sufficient to offset all of the domestic and foreign taxable income in 2002 or 2001 and that an estimated tax provision in the amount of \$300,000 was necessary for the year ended December 31, 2002.

The Company has determined that the stock options (the "Options") granted in January 2001 and October 2002 to senior executive officers of the Company should be accounted for as variable stock options due to the provision in the stock option plan that allowed the holder to exercise the stock option in an immaculate cashless fashion. The cashless exercise feature allows option holders to use the "in the money" value of the options (or the spread between the exercise price and the fair market price of the underlying shares as of the exercise date) as payment for all, or a portion, of the exercise price of an option. The Options were amended in November 2002 to require the option holder to obtain Company approval before the Option holder could use the cashless exercise feature. Subsequent to the modification, fixed option accounting will be applied to the options. Under variable accounting, changes in the intrinsic value of the stock option result in recording a charge or credit to stock based compensation expense. For the year ended December 31, 2002, the restatement resulted in \$1,434,000 being charged to stock option based compensation expense.

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The following table presents amounts from operations as previously reported and as restated (in thousands, except for per share data):

Year Ended December
December 31, 2002