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NATURAL HEALTH TRENDS CORP
Form 10QSB
August 14, 2002

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, 2002

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

59-2705336

State or other jurisdiction of
incorporation or organization

(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 X

No

The number of shares of issuer's Common Stock, \$.001 par value, outstanding as
of August 12, 2002 were 297,999,898 shares.

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NATURAL HEALTH TRENDS CORP.

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CONSOLIDATED BALANCE SHEET

(UNAUDITED)

June 30,
2002

| ASSETS | |
|--|--------------|
| Current Assets: | |
| Cash | \$ 3,468,228 |
| Account receivables | 359,663 |
| Inventories | 1,141,017 |
| Prepaid expenses and other current assets | 71,797 |
| | ----- |
| Total Current Assets | 5,040,705 |
| Restricted cash | 188,931 |
| Property and Equipment, net | 459,874 |
| Deposits and Other Assets | 172,190 |
| Goodwill | 207,765 |
| Website | 99,750 |
| | ----- |
| Total Assets | \$ 6,169,215 |
| | ===== |
| LIABILITIES AND STOCKHOLDERS' DEFICIT | |
| Current Liabilities: | |
| Accounts payable | \$ 1,767,412 |
| Accrued expenses | 572,321 |
| Accrued bonus payable | 1,938,514 |
| Reserve for contingent liability | 2,000,000 |
| Notes payable | 336,606 |
| Current portion of long term debt | 341,082 |
| Deferred revenue | 116,684 |
| Other current liabilities | 332,294 |
| | ----- |
| Total Current Liabilities | 7,404,913 |
| | ----- |
| Minority interest | 196,091 |
| Long term debt | 626,417 |
| | ----- |
| Total Liabilities | 8,227,421 |
| | ----- |
| Stockholders' Deficit: | |
| Preferred stock (\$1,000 par value; authorized 1,500,000 shares; issued 903 shares) | 902,588 |
| Common Stock (\$.001 par value; authorized 500,000,000 shares; issued and outstanding 297,999,898 shares) | 298,000 |
| Additional paid-in capital | 30,612,123 |
| Accumulated deficit | (33,647,083) |
| Deferred compensation | (281,250) |
| Accumulated other comprehensive income | 57,416 |
| | ----- |
| Total Stockholders' Deficit | (2,058,206) |
| | ----- |
| Total Liabilities and Stockholders' Deficit | \$ 6,169,215 |

=====

See Notes to Consolidated Financial Statements.

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|--------------|------------------------------|---------------|
| | 2002 | 2001 | 2002 | 2001 |
| | ----- | ----- | ----- | ----- |
| Net Sales | \$ 9,116,192 | \$ 9,824,203 | \$ 15,270,336 | \$ 13,010,051 |
| Cost of Sales | 1,573,626 | 2,769,023 | 2,664,121 | 3,408,300 |
| | ----- | ----- | ----- | ----- |
| Gross Profit | 7,542,566 | 7,055,180 | 12,606,215 | 9,601,751 |
| Associate commissions | 4,535,501 | 4,786,743 | 7,747,237 | 6,453,637 |
| Selling, general and administrative expenses | 2,355,613 | 1,050,000 | 4,337,451 | 1,793,655 |
| | ----- | ----- | ----- | ----- |
| Operating income | 651,452 | 1,218,437 | 521,527 | 1,354,459 |
| Minority interest in subsidiary | (48,541) | - | (60,378) | - |
| Loss on foreign exchange | (78,781) | (200) | (78,871) | (244) |
| Other expense/income | (45,831) | 37,989 | (76,469) | 35,009 |
| Interest, net | (14,980) | (3,118) | (32,609) | (15,534) |
| | ----- | ----- | ----- | ----- |
| Income before extraordinary items | 463,319 | 1,253,108 | 273,200 | 1,373,690 |
| Extraordinary gain - forgiveness of debt | 200,000 | - | 400,000 | - |
| | ----- | ----- | ----- | ----- |
| Net income | 663,319 | 1,253,108 | 673,200 | 1,373,690 |
| Preferred stock dividends | 19,175 | 124,886 | 41,460 | 230,929 |
| | ----- | ----- | ----- | ----- |
| Net income to common shareholders | \$ 644,144 | \$ 1,128,222 | \$ 631,740 | \$ 1,142,761 |
| | ===== | ===== | ===== | ===== |

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| | | | | |
|-------------------------------------|-------------|-------------|-------------|-------------|
| Basic income per common share | \$ 0.00 | \$ 0.04 | \$ 0.00 | \$ 0.04 |
| | ===== | ===== | ===== | ===== |
| Basic weighted common shares used | 297,271,348 | 59,245,565 | 281,983,013 | 29,622,783 |
| | ===== | ===== | ===== | ===== |
| Diluted income per common share | \$ 0.00 | \$ 0.01 | \$ 0.00 | \$ 0.01 |
| | ===== | ===== | ===== | ===== |
| Diluted weighted common shares used | 368,205,119 | 190,126,367 | 352,916,784 | 160,408,421 |
| | ===== | ===== | ===== | ===== |

See Notes to Consolidated Financial Statements.

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NATURAL HEALTH TRENDS CORP.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(UNAUDITED)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|--------------|------------------------------|--------------|
| | 2002 | 2001 | 2002 | 2001 |
| | ----- | ----- | ----- | ----- |
| Net income | \$ 663,319 | \$ 1,253,108 | \$ 673,200 | \$ 1,373,690 |
| Other comprehensive income, net of tax | | | | |
| Foreign translation adjustment | 53,816 | 445 | 59,658 | 37,203 |
| | ----- | ----- | ----- | ----- |
| Comprehensive income | \$ 717,135 | \$ 1,253,553 | \$ 732,858 | \$ 1,410,893 |
| | ===== | ===== | ===== | ===== |

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, | |
|---|------------------------------|------------------|
| | 2002 | 2001 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$ 673,200 | \$ 1,373,690 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 191,008 | 39,589 |
| Issuance of stock for services rendered/ settlement of interest | 7,192 | 61,758 |
| Gain on forgiveness of debt | (400,000) | - |
| Minority interest of subsidiary | 196,091 | - |
| Changes in assets and liabilities: | | |
| Accounts receivable | (239,846) | (822,048) |
| Inventories | (216,256) | (306,737) |
| Prepaid expenses | 175,393 | (33,782) |
| Deposits and other assets | 152,495 | 52,912 |
| Accounts payable and accrued expenses | 2,476,668 | 1,320,513 |
| Deferred revenue | 116,684 | (80,061) |
| Other current liabilities | 225,071 | (331,195) |
| Total Adjustments | 2,684,500 | (99,051) |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 3,357,700 | 1,274,639 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |

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| | | |
|--|--------------|--------------|
| Capital expenditures | (367,958) | (24,636) |
| | ----- | ----- |
| NET CASH USED IN INVESTING ACTIVITIES | (367,958) | (24,636) |
| | ----- | ----- |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Restricted cash | (88,122) | 6,050 |
| Proceeds from preferred stock | - | 100,000 |
| Proceeds from notes payable and long-term debt | 260,000 | 50,000 |
| Payments of notes payable and long-term debt | (77,365) | (33,187) |
| | ----- | ----- |
| NET CASH PROVIDED BY FINANCING ACTIVITIES | 94,513 | 122,863 |
| | ----- | ----- |
| Effect of Exchange Rate Changes | 59,658 | - |
| | ----- | ----- |
| NET INCREASE IN CASH | 3,143,913 | 1,372,866 |
| | ----- | ----- |
| CASH, BEGINNING OF PERIOD | 324,315 | 108,419 |
| | ----- | ----- |
| CASH, END OF PERIOD | \$ 3,468,228 | \$ 1,481,285 |
| | ----- | ----- |

See Notes to Consolidated Financial Statements.

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NATURAL HEALTH TRENDS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SIX MONTHS ENDED JUNE 30, 2002

(UNAUDITED)

1. BASIS OF PRESENTATION

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-X. 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

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revenues and expenses during the reporting period. Actual results could differ from those estimates. Operating results for the six month period ended June 30, 2002 are not necessarily indicative of the results that may be expected for the year ending December 31, 2002. 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, 2001.

The Company had a working capital deficiency of approximately \$2,364,000 at June 30, 2002 and \$3,522,000 at December 31, 2001. This raises substantial doubt about the Company's ability to continue as a going concern. The Company's continued existence is dependent on its ability to generate profits from operations. While management is unable to predict profitability and can make no assurances, management believes the Company will generate sufficient profits to ease its dependency on debt and equity financing in the foreseeable future.

2. FUTURE EFFECTS OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 141 ("SFAS No. 141"), "Business Combinations." SFAS No. 141 requires the purchase method of accounting for business combinations initiated after June 30, 2001 and eliminates the pooling-of-interest method. The adoption of SFAS No. 141 did not have a significant impact on the financial statements.

In July 2001, FASB issued Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets", ("SFAS No. 142"), which is effective for fiscal years beginning after December 15, 2001. SFAS No. 142 requires, among other things, the discontinuance of goodwill amortization. In addition, the standard includes provisions upon adoption for the reclassification of certain existing recognized intangibles as goodwill, reassessment of the useful lives of existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill and the testing for the impairment of existing goodwill and other intangibles. Application of the non-amortization provisions of the Statement did not have an effect on the Company's financial position or operations.

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In August 2001, the FASB issued Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations", ("SFAS No. 143"), which is effective for all fiscal years beginning after June 15, 2002; however, early adoption is encouraged.

In October 2001, the FASB issued Statement of Financial Accounting Standards No. 144 ("SFAS No. 144"), "Accounting for the Impairment or Disposal of Long-Lived Assets," which supercedes Statement of Financial Accounting Standards No. 121 ("SFAS No. 121"), "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" and certain provisions of APB Opinion No. 30, "Reporting Results of

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Operations - Reporting the Effects of Disposal of a Segment of a Business and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." SFAS No. 144 requires that long-lived assets to be disposed of by sale, including discontinued operations, be measured at the lower of carrying amount or fair value, less cost to sell, whether reported in continuing operations or in discontinued operations. SFAS No. 144 also broadens the reporting requirements of discontinued operations to include all components of an entity that have operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. The provisions of SFAS No. 144 are effective for fiscal years beginning after December 15, 2001. The Company implemented SFAS No. 144 and SFAS No. 143 beginning January 1, 2002.

3. During the first six months of 2002, the Company received notice of conversion on \$1,421,710 of Series F, H and J Preferred Stock. The Company issued 73,289,680 shares of Common Stock upon conversion of the shares of Preferred Stock and the accrued dividends thereon.
4. The Company issued 1,930,000 shares of Common Stock to a law firm in the first six months of 2002 for legal services of approximately \$57,100.
5. The Company issued 1,842,499 shares of Common Stock in the first six months of 2002 for a note payable and its accrued interest of approximately \$27,000.

Item 2. Management's Discussion and Analysis or Plan of Operation

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 speaks 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. ("NHTC") is a Florida corporation. NHTC was incorporated on December 1, 1988 as "Florida Institute of Massage Therapy, Inc." and changed its name to "Natural Health Trends Corp." on June 24, 1993. NHTC's Common Stock, par value \$0.001 per share (the "Common Stock") is listed on the Over-the-Counter Bulletin Board (the "OTCBB") under the symbol "NHTC".

NHTC is a holding company that operates two businesses, both of which distribute products that promote health, wellness and sexual vitality through the multi-level marketing ("MLM") channel.

NHTC's largest operation is Lexxus International, Inc. ("Lexxus"), a Delaware corporation and a majority-owned subsidiary of NHTC. Lexxus sells products that heighten mental and sexual arousal, particularly in women. NHTC's other business, eKaire.com, Inc. ("eKaire"), distributes nutritional supplements aimed at general health and wellness through the Internet and other channels. eKaire consists of companies operating in the U.S., in Canada as Kaire International Canada Ltd. ("Kaire Canada"), in Australia as Kaire Nutraceuticals Australia Pty. Ltd. ("Kaire Australia"), in New Zealand as Kaire Nutraceuticals New Zealand Limited ("Kaire New Zealand"), and in Trinidad as Kaire Trinidad, Ltd. ("Kaire Trinidad").

In January 2001, NHTC entered into a joint venture with Lexxus International and formed a new majority-owned subsidiary, Lexxus International, Inc., a Delaware corporation. The original founders of Lexxus International received an aggregate of 10,000,000 shares of Common Stock.

In March 2001, Global Health Alternatives, Inc., a Delaware corporation and wholly-owned subsidiary of NHTC ("GHA"), and Ellon, Inc., a Delaware corporation and wholly-owned subsidiary of GHA ("Ellon"), filed for Chapter 7 bankruptcy liquidation in the United States Bankruptcy Court of the Northern District of Texas. Neither GHA nor Ellon had operations during the years 2000 or 2001. Both GHA and Ellon were dissolved in June 2001.

In the second quarter of 2001, NHTC incorporated Lexxus International (SW Pacific) Pty. Ltd., an Australian corporation and majority-owned subsidiary of NHTC, which does business in Australia ("Lexxus Australia"). In addition, NHTC 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, NHTC incorporated Lighthouse Marketing Corporation ("LMC"), a Delaware Corporation and a wholly-owned subsidiary of NHTC. As of June 30, 2002, LMC had not conducted any business, but intends to conduct business in the future.

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

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

In March 2002, NHTC incorporated Lexxus International Co. Ltd., a corporation organized under the laws of Hong Kong and a majority-owned subsidiary of NHTC ("Lexxus Hong Kong").

In April 2002, NHTC incorporated Personal Care International India Pvt. Ltd., a corporation organized under the laws of India and a majority-owned subsidiary of NHTC ("MyLexxus India").

In June 2002, NHTC incorporated Lexxus Marketing Pte. Ltd., a

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corporation organized under the laws of Singapore and a majority-owned subsidiary of NHTC ("Lexxus Singapore").

Six Months Ended June 30, 2002 Compared To the Six Months Ended June 30, 2001.

Net Sales. Net sales were approximately \$15,270,000 and \$13,010,000 for the six months ended June 30, 2002 and June 30, 2001, respectively; an increase of approximately \$2,260,000. The increased sales were primarily from the sales of Lexxus products at varying prices in different markets and the expansion of Lexxus into international markets offset by a slight decrease in the sales of eKaire products.

Cost of Goods Sold. Cost of goods sold for the six months ended June 30, 2002 was approximately \$2,664,000 or 17% of net sales. Cost of goods sold for the six months ended June 30, 2001 was approximately \$3,408,000 or 26% of net sales. Cost of goods sold decreased as a percentage of net sales due to increased sales volume of lower priced inventory, the costs associated with the packaging of the Lexxus product line, and increased efficiencies gained from global distribution channels.

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Gross Profit. Gross profit increased from approximately \$9,602,000 for the six months ended June 30, 2001 to approximately \$12,606,000 for the six months ended June 30, 2002. The increase of approximately \$3,004,000 is attributable to higher sales volumes by Lexxus and the international expansion of Lexxus.

Commissions. Associate commissions were approximately \$7,747,000 in the six months ended June 30, 2002 compared to approximately \$6,454,000 for the six months ended June 30, 2001, an increase of approximately \$1,293,000. This increase is directly attributable to the higher sales volume generated in 2002.

Selling, General and Administrative Expenses. Selling, general and administrative expenses as a percentage of net sales increased from approximately \$1,794,000 or 14% of net sales in the six months ended June 30, 2001 to approximately \$4,337,000 or 28% of net sales in the six months ended June 30, 2002. These expenses as a percentage of net sales increased primarily due to the expansion of Lexxus into international markets and the development of a strong global infrastructure, including increased personnel and facility costs.

Income from Operations. Operating income decreased from approximately \$1,354,000 for the six months ended June 30, 2001 to approximately \$522,000 for the six months ended June 30, 2002. The decrease is due to the initial costs incurred in opening international offices and developing a marketing strategy in international markets.

Income Taxes. Income tax benefits were not reflected in either period due to the utilization of net operating loss carryforwards.

Income before Extraordinary Items. As of June 30, 2002 the Company had income before extraordinary times of approximately \$273,000 as compared to approximately \$1,374,000 as of June 30, 2001.

Gain on Forgiveness of Debt. During the six months ended June 30, 2002, NHTC realized a gain of \$400,000 on the various debt and payables related to the

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sale of Kaire Nutraceuticals, Inc.

Net Income. Net income was approximately \$673,000 in the six months ended June 30, 2002 as compared to approximately \$1,374,000 in the six months ended June 30, 2001.

Liquidity and Capital Resources

The Company has funded working capital and capital expenditure requirements primarily from cash receipts which are directly from the sale of Lexxus and eKaire products.

In the six months ended June 30, 2002, NHTC issued 50,988,189 shares of Common Stock to an accredited investor upon conversion of \$1,096,710, face amount of Series F Preferred Stock pursuant to Section 4(2) of the Securities Act of 1933, as amended (the "Act").

In the six months ended June 30, 2002, NHTC issued 3,773,949 shares of Common Stock to an accredited investor upon conversion of \$50,000, face amount of Series H Preferred Stock pursuant to Section 4(2) of the Act.

In the six months ended June 30, 2002, NHTC issued 18,527,542 shares of Common Stock to an accredited investor upon conversion of \$275,000, face amount of Series J Preferred Stock pursuant to Section 4(2) of the Act.

At June 30, 2002, the ratio of current assets to current liabilities was 0.68 to 1.0 and the Company had a working capital deficit of approximately \$2,364,000.

Cash provided by operations for the six months ended June 30, 2002 was approximately \$3,358,000. Cash used in investing activities during the period was approximately \$368,000. Cash provided by financing activities during the period was approximately \$95,000. Total cash increased by approximately \$3,144,000 during the period.

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Our independent auditors' report on the consolidated financial statements stated as of December 31, 2001, that due to a working capital deficit, there is substantial doubt about the company's ability to continue as a going concern. While there can be no assurances, management believes that the profitability achieved during the six months ended June 30, 2002 will continue for the foreseeable future.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

On November 22, 2001, Pfizer, Inc. filed an action in the United States District Court, Southern District of New York, against Lexxus alleging that Lexxus' distribution and marketing of Viacreme TM infringes on

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Pfizer's federally registered trademark, Viagra (R). Pfizer's complaint alleges federal false designation of origin and unfair competition, federal trademark dilution, federal false advertising and unfair competition, common law trademark infringement, trademark dilution and deceptive acts and practices. NHTC settled the Pfizer lawsuit amicably in July 2002.

Item 2. Changes in Securities and Use of Proceeds

In the six months ended June 30, 2002, NHTC issued 50,988,189 shares of Common Stock to an accredited investor upon conversion of \$1,096,710, face amount of Series F Preferred Stock pursuant to Section 4(2) of the Securities Act of 1933, as amended (the "Act").

In the six months ended June 30, 2002, NHTC issued 3,773,949 shares of Common Stock to an accredited investor upon conversion of \$50,000, face amount of Series H Preferred Stock pursuant to Section 4(2) of the Act.

In the six months ended June 30, 2002, NHTC issued 18,527,542 shares of Common Stock to an accredited investor upon conversion of \$275,000, face amount of Series J Preferred Stock pursuant to Section 4(2) of the Act.

Item 3. Defaults upon Senior Securities

None.

Item 4. Submission of Matters to Vote of Security Holders

None.

Item 5. Other Information

None.

PART III - OTHER

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

99.1 Certification of Chief Executive and Financial Officer

(b) Reports on Form 8-K

None.

SIGNATURES

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

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undersigned, thereunto duly authorized.

NATURAL HEALTH TRENDS CORP.

By: /s/ Mark D. Woodburn

Mark D. Woodburn
President

Date: August 14, 2002

