

Edgar Filing: NATURAL HEALTH TRENDS CORP - Form 10QSB/A

NATURAL HEALTH TRENDS CORP  
Form 10QSB/A  
April 13, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-QSB/A  
(Amendment No. 1)

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

For Quarter Ended March 31, 2003

OR

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

For the transition period from to

Commission file number: 0-25238

NATURAL HEALTH TRENDS CORP.

(Exact Name of Small Business Issuer as Specified 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 75234  
(Address of Principal Executive Office) (Zip Code)

(972) 241-4080  
(Issuer's telephone number including area code)

Indicate by check mark whether the issuer (1) has filed all reports  
required to be filed by Section 13 or 15(d) of the Securities Exchange  
Act of 1934 during the preceding 12 months and (2) has been subject to  
such filing requirements for the past 90 days.

Yes

No

The number of shares of issuer's Common Stock, \$.001 par value,  
outstanding as of May 9, 2003 were 4,627,939 shares.

NATURAL HEALTH TRENDS CORP.

Form 10-QSB/A

For Quarter Ended March 31, 2003

Explanatory Note:

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The purpose of this amendment is to amend Part I, Item 2 - Management's Discussion and Analysis and Part I, Item 1 - Financial Statements for the restatements identified in note 2 to the consolidated financial statements and to give effect to the 1 for 100 reverse stock split in March 2003. All other items remain unchanged from the original filing.

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; and
- (vi) income tax provisions.

Consequently, the Company is amending and restating its financial statements for each quarter in 2001, 2002 and 2003 as well as the Form 10-KSB for the years ended December 31, 2001 and 2002.

NATURAL HEALTH TRENDS CORP.

FORM 10-QSB/A

For Quarter Ended March 31, 2003

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### NATURAL HEALTH TRENDS CORP.

#### CONSOLIDATED BALANCE SHEET

(UNAUDITED)

March 31,  
2003  
As Restated  
-----

#### ASSETS

Current Assets:	
Cash	\$ 3,009,487
Restricted Cash	377,668
Accounts receivable	555,864
Inventories	3,160,898
Prepaid expenses and other current assets	977,710
	-----
Total Current Assets	8,081,627
Property and equipment, net	691,884
Deposits and other assets	471,704
Goodwill	207,765
Database	856,845
Website	44,333
	-----
Total Assets	\$ 10,354,158
	-----

#### LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:	
Accounts payable	\$ 1,965,726
Accrued expenses	1,223,904
Accrued associate commissions	868,714
Notes payable	369,529
Current portion of long term debt	191,102
Deferred Revenue	1,887,497
Income Tax Payable	880,000
Other current liabilities	648,541

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Total Current Liabilities	8,035,013
Long term notes payable	39,039
Total Liabilities	8,074,052
Minority interest	532,395
Stockholders' Equity:	
Preferred stock (\$1,000 par value; authorized 1,500,000 shares; issued 16 shares)	16,330
Common stock (\$.001 par value; authorized 500,000,000 shares; issued and outstanding 4,627,939 shares)	4,628
Additional paid in capital	34,184,792
Accumulated deficit	(32,394,562)
Deferred compensation	(78,750)
Accumulated other comprehensive income	15,273
Total Stockholders' Equity	1,747,711
Total Liabilities and Stockholders' Equity	\$ 10,354,158

The accompanying notes are an integral part of these consolidated financial statements.

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NATURAL HEALTH TRENDS CORP.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(UNAUDITED)

	Three Months Ended March 31,	
	2003 As Restated	2002 As Restated
Net Sales	\$ 11,240,317	\$ 4,928,883
Cost of sales	2,096,707	903,291
Gross profit	9,143,610	4,025,592
Associate commissions	4,581,118	3,211,736
Selling, general and administrative expenses	2,822,956	1,981,838
Operating income (loss)	1,739,536	(1,167,982)
Minority interest in subsidiary	(105,648)	(11,837)
Gain (loss) on foreign exchange	52,800	(90)
Other income (expense), net	64,514	(30,638)

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Interest expense, net	(8,400)	(17,629)
	-----	-----
Net income (loss) from continuing operations	1,742,802	(1,228,176)
Income Tax Expense	370,000	--
	-----	-----
Net income (loss)	1,372,802	(1,228,176)
Preferred stock dividends	402	22,285
	-----	-----
Net income (loss) to common shareholders	\$ 1,372,400	\$ (1,250,461)
	=====	=====
Basic income (loss) per common share	\$ 0.30	\$ (0.47)
	=====	=====
Basic weighted common shares used	4,511,391	2,665,248
	=====	=====
Diluted income (loss) per common share	\$ 0.28	\$ (0.37)
	=====	=====
Diluted weighted common shares used	4,907,791	3,398,886
	=====	=====

The accompanying notes are an integral part of these consolidated financial statements.

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NATURAL HEALTH TRENDS CORP.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(UNAUDITED)

	Three Months Ended March 31,	
	2003	2002
	As Restated	As Restated
	-----	-----
Net income (loss)	\$ 1,372,802	\$ (1,228,176)
Other comprehensive income, net of tax:		
Foreign currency translation adjustment	24,840	5,842
	-----	-----
Comprehensive income (loss)	\$ 1,397,642	\$ (1,222,334)
	=====	=====

The accompanying notes are an integral part of these consolidated financial statements.

NATURAL HEALTH TRENDS CORP.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

	Three Months Ended March 31,	
	2003 As Restated	2002 As Restated
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ 1,372,802	\$ (1,228,176)
	-----	-----
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:		
Depreciation and amortization	366,282	154,875
Stock issued for services/ interest	50,265	3,600
Minority interest of subsidiary	105,648	11,837
Changes in assets and liabilities:		
Accounts receivable	(36,112)	(504,090)
Inventories	(7,274)	(203,102)
Prepaid expenses	182,236	(124,027)
Deposits and other assets	318,606	260,585
Accounts payable and accrued expenses	(1,344,122)	1,383,924
Income tax payable	370,000	--
Deferred revenue	(1,611,895)	1,331,396
Other current liabilities	(4,502)	(14,946)
	-----	-----
Total Adjustments	(1,610,868)	2,300,052
	-----	-----
NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES	(238,066)	1,071,876
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(280,664)	(298,609)
Database purchase	(226,845)	--
(Increase) decrease in restricted cash	(49,783)	82,759
	-----	-----
NET CASH USED IN INVESTING ACTIVITIES	(557,292)	(215,850)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from notes payable and long-term debt	--	75,000
Payments of notes payable and long-term debt	(83,940)	(42,901)
Investments by minority interest owner	--	135,714
	-----	-----
NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES	(83,940)	167,813
	-----	-----
Effect of exchange rate	24,839	5,842

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NET (DECREASE) INCREASE IN CASH	(854,459)	1,029,681
CASH, BEGINNING OF PERIOD	3,863,946	324,315
	-----	-----
CASH, END OF PERIOD	\$ 3,009,487	\$ 1,353,996
	=====	=====

The accompanying notes are an integral part of these consolidated financial statements.

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NATURAL HEALTH TRENDS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

THREE MONTHS ENDED MARCH 31, 2003

(UNAUDITED)

1. Basis of Presentation

We are Natural Health Trends Corp. ("NHTC"), an international network marketing organization. We operate through our subsidiaries that distribute products to 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. eKaire.com, Inc. ("eKaire") distributes nutritional supplements aimed at general health and wellness.

The accompanying unaudited financial statements of Natural Health Trends Corp. and its subsidiaries (the "Company") have been prepared in accordance with generally accepted accounting principles for interim financial information and with instructions to Form 10-QSB and Article 10 of Regulation S-B. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation (consisting of normal recurring accruals) of financial position and results of operations for the interim periods have been presented. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Operating results for the three month period ended March 31, 2003 are not necessarily indicative of the results that may be expected for the year ending December 31, 2003. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2002.

NHTC's common stock, par value \$.001 per share (the "Common Stock"), is listed on the OTC Bulletin Board (the "OTCBB"). In March 2003, we effected a 1-for-100 reverse stock split with respect to our outstanding shares of Common Stock. In addition, the trading symbol for the shares of our Common Stock changed from "NHTC" to "NHLC". The effect of the reverse is reflected

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throughout this document.

### 2. 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; and
- (vi) income tax provisions.

Consequently, the Company is amending and restating its financial statements for each quarter in 2001, 2002 and 2003 as well as the Form 10-KSB for the years ended December 31, 2001 and 2002.

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In connection with the engagement of a new independent accounting firm and the review of the Company's financial statements, the Company has revised its accounting treatment for administrative enrollment fees received from distributors in accordance with the principles contained in Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements", ("SAB 101") and related guidance. The Company determined that under SAB 101, 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 three month period ended March 31, 2002 being decreased by approximately \$1,138,000. The restatement resulted in net sales for the three month period ended March 31, 2003 being increased by approximately \$604,000. 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 \$170,000 for the three month period ended March 31, 2002. Compared to amounts previously reported, the restatement increased cost of sales by approximately \$135,000 for the three month period ended March 31, 2003.

In addition, the Company and its new independent accounting firm reviewed revenue cut-off as 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 year ended December 31, 2002 being decreased by \$1,008,000 and net sales for the three months ended March 31, 2003 being increased by \$1,008,000. The restatement also resulted in distributor commissions for the year ended December 31, 2002 being decreased by \$459,000 and distributor commissions for the three month period ended March 31, 2003 being increased by \$459,000.

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

The Company had not recorded a reserve for distributor returns and refunds



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as of September 30, 2003 and for prior periods. Based upon an analysis of the Company's historical returns and refund trends by country, it was determined that a reserve for returns and refunds for prior periods were required and should be recorded. The restatement resulted in net sales for the three months ended March 31, 2002 being decreased by approximately \$88,000, with corresponding adjustments to cost of sales for the estimated cost of products returned. The restatement resulted in net sales for the three months ended March 31, 2003 being increased by approximately \$125,000, with corresponding adjustments to cost of sales for the estimated cost of products returned.

As previously disclosed in the Company's 2001 and 2002 Form 10-KSB, the Company sold in 2001 all of the outstanding common stock in Kaire Nutraceuticals, Inc. ("Kaire"), a Delaware corporation and wholly-owned subsidiary, to an unrelated third party. The gain on the sale of Kaire of approximately \$3.1 million was previously deferred. The Company subsequently recognized into income approximately \$1.9 million from the transaction over the period from Q4 2001 through Q2 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. The restatement resulted in extraordinary gain due to forgiveness of debt for the three months ended March 31, 2002 being decreased by \$200,000. The impact of this restatement for the three months ended March 31, 2003 is a reduction in other income of \$200,000.

The Company disclosed in its 2002 Form 10-KSB 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 either 2001 or 2002. Upon further review, it has been determined that the available net operating loss is not expected to be sufficient to offset all of the taxable income in 2002 and 2003. The impact of this restatement resulted in an increase in income taxes for the period ended March 31, 2003 of \$370,000.

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

	Three Months Ended March 31, 2003	
	As Previously Reported	As Restated
Net sales	\$ 9,643	\$ 11,240
Cost of sales	1,937	2,097
Gross profit	7,706	9,143
Operating expenses	6,945	7,403
Operating income	761	1,740
Interest expense, other income, loss on foreign exchange and gain on discontinued operations	203	3

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Net income from continuing operations	964	1,743
Income tax expense	--	370
Net income	964	1,373
Preferred stock dividends	--	--
	-----	-----
Net income available to common stockholders	\$ 964	\$ 1,373
	=====	=====
Basic income per share	\$ 0.21	\$ 0.30
	=====	=====
Basic weighted commons shares used	4,511	4,511
	=====	=====
Diluted income per share	\$ 0.18	\$ 0.28
	=====	=====
Diluted weighted commons shares used	5,504	4,908
	=====	=====

Basic and Diluted Income per share:

The adjustments in net sales, cost of sales, operating expenses, other income and income taxes resulted in a net increase in net income before discontinued operations of approximately \$409,000 from the amounts previously reported for the three months ended March 31, 2003. Restated basic income per share increased by \$0.09 for the three months ended March 31, 2003. Restated diluted income per share increased by \$0.10 for the three months ended March 31, 2003. The weighted common shares have been recalculated with the treasury stock method utilizing the average stock price for the period versus the closing stock price.

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	Three Months Ended March 31, 2002	
	As Previously Reported	As Restated
	-----	-----
Net sales	\$ 6,154	\$ 4,929
Cost of sales	1,090	903
	-----	-----
Gross profit	5,064	4,026
Operating expenses	5,194	5,194
	-----	-----
Operating income	(130)	(1,168)
Interest expense, other income, loss on foreign exchange and gain on discontinued operations	(60)	(60)
	-----	-----
Income before extraordinary items	(190)	(1,228)
Extraordinary gain-forgiveness of debt	200	--

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Net income	10	(1,228)
Preferred stock dividends	22	22
Net income available to common stockholders	\$ (12)	\$ (1,250)
Basic income per share	\$ 0.00	\$ (0.47)
Basic weighted commons shares used	2,665	2,665
Diluted income per share	\$ 0.00	\$ (0.37)
Diluted weighted commons shares used	3,399	3,399

### Basic and Diluted Income per share:

The adjustments in net sales, cost of sales, operating expenses, other income and income taxes resulted in a net decrease in net income available to stockholders of approximately \$1,238,000 over the amounts previously reported for the three months ended March 31, 2002. Restated basic and diluted income per share decreased \$0.47 and \$0.37, respectively, for the three months ended March 31, 2002.

### 3. Principles of Consolidation and Accounting Policies

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

#### Reclassifications

Certain reclassifications were made to the prior year financial statements to conform to the current year presentation.

#### Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the USA requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### Revenue Recognition

The Company's revenues are primarily derived from sales of products, sales of starter and renewal administrative enrollment packs and shipping fees. Substantially all product sales are sales to associates at published wholesale prices. The Company defers a portion of its revenue from the sale of its starter and renewal packs related to its administrative enrollment fee. The Company amortizes its deferred revenue and its associated direct

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costs over twelve months, the term of the membership. Total deferred revenue for the Company was approximately \$1,887,000 as of March 31, 2003.

The Company also estimates and records a sales return reserve for possible sales refunds based on historical experience.

### Shipping and Handling Costs

The Company records freight and shipping revenues collected from associates as revenue. The Company records shipping and handling costs associated with shipping products to its associates as cost of goods sold.

### Earnings Per Share

Basic earnings per share is computed based on the weighted average number of common shares outstanding during the periods presented. Diluted earnings per share data gives effect to all potentially dilutive common shares that were outstanding during the periods presented.

## 4. Equity Transactions

In January 2003, the Company issued 18,500 shares of Common Stock to a law firm for legal services of approximately \$34,000.

In January 2003, the Company issued 10,000 shares of Common Stock to a consulting firm for consulting services of approximately \$19,000.

On January 31, 2003, the Company entered into a Database Purchase Agreement with NuEworld.com Commerce, Inc. ("NuEworld") and Lighthouse Marketing Corporation, our wholly-owned subsidiary ("Lighthouse"), pursuant to which Lighthouse purchased a database of distributors from NuEworld in exchange for the issuance of 360,000 shares of our Common Stock. NuEworld was in the business of marketing and selling a variety of products and services through its multi-level marketing distribution network. We believe that the NuEworld database will allow us to recruit many new distributors for our Lexxus business.

## 5. Recent Accounting Pronouncements

SFAS No. 145, Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections was issued April 2002. This Statement rescinds FASB Statement No. 4, Reporting Gains and Losses from Extinguishment of Debt, and an amendment of that Statement, FASB Statement No. 64, Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements. This Statement also rescinds FASB Statement No. 44, Accounting for Intangible Assets of Motor Carriers. This Statement amends FASB Statement No. 13, Accounting for Leases, to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions.

This Statement also amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions. The provisions of this Statement related to the rescission of Statement 4 shall be applied in fiscal years beginning after May 15, 2002. The provisions in paragraph 8 and 9(c) of this Statement related to Statement 13 shall be effective for transactions occurring after May 15, 2002. All other provisions of this Statement shall be effective for financial statements issued on or after May 15, 2002. The effects of implementation are not material.

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SFAS No. 146 Accounting for Costs Associated with Exit or Disposal Activities was issued June 2002. This Statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). The provisions of this Statement are effective for exit and disposal activities that are initiated after December 31, 2002.

In September 2002, the FASB issued SFAS No. 147, Acquisition of Certain Financial Institutions. SFAS No. 147 changed the special accounting for unidentifiable intangible assets recognized under SFAS No. 72. Transition provisions for previously recognized unidentifiable intangible assets were effective on October 1, 2002. The effects of implementation had no impact on the Company's consolidated financial statements.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure, which provides alternative methods of transition for a voluntary change to fair value based method of accounting for stock-based employee compensation as prescribed in SFAS No. 123, Accounting for Stock-Based Compensation. Additionally, SFAS No. 148 required more prominent and more frequent disclosures in financial statements about the effects of stock-based compensation. The provisions of this Statement are effective for fiscal years ending after December 15, 2002, with early application permitted in certain circumstances.

### Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATIONS

The following discussions should be read in conjunction with the consolidated financial statements and notes contained in Item 1 hereof.

#### Forward Looking Statements

When used in Form 10-QSB and in future filings by the Company with the Securities and Exchange Commission, the words "will likely result", "the Company expects", "will continue", "is anticipated", "estimated", "projected", "outlook" or similar expressions are intended to identify "forward looking statements" within the meaning of the Private Securities Litigation Act of 1995. The Company wishes to caution readers not to place undue reliance on such forward-looking statements, each of which speak only as of the date made. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. The Company has no obligation to publicly release the results of any revisions, which may be made to any forward-looking statements to reflect anticipated or unanticipated events or circumstances occurring after the date of such statements.

#### Overview

Natural Health Trends Corp. was incorporated on December 1, 1988 in the state of Florida. NHTC is an international direct-selling company operating in more than 29 markets throughout Asia, North America and Eastern Europe.

The Company markets premium quality personal care products under the Lexxus brand and markets its nutritional supplement products under the Kaire brand. NHTC's Common Stock, par value \$0.001 per share (the "Common Stock"), is listed on the OTC Bulletin Board (the "OTCBB"). In March 2003, NHTC effected a 1-for-100 reverse stock split with respect to our outstanding shares of Common Stock. In addition, the trading symbol for the shares of our Common

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Stock changed from "NHTC" to "NHLC".

NHTC is a holding company that operates two businesses, Lexxus and eKaire, which distribute products that promote health, wellness and vitality through two distinct multi-level marketing ("MLM") channels. The following paragraphs will outline the progression of NHTC as it is organized today.

In February 1999, NHTC Holdings Inc. acquired certain assets (the "Kaire Assets") of Kaire International, Inc., a Delaware corporation ("KII"). The assets included, but not limited to, the corporate name, all variations and any other product name, registered and unregistered trademarks, tradenames, servicemarks, patents, logos and copyrights of KII, and independent distributor lists.

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In January 2001, NHTC entered into a joint venture with Lexxus International and formed a new majority-owned USA subsidiary, Lexxus International, Inc., a Delaware corporation. The original founders of Lexxus International received an aggregate of 100,000 shares of our Common Stock and own 49% of the total number of shares of capital stock of Lexxus International, Inc., a Delaware corporation.

In the second quarter of 2001, we incorporated Lexxus International (SW Pacific) Pty. Ltd., an Australian corporation and our majority-owned subsidiary, which does business in Australia ("Lexxus Australia"). In addition, we incorporated Lexxus International (New Zealand) Limited, a New Zealand corporation and majority-owned subsidiary of NHTC, which does business in New Zealand ("Lexxus New Zealand").

In June 2001, we incorporated Lighthouse Marketing Corporation ("Lighthouse"), a Delaware Corporation and our wholly-owned subsidiary. As of January 31, 2003, Lighthouse acquired certain assets from NuEworld. See Footnote 5 for more detail.

In June 2001, we sold all of the outstanding Common Stock in Kaire Nutraceuticals, Inc., a Delaware corporation, to a South African firm.

On November 16, 2001, we incorporated Lexxus International Co., Ltd., a corporation organized under the laws of the Republic of China and our majority-owned subsidiary ("Lexxus Taiwan") which does business in Taiwan.

On January 28, 2002, we incorporated MyLexxus Europe AG, a corporation organized under the laws of Switzerland and our majority-owned subsidiary ("MyLexxus Europe"). This company manages the sales of product into sixteen eastern European countries, including Russia.

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.

In April 2002, we incorporated Personal Care International India Pvt. Ltd., a corporation organized under the laws of India and our wholly-owned subsidiary ("MyLexxus India") which does business in India.

In June 2002, we incorporated Lexxus International Marketing Ltd., a corporation organized under the laws of Singapore and our majority-owned subsidiary ("Lexxus Singapore") which does business in Singapore.

In November 2002, we incorporated Lexxus International (Philippines) Inc., a corporation organized under the laws of the Philippines and our

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majority-owned subsidiary ("Lexxus Philippines") which does business in the Philippines.

Results of Operations - Three Months Ended March 31, 2003 Compared To The Three Months Ended March 31, 2002.

As discussed in Note 2 to the consolidated financial statements, we have amended and restated our results for the three month period ended March 31, 2003 and March 31, 2002. All of the following analyses apply the basis of the restated amounts.

Net Sales. Revenues were approximately \$11,240,000 and \$4,929,000 for the three months ended March 31, 2003 and March 31, 2002, respectively; an increase of \$6,311,000. The increased sales were primarily from additional sales of Lexxus products and the expansion of Lexxus into new international markets, offset by a slight decrease in the sales of eKaire products.

Cost of Sales. Cost of sales for the three months ended March 31, 2003 was approximately \$2,097,000 or 19% of net sales. Cost of sales for the three months ended March 31, 2002 was approximately \$903,000 or 18% of net sales. The total cost of sales increased due to increased sales volume and increased costs associated with the packaging of the Lexxus product line.

Gross Profit. Gross profit increased from approximately \$4,026,000 in the three months ended March 31, 2002 to approximately \$9,144,000 in the three months ended March 31, 2003. The increase in gross profit of approximately \$5,118,000 was attributable to higher sales volumes by Lexxus.

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Associate Commissions. Associate commissions were approximately \$4,581,000 or 41% of sales in the three months ended March 31, 2003 compared to approximately \$3,212,000 or 65% of sales for the three months ended March 31, 2002. The increase of commission expense is directly related to the increase in gross sales and the terms of the compensation plans. The decrease in commission expense as a percentage of sales is due to the normal fluctuations that occur in the compensation plan and also due to the amount of revenues allocated to the compensation plan.

Selling, General and Administrative Expenses. Selling, general and administrative expenses as a percentage of net sales decreased from approximately \$1,982,000 or 40% of sales in the three months ended March 31, 2002 to approximately \$2,823,000 or 25% of sales in the three months ended March 31, 2003. These costs as a percentage of net sales decreased primarily due to recent cost containment efforts and the leverage of Lexxus expansion into new international markets.

Operating Income (loss). Operating (loss) income increased from an operating loss of approximately \$1,168,000 in the three months ended March 31, 2002 to operating income of approximately \$1,740,000 in the three months ended March 31, 2003. This is attributable to higher sales volume, increased selling, general and administrative costs offset by decreased associate commissions.

Income Taxes. Income tax benefits were not reflected for the period ended March 31, 2002. The anticipated benefits of utilizing net operating losses against future profits were not recognized in the three months ended March 31, 2002 under the provisions of SFAS No. 109, Accounting for Income Taxes, utilizing the Company's loss carry forward as a component of income tax expense. A valuation allowance equal to the net deferred tax asset has been recorded, 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. In

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March 2003, the Company recorded income tax expense of \$370,000, as the utilization of the net operating loss was limited by Section 382 of the Internal Revenue Code.

Net Income (loss). Net income was approximately \$1,373,000 in the three months ended March 31, 2003 as compared to a loss of approximately \$1,228,000 in the three months ended March 31, 2002. This increase is due to increased sales and efficient cost containment efforts.

### Liquidity and Capital Resources:

The Company has funded the working capital and capital expenditure requirements primarily from cash provided through operations and through limited borrowings from individuals.

At March 31, 2003, the ratio of current assets to current liabilities was 1.0 to 1.0 and the Company had working capital of approximately \$47,000.

Cash used in operations for the three months ended March 31, 2003 was approximately \$238,000 primarily due to the payment of accounts payable and accrued expenses. Cash used in investing activities during the period was approximately \$557,000 primarily due to the purchase of a database and capital expenditures. Cash used by financing activities during the period was approximately \$84,000. Total cash decreased by approximately \$854,000 during the period.

### CRITICAL ACCOUNTING POLICIES

A summary of significant accounting policies is included in Note 2 to the audited consolidated financial statements included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2002. Management believes that the application of these policies on a consistent basis enables the Company to provide useful and reliable financial information about the Company's operating results and financial condition.

### SEASONALITY

In addition to general economic factors, we are impacted by seasonal factors and trends such as major cultural events and vacation patterns. For example, most Asian markets celebrate their respective local New Year in the first

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quarter, which generally has a negative impact on that quarter. We believe that direct selling in the United States and Europe is also generally negatively impacted during the month of August, which is in our third quarter, when many individuals, including our distributors, traditionally take vacations.

### CURRENCY RISK AND EXCHANGE RATE INFORMATION

Some of our revenue and some of our expenses are recognized outside of the United States, except for inventory purchases which are primarily transacted in U.S. dollars from vendors in the United States. The local currency of each of our subsidiary's primary markets is considered the functional currency. Revenue and expenses are translated at the weighted average exchange rates for the periods reported. Therefore, our reported revenue and earnings will be positively impacted by a weakening of the U.S. dollar and will be negatively impacted by a strengthening of the U.S. dollar. Given the uncertainty of exchange rate fluctuations, we cannot estimate the effect of



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these fluctuations on our future business, product pricing, results of operations or financial condition.

### ITEM 3. CONTROLS AND PROCEDURES

Within the 90 days prior to the date of this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's President and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures, as defined in Exchange Act Rules 13a-14(c) and 15d-14(c).

Based upon that evaluation, the Company's President and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in enabling the Company to record, process, summarize and report information required to be included in the Company's periodic SEC filings within the required time period.

There have been no significant changes in the Company's internal controls or in other factors that could significantly affect internal controls subsequent to the date the Company carried out its evaluation.

## PART II - OTHER INFORMATION

### Item 1. Legal Proceedings

Not applicable.

### Item 2. Changes in Securities and Use of Proceeds

In the three months ended March 31, 2003, NHTC issued 360,000 shares of our Common Stock to NuEworld.com Commerce, Inc. pursuant to a database purchase agreement.

In January 2003, the Company issued 18,500 shares of Common Stock to a law firm for legal services of approximately \$34,000.

In January 2003, the Company issued 10,000 shares of Common Stock to a consulting firm for consulting services of approximately \$19,000.

### Item 3. Defaults upon Senior Securities

Not applicable.

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

On March 11, 2003, the Company held its Annual Meeting of Stockholders where the stockholders of the Company approved the following proposals:

(a) Election of Directors. Mark D. Woodburn and Terry LaCore were elected to the Board of Directors of the Company for a term of one (1) year, receiving 415,838,786 votes and 416,038,786 votes respectively in favor of his election (89.8% of the shares outstanding).

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(b) Reverse Stock Split. The reverse stock split of the Company's issued common stock, par value \$.001 per share, on the basis of one (1) new share of common stock for each one hundred (100) shares of common stock outstanding was approved by the stockholders of the Company

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(409,797,841 votes for (88.5% of the shares outstanding); 4,177,119 shares against; and 3,418,759 shares abstained).

(c) 2002 Stock Plan. The adoption of the Company's 2002 Stock Plan was approved by the stockholders of the Company (412,733,533 votes for (89.2% of the shares outstanding); 4,349,569 shares against; and 310,615 shares abstained).

(d) Ratification of the Appointment of Independent Accountants. The ratification of the appointment of Sherb & Co., LLP as independent accountants of the Company for fiscal year ending December 31, 2002 was approved by the stockholders of the Company (416,097,978 votes for (89.9% of the shares outstanding); 1,134,816 votes against; and 160,925 shares abstained).

(e) Ratification of the Amendment to the Company's Articles of Incorporation. The ratification of the amendment to the Company's Articles of Incorporation pursuant to which the Company increased the number of authorized shares of common stock from 50,000,000 shares to 500,000,000 shares was approved by the stockholders of the Company (414,491,065 votes for (89.5% of the shares outstanding); 2,531,104 votes against; and 371,550 shares abstained).

### Item 5. Other Information

Not applicable.

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

#### (a) Exhibits

99.1 Certification of President and Chief Financial Officer.

#### (b) Reports on Form 8-K

Current Report on Form 8-K filed with the Commission on February 13, 2003 with respect to Item 5.

Current Report on Form 8-K filed with the Commission on March 19, 2003 with respect to Items 5, 7 and 9.

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### SIGNATURE

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

NATURAL HEALTH TRENDS CORP.

By: /s/ MARK D. WOODBURN

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Mark D. Woodburn  
President

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Date: April 12, 2004