

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 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	59-2705336
State or other jurisdiction of incorporation or organization	(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 August 8, 2003 were 4,656,408 shares.

NATURAL HEALTH TRENDS CORP.

Form 10-QSB/A

For Quarter Ended June 30, 2003

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## 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

For Quarter Ended June 30, 2003

(UNAUDITED)

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NATURAL HEALTH TRENDS CORP.

CONSOLIDATED BALANCE SHEET

(UNAUDITED)

June 30,  
2003  
As Restated  
-----

ASSETS

Current Assets:	
Cash	\$ 2,856,235
Accounts receivable	1,182,073
Restricted cash	955,926
Inventories	3,156,800
Prepaid expenses and other current assets	878,559
	-----
Total Current Assets	9,029,593
Property and equipment, net	972,508
Deposits and other assets	763,584
Goodwill	207,765
Database	856,845
Website	33,250
	-----
Total Assets	\$ 11,863,545
	-----

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:	
Accounts payable	\$ 2,163,990
Accrued expenses	1,121,017
Accrued associate commissions	1,087,147
Notes payable	334,437
Current portion of long term debt	137,861
Deferred revenue	1,925,131
Income tax payable	1,210,322

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Other current liabilities	667,645
	-----
Total Current Liabilities	8,647,550
	-----
Long term notes payable	13,198
	-----
Total Liabilities	8,660,748
Minority interest	449,978
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	34,201,502
Accumulated deficit	(31,447,960)
Deferred compensation	(11,250)
Accumulated other comprehensive income	5,871
	-----
Total Stockholders' Equity	2,752,819
	-----
Total Liabilities and Stockholders' Equity	\$ 11,863,545
	=====

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

1

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003 As Restated	2002 As Restated	2003 As Restated	2002 As Restated
	-----	-----	-----	-----
Net sales	\$ 11,984,085	\$ 8,786,282	\$ 23,224,402	\$ 13,715,165
Cost of sales	1,681,983	1,516,204	3,778,690	2,419,495
	-----	-----	-----	-----
Gross profit	10,302,102	7,270,078	19,445,712	11,295,670
Associate commissions	4,928,928	4,535,501	9,510,046	7,747,237
Selling, general and administrative expenses	4,026,873	2,355,613	6,849,829	4,337,451
	-----	-----	-----	-----
Operating income	1,346,301	378,964	3,085,837	(789,018)

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Minority interest in subsidiary	82,417	(48,540)	(23,231)	(60,377)
Loss on foreign exchange	(64,292)	(78,782)	(11,492)	(78,872)
Other income, net	(75,318)	(45,831)	(10,804)	(76,469)
Interest, net	(11,776)	(14,980)	(20,176)	(32,609)
	-----	-----	-----	-----
Net income before taxes	1,277,332	190,831	3,020,134	(1,037,345)
Income tax expense	330,322	--	700,322	--
Net income	947,010	190,831	2,319,812	(1,037,345)
Preferred stock dividends	408	19,175	810	41,460
	-----	-----	-----	-----
Net income (loss) to common stockholders	\$ 946,602	\$ 171,656	\$ 2,319,002	\$ (1,078,805)
	=====	=====	=====	=====
Basic income (loss) per common share	\$ 0.20	\$ 0.06	\$ 0.51	\$ (0.38)
	=====	=====	=====	=====
Basic weighted common shares used	4,627,941	2,972,713	4,569,988	2,819,830
	=====	=====	=====	=====
Diluted income (loss) per common share	\$ 0.17	\$ 0.05	\$ 0.43	\$ (0.31)
	=====	=====	=====	=====
Diluted weighted common shares used	5,628,487	3,682,051	5,421,302	3,529,168
	=====	=====	=====	=====

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 June 30,		Six Months Ended June 30,	
	2003 As Restated	2002 As Restated	2003 As Restated	2002 As Restated
	-----	-----	-----	-----
Net income (loss)	\$ 947,010	\$ 190,831	\$ 2,319,812	\$ (1,037,345)
Other comprehensive				

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income, net of tax:				
Foreign currency translation adjustments	(9,403)	53,815	15,437	59,657
	-----	-----	-----	-----
Comprehensive income (loss)	\$ 937,607	\$ 244,646	\$ 2,335,249	\$ (977,688)
	=====	=====	=====	=====

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

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

	Six Months Ended June 30,	
	2003 As Restated	2002 As Restated
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	\$ 2,319,812	\$ (1,037,345)
	-----	-----
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	444,866	224,218
Stock issued for compensation	50,265	5,350
Minority interest of subsidiary	23,231	60,377
Changes in operating assets and liabilities:		
Accounts receivable	(662,321)	(239,846)
Inventories	(3,176)	(251,256)
Prepaid expenses	281,387	(34,232)
Deposits and other assets	26,726	152,495
Accounts payable	(1,085,428)	131,739
Accrued expenses	55,116	2,759,487
Deferred revenue	(1,574,261)	1,496,855
Income tax payable	700,322	--
Other current liabilities	14,602	225,071
	-----	-----
Total Adjustments	(1,728,671)	4,530,258
	-----	-----
NET CASH PROVIDED BY OPERATING ACTIVITIES	591,141	3,492,913
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(561,289)	(399,329)
Database purchase	(226,845)	--
Increase in restricted cash	(628,041)	(88,122)
	-----	-----
NET CASH USED IN INVESTING ACTIVITIES	(1,416,175)	(487,451)

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CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from notes payable and long-term debt	--	100,000
Minority interest contribution		135,714
Payments of notes payable and long-term debt	(198,114)	(156,920)
	-----	-----
NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES	(198,114)	78,794
	-----	-----
Effect of exchange rate	15,437	59,657
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
	=====	=====

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

SIX MONTHS ENDED JUNE 30, 2003

(UNAUDITED)

1. Basis of Presentation

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.

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 six month period ended June 30, 2003

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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 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.

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

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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 and six-month periods ended June 30, 2003 being decreased by approximately \$38,000 and increased by approximately \$566,000, respectively. The restatement resulted in net sales for the three and six-month periods ended June 30, 2002 being decreased by approximately \$242,000 and \$1,380,000, respectively. 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 of cost of sales decreased by approximately \$23,000 and increased by approximately \$112,000 for the three and six-month periods ended June 30, 2003, respectively. Compared to amounts previously reported, the restatement decreased cost of sales by approximately \$40,000 and \$210,000 for the three and six-month periods ended June 30, 2002, respectively.

In addition, the Company and its new independent accounting firm reviewed revenue cut-off as of the beginning of 2003. It was noted that approximately \$1,008,000 of sales originally recorded in 2002 were not actually shipped



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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 quarter ended March 31, 2003 being increased by the same amount. The restatement also resulted in distributor commissions for the year ended December 31, 2002 being decreased by \$459,000 and distributor commissions for the quarter ended March 31, 2003 being increased by the same amount.

Also in connection with its review, the Company determined that its accounts receivable as of March 31 and June 30, 2003 did not reconcile in total to supporting details for such transactions. The restatement resulted in net sales being decreased by \$260,000 and \$400,000 for the three and six month period ended June 30, 2003, respectively.

The Company had not recorded reserves for distributor returns and refunds 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 and six months ended June 30, 2003 being increased by approximately \$125,000 and \$250,000 respectively, with corresponding adjustments to cost of sales for the estimated cost of products returned. Compared to amounts previously reported, the restatement decreased net sales for the three and six months ended June 30, 2002 by approximately \$88,000 and \$175,000 with a corresponding adjustment 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 impact of this restatement for the three and six months ended June 30, 2002, is a reduction of extraordinary item - forgiveness of debt of \$200,000 and \$400,000, respectively. The impact of the restatement for the three and six months ended June 30, 2003 is a reduction of other income of \$200,000 and \$400,000, respectively.

The Company disclosed in it's 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 in 2002 or 2003. 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 six months ended June 30, 2003 of \$370,000, recognized in the quarter ended March 31, 2003.

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

Three Months Ended June 30, 2003		Six Months Ended June 30, 2003	
As	As	As	As

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	Previously Reported	Restated	Previously Reported	Restate
Net sales	\$ 12,157	\$ 11,984	\$ 21,800	\$ 23,
Cost of sales	1,680	1,682	3,617	3,
Gross profit	10,477	10,302	18,183	19,
Operating expenses	8,956	8,956	15,901	16,
Operating income	1,521	1,346	2,282	3,
Interest expense, other income, loss on foreign exchange and gain on discontinued operations	131	(69)	334	
Net income (loss)	1,652	1,277	2,616	3,
Income tax expense	330	330	330	
Net income	1,322	947	2,286	2,
Preferred stock dividends	--	--	1	
Net income available to common stockholders	\$ 1,322	\$ 947	\$ 2,285	\$ 2,
Basic income per share	\$ 0.28	\$ 0.20	\$ 0.50	\$ 0
Basic weighted common shares used	4,656	4,628	4,570	4,
Diluted income per share	\$ 0.23	\$ 0.17	\$ 0.41	\$ 0
Diluted weighted common shares used	5,695	5,628	5,609	5,

Basic and Diluted Income per share:

The adjustments in net sales and cost of sales, operating expenses, other income and income taxes resulted in a net decrease in net income available to stockholders of approximately \$375,000 and an increase of approximately \$34,000 over the amounts previously reported for the three and six months ended June 30, 2003, respectively. Restated basic income per share decreased \$0.08 for the three months ended June 30, 2003. Restated basic income per share increased by \$0.01 for the six months ended June 30, 2003. Restated diluted income per share decreased \$0.06 for the three months ended June 30, 2003. Restated diluted income per share increased by \$0.02 for the six months ended June 30, 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.

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

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	Three Months Ended June 30, 2002		Six Months Ended June 30, 2002	
	As Previously Reported	As Restated	As Previously Reported	As Restated
Net sales	\$ 9,116	\$ 8,786	\$ 15,270	\$ 15,270
Cost of sales	1,574	1,516	2,664	2,664
Gross profit	7,542	7,270	12,606	12,606
Operating expenses	6,891	6,891	12,085	12,085
Operating income	651	379	521	521
Interest expense, other income, loss on foreign exchange and gain on discontinued operations	(188)	(188)	(248)	(248)
Income before extraordinary items	463	191	273	273
Extraordinary gain - forgiveness of debt	200	--	400	400
Net income	663	191	673	673
Preferred stock dividends	19	19	41	41
Net income available to common stockholders	\$ 644	\$ 172	\$ 632	\$ 632
Basic income per share	\$ 0.22	\$ 0.06	\$ 0.22	\$ 0.06
Basic weighted common share used	2,973	2,973	2,820	2,820
Diluted income per share	\$ 0.17	\$ 0.05	\$ 0.18	\$ 0.05
Diluted weighted commons shares used	3,682	3,682	3,529	3,529

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 \$472,000 and \$1,710,000 over the amounts previously reported for the three and six months ended June 30, 2002, respectively. Restated basic income per share decreased \$0.16 and \$0.60 for the three and six months ended June 30, 2002, respectively. Restated diluted

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income per share decreased \$0.12 and \$0.49 for the three and six months ended June 30, 2002, respectively.

### 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.

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#### 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 costs over twelve months, the term of the membership. Total deferred revenue for the Company was approximately \$1,925,000 as of June 30, 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. Recent 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

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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.

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 Operations - Reporting the Effects of Disposal of a Segment of a Business and

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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.

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

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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.

### 5. 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 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.

### 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

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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") 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,

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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 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.

In November 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.

In January 2002, we incorporated MyLexxus Europe AG, a corporation organized under the laws of Switzerland and our majority-owned subsidiary ("MyLexxus Europe"). This company 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 majority-owned

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subsidiary ("Lexxus 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 ("Lexxus Korea") which does business in South Korea.

Results of Operations - Six Months Ended June 30, 2003 Compared To  
The Six Months Ended June 30, 2002.

As discussed in Note 2 to the consolidated financial statements, we have amended and restated our results for the six month period ended June 30, 2003 and June 30, 2002. All of the following analyses apply the basis of the restated amounts.

Net Sales. Net sales were approximately \$23,224,000 and \$13,715,000 for the six months ended June 30, 2003 and June 30, 2002, respectively; an increase of \$9,509,000 or 69%. The increased sales were primarily from additional sales of Lexxus products and the expansion of Lexxus 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 \$3,779,000 or 16% of net sales. Cost of sales for the six months ended June 30, 2002 was approximately \$2,419,000 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 \$11,296,000 in the six months ended June 30, 2002 to approximately \$19,446,000 in the six months ended June 30, 2003, or an increase of 72%. The increase in gross profit of approximately \$8,150,000 was attributable to higher sales volumes by Lexxus.

Associate Commissions. Associate commissions were approximately \$9,510,000 or 41% of sales in the six months ended June 30, 2003 compared to approximately \$7,747,000 or 56% 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 32% of sales in the six months ended June 30, 2002 to approximately \$6,850,000 or 29% of sales in the six months ended June 30, 2003. These costs as a percentage of net sales increased primarily due to general and administrative costs, such as hiring staff, preparing office space and initial marketing efforts through the expansion into new international markets.

Operating (Loss) Income. Operating income increased from an operating loss of approximately \$789,000 in the six months ended June 30, 2002 to operating income of approximately \$3,086,000 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 of 2003, the Company has provided income taxes in the amount of approximately \$700,000, 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.

Net Income. Net income was approximately \$2,320,000 in the six months ended June 30, 2003 as compared to a loss of approximately \$1,037,000 in the six months



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ended June 30, 2002. The increase in net income of approximately \$3,357,000 is due to increased sales and efficient cost containment efforts partially offset by an income tax expense.

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### 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 1.04 to 1.0 and the Company had working capital of approximately \$382,000.

Cash provided by operations for the six months ended June 30, 2003 was approximately \$591,000 primarily due to increased sales, the launch of the 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 \$1,416,000 due to the purchase of an associate database, increased capital expenditures and an increase in 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.

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

### Item 3. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to ensure that

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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 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.

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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

Not applicable.

#### 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

Not applicable.

#### 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

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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).

- (c) 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, 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

Not applicable.

### 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

Not applicable.

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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

Date: April 12, 2004

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