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NATURAL HEALTH TRENDS CORP
Form 10QSB
August 14, 2003

FORM 10-QSB

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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

For Quarter Ended June 30, 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.)

5605 N. MacArthur Boulevard, 11th Floor
Irving, Texas 75038
(Address of Principal Executive Office) (Zip Code)

(972) 819-2035
(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 August 8, 2003 were 4,656,408 shares.

NATURAL HEALTH TRENDS CORP.

FORM 10-QSB

For Quarter Ended June 30, 2003

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NATURAL HEALTH TRENDS CORP.

CONSOLIDATED BALANCE SHEET

(UNAUDITED)

June 30,
2003

ASSETS

Current Assets:

Cash	\$ 2,856,235
Accounts receivable	1,582,073
Inventories	2,974,300
Prepaid expenses and other current assets	237,923

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Total Current Assets	7,650,531
Restricted cash	955,926
Property and equipment, net	972,508
Deposits and other assets	763,584
Goodwill	207,765
Database	856,845
Website	33,250
Total Assets	\$ 11,440,409
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current Liabilities:	
Accounts payable	\$ 3,363,990
Accrued expenses	371,017
Accrued bonus payable	1,087,147
Notes payable	334,437
Current portion of long term debt	109,416
Income tax payable	330,322
Other current liabilities	367,645
Total Current Liabilities	5,963,974
Long term notes payable	41,643
Total Liabilities	6,005,617
Minority interest	749,978
Stockholders' Equity:	
Preferred stock (\$1,000 par value; authorized 1,500,000 shares)	--
Common stock (\$.001 par value; authorized 500,000,000 shares; issued and outstanding 4,656,408 shares)	4,656
Additional paid in capital	32,647,502
Accumulated deficit	(27,961,965)
Deferred compensation	(11,250)
Accumulated other comprehensive income	5,871
Total Stockholders' Equity	4,684,814
Total Liabilities and Stockholders' Equity	\$ 11,440,409

See Notes to Consolidated Financial Statements.

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(UNAUDITED)

	Three Months Ended June 30,		Six Months June
	2003	2002	2003
	-----	-----	-----
Net sales	\$ 12,156,719	\$ 9,116,192	\$ 21,800,141
Cost of sales	1,680,340	1,573,626	3,617,186
	-----	-----	-----
Gross profit	10,476,379	7,542,566	18,182,955
Associate commissions	4,928,928	4,535,501	9,051,342
Selling, general and administrative expenses	4,026,873	2,355,613	6,849,829
	-----	-----	-----
Operating income	1,520,578	651,452	2,281,784
Minority interest in subsidiary	82,417	(48,541)	(23,231)
Loss on foreign exchange	(64,292)	(78,781)	(11,492)
Other income, net	124,682	154,169	389,196
Interest, net	(11,776)	(14,980)	(20,176)
	-----	-----	-----
Net income before taxes	1,651,609	663,319	2,616,081
Income tax expense	330,322	--	330,322
Net income	1,321,287	663,319	2,285,759
Preferred stock dividends	408	19,175	810
	-----	-----	-----
Net income to common stockholders	\$ 1,320,879	\$ 644,144	\$ 2,284,949
	=====	=====	=====
Basic income per common share	\$ 0.28	\$ 0.22	\$ 0.50
	=====	=====	=====
Basic weighted common shares used	4,656,408	2,972,713	4,569,986
	=====	=====	=====
Diluted income per common share	\$ 0.23	\$ 0.17	\$ 0.41
	=====	=====	=====
Diluted weighted common shares used	5,695,045	3,682,051	5,608,623
	=====	=====	=====

See Notes to Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(UNAUDITED)

	Three Months Ended June 30,		Six
	2003	2002	2003
	-----	-----	-----
Net income	\$ 1,321,287	\$ 663,319	\$ 2,285,759
Other comprehensive income, net of tax Foreign translation adjustment	(18,967)	53,816	5,871
	-----	-----	-----
Comprehensive income	\$ 1,302,320	\$ 717,135	\$ 2,291,630
	=====	=====	=====

See Notes to Consolidated Financial Statements.

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NATURAL HEALTH TRENDS CORP.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Six Months Ended June 30,	
	2003	2002
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 2,285,759	\$ 673,200
	-----	-----
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	310,051	191,008
Stock issued for compensation	51,826	7,192
Gain on forgiveness of debt	(400,000)	(400,000)
Minority interest of subsidiary	23,231	196,091
CHANGES IN ASSETS AND LIABILITIES:		
Accounts receivable	(1,062,321)	(239,846)
Inventories	(53,176)	(216,256)
Prepaid expenses	169,883	175,393
Deposits and other assets	(431,978)	152,495

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Accounts payable and accrued expenses	(780,311)	2,476,668
Deferred revenue	--	116,684
Income tax payable	330,322	--
Other current liabilities	14,602	225,071
	-----	-----
Total Adjustments	(1,827,871)	2,684,500
	-----	-----
NET CASH PROVIDED BY OPERATING ACTIVITIES	457,888	3,357,700
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(428,037)	(367,958)
Database purchase	(226,845)	--
Increase in restricted cash	(628,041)	(88,122)
	-----	-----
NET CASH USED IN INVESTING ACTIVITIES	(1,282,923)	(456,080)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from notes payable and long-term debt	--	260,000
Payments of notes payable and long-term debt	(198,114)	(77,365)
	-----	-----
NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES	(198,114)	182,635
	-----	-----
Effect of Exchange Rate Changes	15,438	59,658
NET (DECREASE) INCREASE IN CASH	(1,007,711)	3,143,913
CASH, BEGINNING OF PERIOD	3,863,946	324,315
	-----	-----
CASH, END OF PERIOD	\$ 2,856,235	\$ 3,468,228
	=====	=====

See Notes to Consolidated Financial Statements.

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NATURAL HEALTH TRENDS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SIX MONTHS ENDED JUNE 30, 2003

(UNAUDITED)

1. We are Natural Health Trends Corp. ("NHTC"), an international direct-selling company. 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., our wholly-owned subsidiary ("eKaire"), distributes nutritional supplements aimed at general health and wellness.
2. The accompanying unaudited financial statements of Natural Health Trends Corp. and its subsidiaries (the "Company") have been prepared in accordance

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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 six month period ended June 30, 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.

3. In January 2003, the Company issued 18,500 shares of Common Stock to a law firm for legal services of approximately \$34,000.
4. In January 2003, the Company issued 10,000 shares of Common Stock to a consulting firm for consulting services of approximately \$19,000.
5. 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 associates 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.
6. In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities". SFAS No. 149 amends and clarifies under what circumstances a contract with initial investments meets the characteristics of a derivative and when a derivative contains a financing component. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003. The Company does not expect that the adoption of SFAS No. 149 will have a significant effect on the Company's financial statement presentation or disclosures.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity". SFAS No. 150 establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003 and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. SFAS No. 150 is to be implemented by reporting the cumulative effect of a change in accounting principle for financial instruments created before the issuance date of SFAS No. 150 and still existing at the beginning of the interim period of adoption. Restatement is not permitted. The Company does not expect that the adoption of SFAS No. 150 will have a significant effect on the Company's financial statement presentation or disclosures.

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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 30 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 July 2003, we applied for listing of our shares of Common Stock on The American Stock Exchange. We anticipate that our shares of Common Stock will commence trading on The American Stock Exchange during the third quarter of 2003. 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".

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 associate lists.

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.

In the second quarter of 2001, we incorporated Lexxus International (SW Pacific) Pty. Ltd., an Australian corporation and our majority-owned

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subsidiary, which does business in Australia ("Lexus Australia"). In addition, we incorporated Lexus International (New Zealand) Limited, a New Zealand corporation and majority-owned subsidiary of NHTC, which does business in New Zealand ("Lexus 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.

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

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

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

In March 2002, we incorporated Lexus International Co., Ltd., a corporation organized under the laws of Hong Kong and our wholly-owned subsidiary ("Lexus 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 ("MyLexus India") which does business in India.

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

In November 2002, we incorporated Lexus International (Philippines) Inc., a corporation organized under the laws of the Philippines and our majority-owned subsidiary ("Lexus Philippines") which does business in the Philippines.

In June 2003, we incorporated LXX Ltd. (South Korea), a corporation organized under the laws of South Korea and our wholly-owned subsidiary ("Lexus Korea") which does business in South Korea.

Six Months Ended June 30, 2003 Compared To
The Six Months Ended June 30, 2002.

Revenues. Revenues were approximately \$21,800,000 and \$15,270,000 for the six months ended June 30, 2003 and June 30, 2002, respectively; an increase of \$6,530,000 or 43%. The increased sales were primarily from additional sales of Lexus products and the expansion of Lexus into new international markets, including South Korea in June 2003, partially offset by a slight decrease in the sales of eKaire products.

Cost of Sales. Cost of sales for the six months ended June 30, 2003 was approximately \$3,617,000 or 17% of net sales. Cost of sales for the six months ended June 30, 2002 was approximately \$2,664,000 or 17% of net sales. The total cost of sales increased due to increased sales volume and increased costs associated with the packaging of the Lexus product line.

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Gross Profit. Gross profit increased from approximately \$12,606,000 in the six months ended June 30, 2002 to approximately \$18,183,000 in the six months ended June 30, 2003, or an increase of 44%. The increase in gross profit of approximately \$5,577,000 was attributable to higher sales volumes by Lexxus.

Associate Commissions. Associate commissions were approximately \$9,051,000 or 42% of sales in the six months ended June 30, 2003 compared to approximately \$7,747,000 or 51% of sales for the six months ended June 30, 2002. The increase of commission expense is directly related to the increase in gross sales and the terms of the Company's 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 increased from approximately \$4,337,000 or 28% of sales in the six months ended June 30, 2002 to approximately \$6,850,000 or 31% of sales in the six months ended June 30, 2003. These costs as a percentage of net sales increased primarily due to

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general and administrative costs, such as hiring staff, preparing office space and initial marketing efforts through the expansion into new international markets.

Operating income. Operating income increased from an operating income of approximately \$522,000 in the six months ended June 30, 2002 to operating income of approximately \$2,282,000 in the six months ended June 30, 2003. This is attributable to higher sales volume, increased selling, general and administrative costs and increased associate commissions.

Income Taxes. In the second quarter 2003, the Company has provided income taxes in the amount of \$330,000, due to the limitation of the utilization of the Company's available net operating loss carryforwards pursuant to Section 382 of the Internal Revenue Code.

Other Income. As part of other income during the six months ended June 30, 2003 and the six months ended June 30, 2002, NHTC realized a gain of approximately \$400,000 in other income due to forgiveness of debt.

Net Income. Net income was approximately \$2,286,000 in the six months ended June 30, 2003 as compared to approximately \$673,000 in the six months ended June 30, 2002. The increase in net income of approximately \$1,613,000 is due to increased sales and efficient cost containment efforts partially offset by an income tax expense.

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 June 30, 2003, the ratio of current assets to current liabilities was 1.28 to 1.0 and the Company had working capital of approximately \$1,687,000.

Cash provided by operations for the six months ended June 30, 2003 was approximately \$458,000 primarily due from increased sales, the launch of the

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Company's South Korean operations which were partially offset by increased accounts receivable and the reduction of accounts payable. Cash used in investing activities during the period was approximately \$1,283,000 due to the purchase of an associate database, the increase of capital expenditures and the increase of restricted cash. Cash used by financing activities during the period was approximately \$198,000. Total cash decreased by approximately \$1,008,000 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.

EFFECT OF NEW ACCOUNTING STANDARDS

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities". SFAS No. 149 amends and clarifies under what circumstances a contract with initial investments meets the characteristics of a derivative and when a derivative contains a financing component. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003. The Company does not expect that the adoption of SFAS No. 149 will have a significant effect on the Company's financial statement presentation or disclosures.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity". SFAS No. 150 establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003 and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. SFAS No. 150 is to be implemented by reporting the cumulative effect of a change in accounting principle for financial instruments created before the issuance date of SFAS No. 150 and still existing at the beginning of the interim period of adoption. Restatement is not permitted. The Company does not expect that the adoption of SFAS No. 150 will have a significant effect on the Company's financial statement presentation or disclosures.

Item 3. Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our management, including our President and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management

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is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by SEC Rule 13a-15(b), we carried out an evaluation, under the supervision and with the participation of our management, including our President and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the quarter covered by this report. Based on the foregoing, our President and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

There has been no change in our internal controls over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 2. Changes in Securities and Use of Proceeds

In March 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

None.

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

On May 22, 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, Terry LaCore, Sir Brian Wolfson and Randall A. Mason were elected to the Board of Directors of the Company for a term of one (1) year, each receiving 3,218,419, 3,218,299, 3,215,149 and 3,218,519 votes respectively in favor of his election (69.5% of the shares outstanding).

(b) Amendment to the 2002 Stock Option Plan. The amendment to the Company's 2002 Stock Plan was approved by the stockholders of the Company (3,215,333 votes for (69.46% of the shares outstanding); 4,891 shares against; and 1,230 shares abstained).

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(c) Ratification of the Appointment of Independent Accountants. The ratification of the appointment of Sherb & Co., LLP as independent accountants

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of the Company for fiscal year ending December 31, 2003 was approved by the stockholders of the Company (3,221,055 votes for (69.59% of the shares outstanding); 284 votes against; and 115 shares abstained).

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

31.1 Certification of the President and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of the President and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K

None.

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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

Mark D. Woodburn
President

Date: August 13, 2003

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