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ADVANTAGE MARKETING SYSTEMS INC/OK
Form 10-Q
May 13, 2003

U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2003

or

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

For the transition period from _____ to _____

Commission File Number: 001-13343

ADVANTAGE MARKETING SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Oklahoma 73-1323256
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

2601 NW Expressway, Suite 1210W 73112
Oklahoma City, Oklahoma (Zip Code)
(Address of principal executive offices)

(405) 842-0131
(Registrants' telephone number, including area code)

Indicate by check mark whether the registrant (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 (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is an accelerated filer as defined in Rule 12b-2 of the Exchange Act.

Yes No

On May 12, 2003, we had outstanding 4,424,314 shares of our common stock, \$.0001 par value.

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ADVANTAGE MARKETING SYSTEMS, INC. QUARTERLY REPORT ON FORM 10-Q

FOR THE THREE MONTHS ENDED MARCH 31, 2003

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Certain statements under the caption "Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations" constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Certain, but not necessarily all, of such forward-looking statements can be identified by the use of forward-looking terminology such as "anticipates", "believes", "expects", "may", "will", or "should" or other variations thereon, or by discussions of strategies that involve risks and uncertainties. Our actual results or industry results may be materially different from any future results expressed or implied by such forward-looking statements. Factors that could cause actual results to differ materially include general economic and business conditions; our ability to implement our business and acquisition strategies; changes in the network marketing industry and changes in consumer preferences; competition; availability of key personnel; increasing operating costs; unsuccessful advertising and promotional efforts; changes in brand awareness; acceptance of new product offerings; changes in, or the failure to comply with, government regulations (especially food and drug laws and regulations); product liability matters; our ability to obtain financing for future acquisitions and other factors.

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PART I -FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ADVANTAGE MARKETING SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS MARCH 31, 2003 AND DECEMBER 31, 2002

	ASSETS	MARCH 31, 2003
		----- (Unaudited)
CURRENT ASSETS:		
Cash and cash equivalents	\$	816,732
Marketable securities, available for sale, at fair value		1,599,801
Receivables		101,932
Receivable from affiliates		49,627
Prepaid taxes and income tax receivable		464,975
Inventory		703,248
Deferred income taxes		125,357
Other assets		312,532

Total current assets		4,174,204
RECEIVABLES		237,817
PROPERTY AND EQUIPMENT, Net		3,923,954
COVENANTS NOT TO COMPETE and other intangibles, Net		616,367
DEFERRED INCOME TAXES		1,449,955
OTHER ASSETS		88,857

TOTAL	\$	10,491,154
		=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$	237,873
Accrued commissions and bonuses		375,663
Accrued other expenses		174,664
Accrued sales tax liability		127,399
Notes payable		473,590
Capital lease obligations		101,177

Total current liabilities		1,490,366
LONG-TERM LIABILITIES:		
Notes payable		1,851,379
Capital lease obligations		98,005

Total liabilities		3,439,750

COMMITMENTS AND CONTINGENCIES (NOTE 7)		
STOCKHOLDERS' EQUITY		
Common stock - \$.0001 par value; authorized 495,000,000 shares; issued 4,896,674 shares, outstanding 4,424,314 shares		490
Paid-in capital		11,793,240
Notes receivable for exercise of options		(31,000)
Accumulated deficit		(2,389,597)
Accumulated other comprehensive loss, net of tax		(77,253)

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Total capital and accumulated deficit	9,295,880
Less cost of treasury stock (472,795 shares, common)	(2,244,476)
Total stockholders' equity	7,051,404
TOTAL	\$ 10,491,154

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

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ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE PERIODS ENDED MARCH 31, 2003 AND 2002
(UNAUDITED)

	THREE MONTHS ENDED MARCH 31,	
	2003	2002
Net sales	\$ 4,614,153	\$ 6,281,373
Cost of sales	3,226,525	4,290,111
Gross profit	1,387,628	1,991,262
Marketing, distribution and administrative expenses:		
Marketing	391,525	471,732
Distribution and administration	1,395,949	1,375,873
Total Marketing, distribution and administrative expenses	1,787,474	1,847,605
Income (loss) from operations	(399,846)	143,657
Other income (expense):		
Interest and dividends, net	(22,692)	(21,342)
Other, net	(21,298)	27,667
Total other income (expense)	(43,990)	6,325
Income (loss) before taxes	(443,836)	149,982

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Income tax expense (benefit)	(173,096)	58,493
	-----	-----
Net income (loss)	\$ (270,740)	\$ 91,489
	=====	=====
Net income (loss) per common share - basic	\$ (.06)	\$.02
	=====	=====
Net income (loss) per common share - assuming dilution	\$ (.06)	\$.02
	=====	=====
Weighted average common shares outstanding - basic	4,424,314	4,409,690
	=====	=====
Weighted average common shares outstanding - assuming dilution	4,424,314	4,536,281
	=====	=====

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

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ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31, 2003 AND 2002
(UNAUDITED)

	MARCH 31 2003

CASH FLOWS FROM OPERATING ACTIVITIES:	
Net income (loss)	\$ (270,7
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:	
Depreciation and amortization	242,8
(Gain) loss on sale of assets	8,8
Realized loss on sale of marketable securities	17,0
Deferred taxes	(173,0
Changes in assets and liabilities which provided (used) cash:	
Receivables	122,9
Inventory	94,9
Other assets	(281,3
Accounts payable and accrued expenses	236,8

Net cash provided by (used in) operating activities	(1,6

CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchases of property and equipment	(245,2
Sales of property and equipment	4,4
Purchases of marketable securities, available for sale	(500,9

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Sales of marketable securities, available for sale	491,8
Payments on advances to affiliates	13,9

Net cash provided by (used in) investing activities	(235,9

 CASH FLOWS FROM FINANCING ACTIVITIES:	
Proceeds from issuance of common stock	
Principal payment on notes payable	(119,6
Principal payment on capital lease obligations	(33,2

Net cash used in financing activities	(152,9

 NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	 (390,5
CASH AND CASH EQUIVALENTS, BEGINNING	1,207,2

CASH AND CASH EQUIVALENTS, ENDING	\$ 816,7
	=====

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

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ADVANTAGE MARKETING SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR THE THREE MONTHS ENDED MARCH 31, 2003 AND 2002 (UNAUDITED)

1. UNAUDITED INTERIM FINANCIAL STATEMENTS

The unaudited condensed consolidated financial statements and related notes have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted pursuant to such rules and regulations. The accompanying condensed consolidated financial statements and related notes should be read in conjunction with the audited consolidated financial statements of the Company, and notes thereto, for the year ended December 31, 2002.

The information furnished reflects, in the opinion of management, all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the results of the interim periods presented. Operating results of the interim period are not necessarily indicative of the amounts that will be reported for the year ending December 31, 2003.

2. SIGNIFICANT ACCOUNTING POLICIES

In December 2002, The FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure", which amended SFAS No. 123, "Accounting for Stock-Based Compensation". The new standard provides alternative methods of transition for a voluntary

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change to the fair value based method of accounting for stock-based employee compensation. In compliance with SFAS No. 148, the Company elected to continue to follow the intrinsic value method in accounting for its stock-based employee compensation arrangement as defined by APB No. 25. Accordingly, no compensation cost has been recognized for stock options granted in the accompanying consolidated financial statements. The following pro forma data is calculated net of tax as if compensation cost for the Company's stock-based compensation awards was determined based upon the fair value at the grant date consistent with the methodology prescribed under SFAS No. 123.

	QUARTER ENDED MARCH 31,	
	2003	2002
Net income as reported	\$ (270,740)	\$ 91,489
Adjustment, net of tax	(37,792)	(60,310)
Proforma net income (loss)	\$ (308,532)	\$ 31,179
Net income (loss) per common share as reported ...	\$ (.06)	\$.02
Adjustment, net of tax	(.01)	(.01)
Proforma net income (loss) per common share	\$ (.07)	\$.01
Proforma net income (loss) per common share-		
assuming dilution	\$ (.07)	\$.01
Weighted average common shares outstanding	4,424,314	4,409,690
Weighted average common shares outstanding -		
assuming dilution	4,424,314	4,536,281

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants in 2003 and 2002, respectively: risk-free interest rates of 2.77 and 2.65 percent; no dividend yield or assumed forfeitures; an expected life of 5.0 years; and volatility of 64 percent. The pro forma amounts above are not likely to be representative of future years because there is no assurance that additional awards will be made each year. In January 2003, the Company adopted a new stock incentive plan, under which shares were issued in the first quarter of 2003. This plan is subject to shareholder approval at the 2003 annual meeting of shareholders.

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ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED MARCH 31, 2003 AND 2002
(UNAUDITED)

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities", or FIN 46. Subject to certain criteria defined in the Interpretation, FIN 46 will require consolidation by business enterprises of variable interest entities if

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the enterprise has a variable interest that will absorb the majority of the entity's expected losses, receive the majority of its expected returns, or both. The provisions of FIN 46 are effective immediately for interests acquired in variable interest entities after January 31, 2003, and at the beginning of the first interim or annual period beginning after June 15, 2003, for interests acquired in variable interest entities before February 1, 2003. The Company will adopt FIN 46 in the third quarter of 2003. Certain disclosures concerning variable interest entities are required in financial statements initially issued after January 31, 2003. The Company is evaluating the effect of FIN 46 but does not believe FIN 46 will have a material impact on its financial statements.

3. MARKETABLE SECURITIES

Securities are classified as available for sale with the related unrealized gains and losses excluded from earnings and reported net of income tax as a separate component of stockholders' equity until realized. Realized gains and losses on sales of securities are based on the specific identification method. Declines in the fair value of investment securities below their carrying value that are other than temporary are recognized in earnings.

Net unrealized losses, net of tax, of approximately \$8,285 were included in accumulated other comprehensive loss for the three months ended March 31, 2003, and net unrealized gains, net of tax, of approximately \$874 were included in other comprehensive loss for the three months ended March 31, 2002. Total comprehensive loss for the three months ended March 31, 2003 was \$284,038 and total comprehensive income for the three months ended March 31, 2002 was \$92,892.

4. NOTES PAYABLE

Notes payable consists of the following:

	MARCH 31, 2003	DE
	-----	---
Notes payable to RMS Limited Partnership, 7.5% effective rate, payable in 60 monthly installments	\$1,272,721	\$
Note payable to bank, with interest at prime less .5% floating, with a floor of 2.5% (4.0% at March 31, 2003 and 4.5% at December 31, 2002), payable in monthly installments of principal and interest, due on September 30, 2006, collateralized by marketable securities	1,048,695	
Other	3,553	
	-----	---
Total	2,324,969	
Less: current maturities	473,590	
	-----	---
Long-term notes payable	\$1,851,379	\$
	=====	==

5. EARNINGS (LOSS) PER SHARE

Earnings (loss) per common share - basic is computed based upon net income (loss) divided by the weighted average number of common shares outstanding during each period. Earnings (loss) per common share

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- assuming dilution is computed based upon net income (loss) divided by the weighted average number of common shares outstanding during each period adjusted for the effect of dilutive potential common shares calculated using the treasury stock method.

The following is a reconciliation of the common shares used in the calculations of earnings (loss) per common share - basic and earnings (loss) per common share - assuming dilution:

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ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED MARCH 31, 2003 AND 2002
(UNAUDITED)

	INCOME (NUMERATOR)	(D)
	-----	---
Weighted average common shares outstanding:		
For the three months ended March 31, 2003:		
Earnings (loss) per common share - basic:		
Income (loss) available to common stockholders	\$ (270,740)	
Earnings (loss) per common share - assuming dilution:		
Options	--	
	-----	---
Income available to common stockholders plus assumed conversions	\$ (270,740)	
	=====	==
For the three months ended March 31, 2002:		
Earnings per common share - basic:		
Income available to common stockholders	\$ 91,489	
Earnings per common share - assuming dilution:		
Options	--	
	-----	---
Income available to common stockholders plus assumed conversions	\$ 91,489	
	=====	==

Options to purchase 2,620,115 shares of common stock at exercise prices ranging from \$1.31 to \$6.13 per share were outstanding at March 31, 2003 but were not included in the computation of earnings (loss) per common share - assuming dilution because such inclusion would not be dilutive.

Options to purchase 684,805 shares of common stock at exercise prices ranging from \$2.60 to \$6.13 per share were outstanding at March 31, 2002 but were not included in the computation of earnings per common share - assuming dilution because the options' exercise price was greater than the average market price of the common shares.

Warrants to purchase 1,874,768 shares of common stock at exercise prices ranging from \$3.40 to \$5.40 per share were outstanding at March 31, 2003 and 2002 but were not included in the computation of earnings per common share - assuming dilution because the warrants' exercise price was greater than the average market price of the common shares.

As part of the LifeScience Technologies Acquisition, the sellers receive monthly cash payments in an amount equal to the greater of \$41,667 or 5% of LifeScience Technologies product sales. The sellers may elect to take each monthly payment in shares of common stock rather than cash at \$3.00 per share exercise price, but cannot acquire more than 860,000 shares pursuant to elections. The date, the sellers have not elected to take stock rather than cash. None of the shares of common stock subject to this election right were included in the computation of earnings (loss) per common share - assuming dilution for the three months ended March 31, 2003 or 2002 because the exercise price was greater than the average market price of the common shares.

6. DEFERRED TAXES

On a regular basis, management evaluates all available evidence, both positive and negative, regarding the ultimate realization of the tax benefits of its deferred tax assets. Management has

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ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED MARCH 31, 2003 AND 2002
(UNAUDITED)

concluded that it is more likely than not that a tax benefit will be realized from its deferred tax assets. The Company has net operating loss carryforwards of approximately \$575,000 available to reduce future taxable income, which will begin to expire in 2009. Net operating loss carryforwards of \$196,000 are limited in usage.

7. COMMITMENTS AND CONTINGENCIES

RECENT REGULATORY DEVELOPMENTS - A significant portion of the Company's net sales continues to be dependent upon the Company's AM-300 product. The Company's net sales of AM-300 represented 45.0% and 43.1% of net sales for the three months ended March 31, 2003 and 2002, respectively. One of the ingredients in the Company's AM-300 products is ephedra, an herb which contains naturally-occurring ephedrine. The Company's manufacturer uses a powdered extract of that herb when manufacturing AM-300. The Company markets AM-300 principally as an aid in weight management. The extract is an 8% extract which means that every 100 milligrams of the powdered extract contains approximately eight milligrams of naturally occurring ephedrine alkaloids. Ephedrine containing products have been the subject of adverse publicity in the United States and other countries relating to alleged harmful effects.

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The FDA published a proposed rule in the Federal Register on June 4, 1997, which proposed significant limitations on the sale of ephedrine-containing dietary supplements. The proposed rule would have significantly limited the Company's ability to sell products containing ephedra if it had been made effective. On April 3, 2000, the FDA withdrew most of the provisions of its proposed rule. This action was prompted largely by a report issued by the United States General Accounting Office ("GAO") in which the GAO criticized the scientific basis for the proposed rule and the FDA's evaluation of approximately 900 reports of adverse events supposedly related to the consumption of dietary supplements containing ephedrine alkaloids. The FDA has made available for public inspection most of these adverse event reports.

On March 7, 2003, the FDA published a notice in the Federal Register, which indicates that it will be taking final action on the 1997 proposed rule in the near future. The FDA re-opened the public comment period, until April 7, 2003, to allow for additional public input on the two proposed limitations on the sale of ephedrine-containing dietary supplements that remained after the FDA's action of April 3, 2000. One proposed limitation is a warning that would be required to appear on the label of all ephedrine-containing supplements. The other proposed limitation is that ephedrine-containing supplements may not contain other substances that are known to have stimulant effects (e.g., caffeine). The proposed warning addresses potential health risks allegedly associated with ephedrine-containing dietary supplements. It is similar, but not identical, to mandatory warnings that have been required by Texas law since 1999 and California law since January 1, 2003. AM-300 and the Company's other ephedrine-containing supplements comply with these state law requirements. However, some of the Company's ephedrine-containing products, like AM-300, contain caffeine or other stimulants. Therefore, if the proposed rule is made final in its current form, it will prohibit the sale of some of the Company's products.

On March 13, 2003, the FDA published a proposed rule in the Federal Register which proposes comprehensive requirements for the manufacturing, packing and holding dietary supplements, also known as good manufacturing practices ("GMP" or "GMPs"). The FDA is accepting public comments on the proposed GMPs until June 11, 2003; final GMPs will be promulgated after the FDA has reviewed the public comments. Once final GMP regulations become effective, the Company's manufacturer will be required to adhere to them. The FDA will most likely institute an effective date for the GMPs which will allow the Company's manufacturer a reasonable amount of time to conduct

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ADVANTAGE MARKETING SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR THE THREE MONTHS ENDED MARCH 31, 2003 AND 2002 (UNAUDITED)

this review and, if necessary, revise its manufacturing operations to comply with the final GMP regulations.

The Company's certificate of incorporation and bylaws provide

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that the Company will indemnify its directors and officers to the fullest extent permitted by the Oklahoma General Corporation Act. Under such provisions, any director or officer, who in his capacity as such, is made or threatened to be made, a party to any suit or proceeding, may be indemnified if the Company's board of directors determines such director or officer acted in good faith and in a manner he reasonably believed to be in or not opposed to its best interests.

The Company's certificate of incorporation and bylaws and the Oklahoma General Corporation Act further provide that such indemnification is not exclusive of any other rights to which such individuals may be entitled under its certificate, its bylaws, an agreement, vote of shareholders or disinterested directors or otherwise. Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to the Company's directors and officers pursuant to the foregoing provisions, or otherwise, the Company has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy and is, therefore, unenforceable.

PRODUCT LIABILITY - The Company, like other marketers of products that are intended to be ingested, faces the inherent risk of exposure to product liability claims in the event that the use of its products results in injury. The Company maintains a claims made policy, with limited (excluding ephedra) product liability insurance coverage. The limits of this coverage are \$1,000,000 per occurrence and \$2,000,000 in the aggregate. Products containing ephedra, which represented approximately 45.0% of the Company's first quarter 2003 net revenue, are not covered by the Company's product liability insurance. The Company generally does not obtain contractual indemnification from parties manufacturing its products. However, all of the Company's product manufacturers carry product liability insurance which covers the Company's products. A product liability claim could result in a material loss.

LEGAL PROCEEDINGS - The Company is currently involved in two products liability suits related to the ingestion of its ephedra-based products. Answers have been filed to both of these petitions denying any wrongdoing. The Company intends to vigorously defend the claims. The amounts of damages sought are unknown, but include compensatory and punitive damages.

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors and Stockholders
Advantage Marketing Systems, Inc.

We have reviewed the accompanying condensed consolidated balance sheet of Advantage Marketing Systems, Inc. and Subsidiaries as of March 31, 2003, and the related condensed consolidated statements of operations and cash flows for the three-month periods ended March 31, 2003 and 2002. These financial statements are the responsibility of the Company's management.

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We conducted our reviews in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the condensed consolidated financial statements, as of and for the periods ended March 31, 2003 and 2002, for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet of Advantage Marketing Systems, Inc. and Subsidiaries as of December 31, 2002 and the consolidated statements of operations, stockholders' equity and cash flows for the year then ended (not presented herein) and, in our report dated February 22, 2003, we expressed an unqualified opinion on those statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2002 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

GRANT THORNTON LLP

Oklahoma City, Oklahoma
April 28, 2003

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GENERAL

We market a product line consisting of approximately one hundred products in three categories; weight management, dietary supplement and personal care products. These products are marketed through a network marketing organization in which independent associates purchase products for resale to retail customers as well as for their own personal use.

We prepare our consolidated financial statements in conformity with accounting principles generally accepted in the United States, which require us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the year. Actual results could differ from those estimates. We consider the following policies to be most critical in understanding the judgments that are involved in preparing our financial statements and the uncertainties that could impact our results of operations, financial condition and cash flows.

Throughout this report, "net sales" represents the gross sales amounts reflected on our invoices to our associates less associate discounts, sales returns, and freight income. Beginning June 1, 2001, we adopted a new billing policy, which requires billing customers a portion of freight costs, which is included in net sales. All of our products include a customer satisfaction

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guarantee. Our products may be returned within 30 days of purchase for a full refund or credit toward the purchase of another product. We also have a buy-back program whereby we repurchase products sold to an independent associate (subject to a restocking fee), provided the associate terminates his/her associateship agreement with us and returns the product within 12 months of original purchase in marketable condition. We receive our net sales price in cash or through credit card payments upon receipt of orders from associates.

Our "gross profit" consists of net sales less:

- o Commissions and bonuses, consisting of commission payments to associates based on their current associate level within their organization, and other one-time incentive cash bonuses to qualifying associates;
- o Cost of products, consisting of the prices we pay to our manufacturers for products and royalty overrides earned by qualifying associates on sales within their associate organizations; and
- o Cost of shipping, consisting of costs related to shipments, duties and tariffs, freight expenses relating to shipment of products to associates, and similar expenses.

We recognize revenue upon shipment of products, training aids and promotional material to the independent associates. All of our customers pay for sales in advance of shipment. As such, we have no trade receivables. Loans to associates are repayable in five years or less; are secured by commissions controlled by us; and are no longer allowed. Interest rates on loans are typically two percent or more above the Prime rate and are fixed. All loans and receivables are secured by guaranteed payment sources that are within our control. As such, we believe there is no need for an allowance for doubtful accounts.

We write down our inventory to provide for estimated obsolete or unsalable inventory based on assumptions about future demand for our products and market conditions. If future demand and market conditions are less favorable than management's assumptions, additional inventory write-downs could be required. Likewise, favorable future demand and market conditions could positively impact future operating results if written-off inventory is sold.

We account for contingencies in accordance with SFAS No. 5, "Accounting for Contingencies". SFAS 5 requires that we record an estimated loss from a loss contingency when information available prior to issuance of our financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. Accounting for contingencies such as legal and income tax matters requires us to use our judgment. Many legal and tax contingencies can take years to resolve. Generally, as the time period increases over which the uncertainties are resolved, the likelihood of changes to the estimate of the ultimate outcome increases. However, an adverse outcome in these matters could have a material impact on our results of operations, financial condition and cash flows.

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RESULTS OF OPERATIONS

The following table sets forth, as a percentage of our net sales, selected

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results of operations for the three months ended March 31, 2003 and 2002. The selected results of operations are derived from our unaudited condensed consolidated financial statements. The results of operations for the periods presented are not necessarily indicative of our future operations.

	FOR THE THREE MONTHS		
	MARCH 31,		
	2003		
	AMOUNT	PERCENT	AMOUNT
	-----	-----	-----
Net sales	\$ 4,614,153	100.0%	\$ 6,281,373
Cost of sales:			
Commissions and bonuses	2,038,236	44.2	2,038,236
Cost of products	780,133	16.9	1,063,586
Cost of shipping	408,156	8.8	408,156
Total cost of sales	3,226,525	69.9	4,290,111
Gross profit	1,387,628	30.1	1,667,220
Marketing, distribution and administrative expenses:			
Marketing	391,525	8.5	391,525
Distribution and administrative	1,395,949	30.2	1,395,949
Total marketing, distribution and administrative expenses	1,787,474	38.7	1,787,474
Income (loss) from operations	(399,846)	(8.6)	(399,846)
Other income (expense):			
Interest, net	(22,692)	(0.5)	(22,692)
Other income (expense)	(21,298)	(0.5)	(21,298)
Total other income (expense)	(43,990)	(1.0)	(43,990)
Income (loss) before taxes	(443,836)	(9.6)	(443,836)
Tax expense (benefit)	(173,096)	(3.7)	(173,096)
Net income (loss)	\$ (270,740)	(5.9)%	\$ 1,063,586

COMPARISON OF THE THREE MONTH PERIODS ENDED MARCH 31, 2003 AND 2002

Our net sales during the three months ended March 31, 2003, decreased by \$1,667,220, or 26.5%, to \$4,614,153 from \$6,281,373 during the three months ended March 31, 2002. The sales decrease is due to the decrease in recruiting of new independent associates experienced by us in 2002. We are currently implementing a new marketing strategy to reverse the downward recruiting trend and to increase sales.

Our cost of sales during the three months ended March 31, 2003, decreased by \$1,063,586, or 24.8%, to \$3,226,525 from \$4,290,111 during the same period in 2002. Total cost of sales, as a percentage of net sales, increased to 69.9% during the three months ended March 31, 2003 from 68.3% during the same period in 2002. The decrease in cost of sales was attributable to:

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- o A decrease of \$559,810 in associate commissions and bonuses due to the decreased level of sales;
- o A decrease of \$471,841 in the cost of products sold due to the decreased level of sales; and
- o A decrease of \$31,935 in shipping costs primarily due to decreased sales.

The factors discussed above resulted in a decrease in gross profit of \$603,634, or 30.3%, to \$1,387,628 for the three months ended March 31, 2003 from \$1,991,262 for the same period in 2002.

Marketing, distribution and administrative expenses decreased \$60,131, or 3.3%, to \$1,787,474 during the three months ended March 31, 2003, from \$1,847,605 during the same period in 2002. This decrease was primarily attributable to:

- o A decrease in promotion costs of approximately \$53,000;

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- o An increase in staffing and related payroll costs of approximately \$80,000 to supplement our technical staff during implementation of our new marketing strategy;
- o A decrease in insurance costs of approximately \$20,000 related to better rates for liability insurance; and
- o A decrease of approximately \$72,000 in other variable costs such as postage, telephone, bank service charges and supplies.

The marketing, distribution and administrative expenses as a percentage of net sales increased to 38.7% during the three months ended March 31, 2003 from 29.4% during the same period in 2002. Management expects marketing, distribution and administrative expenses to continue at the current level.

Our net other income (reduced by other expense) decreased by \$50,315 to net other expense of \$43,990 at March 31, 2003, from a net other income of \$6,325 during the same period in 2002. This decrease was primarily due to:

- o A loss on sale of marketable securities of approximately \$15,000; and
- o An increase in loss on sale of assets of approximately \$34,000.

RECENTLY ISSUED ACCOUNTING STANDARDS

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities", or FIN 46. Subject to certain criteria defined in the Interpretation, FIN 46 will require consolidation by business enterprises of variable interest entities if the enterprise has a variable interest that will absorb the majority of the entity's expected losses, receive the majority of its expected returns, or both. The provisions of FIN 46 are effective immediately for interests acquired in variable interest entities after January 31, 2003, and at the beginning of the first interim or annual period beginning after June 15, 2003, for interests acquired in variable interest entities before February 1, 2003. We will adopt FIN 46 in the third quarter of 2003. Certain disclosures concerning variable interest entities are required in financial

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statements initially issued after January 31, 2003. We are evaluating the effect of FIN 46 but do not believe FIN 46 will have a material impact on our financial statements.

SEASONALITY

No pattern of seasonal fluctuations presently exists. However, there is no assurance that we will not become subject to seasonal fluctuations in operations.

LIQUIDITY AND CAPITAL RESOURCES

Our primary source of liquidity has been cash provided by sales of our marketable securities and our operating activities. At March 31, 2003, we had working capital of \$2,851,920, compared to \$3,186,584 at December 31, 2002. We believe our cash and cash equivalents, current marketable securities, cash flows from operations and expected cash flows from financing activities will be sufficient to fund our working capital and capital expenditure needs over the next twelve months. During the three months ended March 31, 2003, net cash used in operating activities was \$1,684, net cash used in investing activities was \$235,946 and net cash used in financing activities was \$152,938. This represented a net decrease in cash during this period of \$390,568. Our working capital needs over the next 12 months consist primarily of marketing, distribution and administrative expenses.

In 2001, we completed construction of a 23,346 square foot distribution and call center facility in Oklahoma City. This project was funded, in part, with bank loans of \$980,000 for the land and building and \$166,216 for the warehouse equipment. Both loans are with Bank One Oklahoma, N.A. and accrue interest at the prime rate less .5% floating, with a floor of 2.5%.

The loans contain covenants restricting us from various activities without written consent of Bank One, the most significant of which restrict us from:

- o Transferring, selling or otherwise disposing of any assets;
- o Making any loans to any persons or entity in excess of \$500,000 in the aggregate;

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- o Engaging in any merger or acquisition in which we are not the surviving corporation;
- o Changing executive management personnel; and
- o Purchasing or acquiring any interest in any other entity.

The loan is secured by a first lien on all our marketable securities.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our balance sheet includes marketable securities, which we believe are a conservative blend of income and growth investments resulting in moderate market risk. We invest in equity marketable securities to generate capital growth, and fixed-income marketable securities to provide current income. Because of the nature of these investments, total return and risk will be affected by both current interest rates and equity market movements. Our fixed income investments of approximately \$800,000 are subject to interest risk only. We have

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approximately \$800,000 of equity investments that are exposed to market risk.

INTEREST RATE RISK. We currently maintain an investment portfolio of high-quality fixed-income marketable securities. All securities are available for sale and recorded in the balance sheet at fair value with fluctuations in fair value reported as a component of accumulated other comprehensive income in stockholders equity. We do not hedge our investment portfolio or our outstanding credit facility or other long-term indebtedness. Fixed-income investments with a maturity date of three months or less at the date of purchase are deemed to be cash equivalents. Any remaining fixed-income securities are considered short-term and mainly consist of investments in U.S. Treasury notes and bonds.

The following table lists our cash equivalents and our short-term fixed-income marketable securities at March 31, 2003 and December 31, 2002:

		MARCH 31, 2003		
	AVERAGE INTEREST RATE (1)	COST	FAIR VALUE	AVERAG INTEREST RA
Cash equivalents...	-----	\$ 23,062	\$ 23,062	-----
Short-term				
Investments.....	5.8%	763,899	774,019	6.0%
		\$ 786,961	\$ 797,081	
		=====	=====	

(1) Average interest rate is calculated by taking the individual security interest rates multiplied by each investments' weighted average share of the total fixed-income marketable securities.

Average interest rates for the quarter ended March 31, 2003 decreased .20% from December 31, 2002 due to the redemption of 100,000 units of 6.25% U.S. Treasury Notes, which represented 80% of our total fixed-income marketable securities at December 31, 2002.

Fair value of the cash equivalents and fixed-income marketable securities decreased \$22,466 during the quarter ended March 31, 2003 to \$797,081 from \$819,547 at December 31, 2002. This decrease was due to the reduction of approximately \$100,000 relating to the redemption of 6.25% U.S. Treasury Notes, partially offset by the purchase, net of sales, of fixed-income mutual funds of approximately \$73,000.

EQUITY MARKET RISKS. We currently maintain an investment portfolio of equity securities. All securities are available for sale and recorded in the balance sheet at fair value with fluctuations in fair value reported as a component of accumulated other comprehensive income in stockholders equity. We do not engage in hedging our equity portfolio or otherwise purchase derivative securities. Because of the quality of our portfolio and liquid nature of our equity investments, we do not consider the market risk related to these investments to be material. At March 31, 2003, our equity investments had a value of \$802,720 compared to \$801,595 at December 31, 2002, primarily due to a net purchase of mutual funds of approximately \$28,000, offset by decreased fund prices in the first quarter of 2003.

We attempt to manage our interest and market risk by evaluating and purchasing what we believe to be the best investment securities and rates of return available.

ITEM 4. CONTROLS AND PROCEDURES

Within the 90-day period prior to filing of this report, an evaluation was carried out under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-14(c) under the Securities Exchange Act of 1934). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective. No significant changes were made in our internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are currently involved in two products liability suits related to the ingestion of our ephedra-based products. Answers have been filed to both of these petitions denying any wrongdoing. We intend to vigorously defend the claims. The amounts of damages sought are unknown, but include compensatory and punitive damages.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

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

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

3.1 The Registrant's Certificate of Incorporation, incorporated by reference to the Registration Statement on Form SB-2 (Registration No. 333-47801) filed with the commission on March 11, 1998.

3.2 The Registrant's Bylaws, incorporated by reference to the Registration Statement on Form SB-2 (Registration No. 333-47801) filed with the commission on March 11, 1998.

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- 15 Letter of independent accountants as to unaudited interim financial information.
- 99.1 Chief Executive Officer Certification, filed herewith.
- 99.2 Chief Financial Officer Certification, filed herewith
- (b) Form 8-K

We filed the following Form 8-Ks during the first quarter of 2003:

- o February 7, 2003 - Item 9 filing disclosing the text of John Hail's power point presentation at the Southern California Investors Association meeting on February 8, 2003.

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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 undersigned, thereunto duly authorized.

REGISTRANT:
ADVANTAGE MARKETING SYSTEMS, INC.

Dated: May 12, 2003

By: /s/ REGGIE B. COOK

Reggie B. Cook, Vice President and
Chief Financial Officer

(Duly Authorized Officer of Registrant
and Principal Financial Officer)

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I, John W. Hail, Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Advantage Marketing Systems, Inc. (the "registrant");
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial

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information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - (a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - (c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - (a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Advantage Marketing Systems, Inc.

Date: May 12, 2003

By: /s/ JOHN W. HAIL

John W. Hail
Chairman and Chief Executive Officer

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I, Reggie Cook, Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Advantage Marketing Systems, Inc. (the "registrant");
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - (a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - (c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - (d) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - (e) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant

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deficiencies and material weaknesses.

Advantage Marketing Systems, Inc.

Date: May 12, 2003

By: /s/ REGGIE B. COOK

Reggie B. Cook
Chief Financial Officer

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