ADVANTAGE MARKETING SYSTEMS INC/OK
Form 10-Q
November 05, 2003

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

(X)QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 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: 001-13343

ADVANTAGE MARKETING SYSTEMS, INC.
(Exact name of registrant as specified in its charter)

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

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

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

Indicate by check mark whether the registrant (1) 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 (X) No ( )

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

Yes ( ) No (X)

On October 31, 2003, we had outstanding 4,507,691 shares of our common stock, $.0001 par value.

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

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 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.

PART I -FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2003 AND DECEMBER 31, 2002

	SEPTEMB 200 (Unaudi
ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents	$ 15
Marketable securities, available for sale, at fair value	1,76
Receivables	18
Receivable from affiliates	1
Prepaid income taxes	46
Inventory	1,07
Deferred income taxes	5
Other assets	18
Total current assets	3,90
RECEIVABLES	23
PROPERTY AND EQUIPMENT, Net	3,87
COVENANTS NOT TO COMPETE and other intangibles, Net	57
DEFERRED INCOME TAXES	1,68
OTHER ASSETS	6
TOTAL	$ 10,33
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Accounts payable	$ 28
Accrued commissions and bonuses	42
Accrued other expenses	25
Accrued sales tax liability	13
Notes payable	48
Capital lease obligations	9
Total current liabilities	1,67
LONG-TERM LIABILITIES:	
Notes payable	1,62
Capital lease obligations	17
Total liabilities	3,47
COMMITMENTS AND CONTINGENCIES (NOTE 7)	
STOCKHOLDERS' EQUITY	
Common stock - $.0001 par value; authorized 495,000,000 shares; issued 4,936,674 and 4,896,674 shares, outstanding 4,464,314 and 4,424,314 shares, respectively	
Paid-in capital	11,84
Notes receivable for exercise of options	(3
Accumulated deficit	(2,75
Accumulated other comprehensive gain (loss), net of tax	3
Total capital and accumulated deficit	9,10
Less cost of treasury stock (472,795 shares, common)	(2,24
Total stockholders' equity	6,85
TOTAL	$ 10,33

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE PERIODS ENDED SEPTEMBER 30, 2003 AND 2002
(UNAUDITED)

	THREE MONTHS ENDED SEPTEMBER 30, 2003	THREE MONTHS ENDED SEPTEMBER 30, 2002	2
Net sales	$ 4,883,055	$ 5,525,701	$ 14
Cost of sales	3,248,866	3,850,247	9
Gross profit	1,634,189	1,675,454	4
Marketing, distribution and administrative expenses:			
Marketing	418,812	612,114	1
Distribution and administrative	1,507,742	1,376,142	4
Total marketing, distribution and administrative expenses	1,926,554	1,988,256	5
Income (loss) from operations	(292,365)	(312,802)	
Other income (expense):			
Interest and dividends, net	(21,637)	(4,355)	
Other, net	3,461	(2,700)	
Total other expense	(18,176)	(7,055)	
Loss before taxes	(310,541)	(319,857)	(1
Income tax benefit	(121,232)	(124,744)	
Net loss	$ (189,309)	$ (195,113)	$
Net loss per common share - basic	$ (.04)	$ (.04)	$
Net loss per common share - assuming dilution	$ (.04)	$ (.04)	$
Weighted average common shares outstanding - basic	4,463,092	4,423,879	4

Weighted average common shares outstanding - assuming dilution................................	4,463,092	4,423,879	4

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 NINE MONTHS ENDED SEPTEMBER 30, 2003 AND 2002
(UNAUDITED)

	SEPTEMBER 2003
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net loss..	$ (634
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:	
Depreciation and amortization....................................	743
Realized loss on sale of marketable securities....................	50
Deferred taxes...	(405
Stock issued for services..	56
Loss on sale of property and equipment...........................	12
Changes in assets and liabilities which provided (used) cash:	
Receivables..	40
Prepaid taxes..	
Inventory..	(277
Other assets...	(148
Accounts payable and accrued expenses........................	421
Net cash provided by (used in) operating activities..........	(142
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchases of property and equipment..................................	(509
Sales of property and equipment......................................	24
Purchases of marketable securities, available for sale....................	(1,206
Sales of marketable securities, available for sale........................	1,183
Payments on advances to affiliates...................................	50
Advance on notes receivable..	
Repayment of receivable from affiliates..............................	
Net cash used in investing activities.......................	(457
CASH FLOWS FROM FINANCING ACTIVITIES:	
Proceeds from issuance of common stock...............................	
Principal payment on notes payable...................................	(364
Principal payment on capital lease obligations...........................	(93

Net cash used in financing activities......................	(457
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS........................	(1,056
CASH AND CASH EQUIVALENTS, BEGINNING...	1,207
CASH AND CASH EQUIVALENTS, ENDING..	$ 150

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 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 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.

	THREE MONTHS ENDED SEPTEMBER 30, 2003	2002	NI 2003
Net loss as reported	$ (189,309)	$ (195,113)	$ (634,
Adjustment, net of tax	(44,241)	(9,791)	(113,
Proforma net loss	$ (233,550)	$ (204,904)	$ (747,
Net loss per common share as reported	$ (.04)	$ (.04)	$ (
Adjustment, net of tax	(.01)	--	(
Proforma net loss per common share	$ (.05)	$ (.04)	$ (
Proforma net loss per common share - assuming dilution	$ (.05)	$ (.04)	$ (
Weighted average common shares outstanding	4,463,092	4,423,879	4,445,
Weighted average common shares outstanding - assuming dilution	4,463,092	4,423,879	4,445,

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 2.82 and 2.74 percent; no dividend yield or assumed forfeitures; an expected life of five years; and volatility of 77.4 and 64.0 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, second and third quarters of 2003. This plan was approved at the 2003 annual meeting of shareholders.

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. The Company adopted 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. There was no material impact on the Company's financial statements as a result of adoption of FIN 46. As of September 30, 2003, the Company had no variable interest entities.

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 gains, net of tax, of approximately $18,000 and $106,000 were included in accumulated other comprehensive gain/loss for the three and nine months ended September 30, 2003 and net unrealized losses, net of tax of approximately $55,000 and $71,000 were included in other comprehensive gain/loss for the three and nine months ended September 30, 2002. Total comprehensive loss for the three and nine months ended September 30, 2003 was approximately $171,000 and $528,000, and total comprehensive loss for the three and nine months ended September 30, 2002 was approximately $250,000 and $97,000.

4. NOTES PAYABLE

Notes payable consists of the following:

	SEPTEMBER 30, 2003	DECEMBER 31, 2002
Notes payable to RMS Limited Partnership, 7.5% effective rate, payable in 60 monthly installments	$ 1,067,255	$ 1,372,61
Note payable to bank, with interest at prime less .25% (3.75% at September 30, 2003 and 4.5% at December 31, 2002), payable in monthly installments of principal and interest, due on September 30, 2006, collateralized by warehouse, equipment and marketable securities............	1,014,537	1,066,31
Other..	29,745	5,70
Total..	2,111,537	2,444,62
Less: current maturities...............................	483,239	455,29
Long-term notes payable.................................	$ 1,628,298	$ 1,989,33

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ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2003 AND 2002
(UNAUDITED)

5. LOSS PER SHARE

Loss per common share - basic is computed based upon net loss divided by the weighted average number of common shares outstanding during each period. Loss per common share - assuming dilution is computed based upon net 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 loss per common share - basic and loss per common share - assuming dilution:

	INCOME (NUMERATOR)	SHARES (DENOMINATOR)	P
Weighted average common shares outstanding:			
For the three months ended September 30, 2003:			
Loss per common share:			
Loss available to common stockholders	$(189,309)	4,463,092	
Loss per common share - assuming dilution:			
Options	--	--	
Loss available to common stockholders plus assumed conversions	$(189,309)	4,463,092	
For the three months ended September 30, 2002:			
Loss per common share:			
Loss available to common stockholders	$(195,113)	4,423,879	
Loss per common share - assuming dilution:			
Options	--	--	
Loss available to common stockholders plus assumed conversions	$(195,113)	4,423,879	
For the nine months ended September 30, 2003:			
Loss per common share:			
Loss available to common stockholders	$(634,412)	4,445,541	
Loss per common share - assuming dilution:			
Options	--	--	
Loss available to common stockholders plus assumed conversions	$(634,412)	4,445,541	
For the nine months ended September 30, 2002:			
Loss per common share:			
Loss available to common stockholders	$ (26,198)	4,417,037	
Loss per common share - assuming dilution:			
Options	--	--	

Loss available to common stockholders plus assumed conversions	$ (26,198)	4,417,037

ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2003 AND 2002
(UNAUDITED)

Options to purchase 2,782,192 shares of common stock at exercise prices ranging from $1.30 to $6.13 per share were outstanding for the three and nine months ended September 30, 2003, respectively, but were not included in the computation of loss per common share - assuming dilution for the three or six months ended because all options were antidilutive.

For the three months and nine months ended September 30, 2002, all options were antidilutive and therefore not included in the computation of loss per common share or loss per common share - assuming dilution.

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 September 30, 2003 and 2002 but were not included in the computation of earnings per common share - assuming dilution for the three or nine months ended 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. To 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 per common share - assuming dilution for the three or nine months ended September 30, 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 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 $807,000 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 38.8% and 44.0% of net sales for the nine months ended September 30, 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.

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 accepted 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 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 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 (exluding ephedra) product liability insurance coverage. The limits of this coverage are $1,000,000 per occurrence and $2,000,000 aggregate. Products containing ephedra, which represented approximately 39.6% of the Company's net revenue for the first nine months of 2003, 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 material losses.

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 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 September 30, 2003, and the related condensed consolidated statements of operations for the three- and nine-month periods ended September 30, 2003 and 2002, and the statements of cash flows for the nine months ended September 30, 2003 and 2002. These financial statements are the responsibility of the Company's management.

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 to financial data and of 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 September 30, 2003 and for the periods ended September 30, 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
October 21, 2003

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. All of our products include a customer satisfaction 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:

- 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;

- 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

- 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 materials 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. No amounts were accrued for such uncertainties as of September 30, 2003.

RESULTS OF OPERATIONS

The following table sets forth, as a percentage of our net sales, selected results of operations for the three and nine months ended September 30, 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 ENDED SEPTEMBER 30,				FOR THE N SE	
	2003		2002		2003	
	AMOUNT	PERCENT	AMOUNT	PERCENT	AMOUNT	PERCEN
Net sales....................	4,883,055	100.0%	$5,525,701	100.0%	14,183,992	100.0%
Cost of sales:						
Commissions and bonuses.................	1,983,557	40.6	2,296,013	41.6	6,044,551	42.6
Cost of products...........	869,366	17.8	1,103,507	20.0	2,389,665	16.8
Cost of shipping...........	395,943	8.1	450,727	8.1	1,171,140	8.3
Total cost of sales......	3,248,866	66.5	3,850,247	69.7	9,605,356	67.7
Gross profit...............	1,634,189	33.5	1,675,454	30.3	4,578,636	32.3
Marketing, distribution and administrative expenses:						
Marketing..................	418,812	8.6	612,114	11.1	1,214,174	8.6
Distribution and administrative...........	1,507,742	30.9	1,376,142	24.9	4,287,805	30.2
Total marketing, distribution and administrative expenses..................	1,926,554	39.5	1,988,256	36.0	5,501,979	38.8
Loss from operations.......	(292,365)	(6.0)	(312,802)	(5.7)	(923,343)	(6.5)
Other income (expense):						
Interest, net................	(21,637)	(0.4)	(4,355)	(0.1)	(68,947)	(0.5)
Other, net...................	3,461	(0.0)	(2,700)	(0.0)	(47,928)	(0.3)
Total other expense..........	(18,176)	(0.4)	(7,055)	(0.1)	(116,875)	(0.8)

Loss before taxes............	(310,541)	(6.4)	(319,857)	(5.8)	(1,040,218)	(7.3)
Tax benefit..................	(121,232)	(2.5)	(124,744)	(2.3)	(405,806)	(2.8)
Net loss.....................	$ (189,309)	(3.9)%	$ (195,113)	(3.5)%	(634,412)	(4.5)

COMPARISON OF THE THREE MONTHS ENDED SEPTEMBER 30, 2003 AND 2002

Our net sales during the three months ended September 30, 2003 decreased by $641,646, or 11.6%, to $4,883,055 from $5,525,701 during the three months ended September 30, 2002. The sales decrease is due to the decrease in recruiting of new independent associates experienced by us in 2002. We have implemented a new marketing strategy to reverse the downward recruiting trend and to increase sales, and have begun to see positive effects. We expect to see the true effects in the fourth quarter and into the first quarter of 2004.

Our cost of sales during the three months ended September 30, 2003 decreased by $601,381, or 15.6%, to $3,248,866 from $3,850,247 during the same period in 2002. Total cost of sales, as a percentage of net sales, decreased to 66.5% during the three months ended September 30, 2003 from 69.7% during the same period in 2002. The decrease in cost of sales was attributable to:

- A decrease of $312,456 in associate commissions and bonuses due to the decreased level of sales;

- A decrease of $234,141 in the cost of products sold due to the decreased level of sales; and

- A decrease of $54,784 in shipping costs primarily due to decreased sales.

The factors discussed above resulted in a decrease in gross profit of $41,265, or 2.5%, to $1,634,189 for the three months ended September 30, 2003 from $1,675,454 for the same period in 2002.

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Marketing, distribution and administrative expenses decreased $61,702, or 3.1%, to $1,926,554 during the three months ended September 30, 2003, from $1,988,256 during the same period in 2002. The marketing, distribution and administrative expenses as a percentage of net sales increased to 39.5% during the three months ended September 30, 2003 from 36.0% during the same period in 2002. The decrease in expense was primarily attributable to:

- A decrease in insurance costs of approximately $20,000 related to better rates for liability insurance;

- A decrease in travel costs of approximately $20,000 related to lower airfare and hotel expense due to the purchase of a motor home for use by our herbalist; and

- A decrease in rental expense of approximately $22,000 due to the lease expiration on our old warehouse building.

Management expects marketing, distribution and administrative expenses to continue at or near the current dollar level.

Our net other income (reduced by other expense) increased by $11,121 to net other expense of $18,176 at September 30, 2003, from a net other expense of

$7,055 during the same period in 2002.

COMPARISON OF THE NINE MONTHS ENDED SEPTEMBER 30, 2003 AND 2002

Our net sales during the nine months ended September 30, 2003 decreased by $3,488,932, or 19.7%, to $14,183,992 from $17,672,924 during the nine months ended September 30, 2002. The sales decrease is due to the decrease in recruiting of new independent associates experienced by us in 2002. We have implemented a new marketing strategy to reverse the downward recruiting trend and to increase sales, and have begun to see positive effects. We expect to see the true effects in the fourth quarter and into the first quarter of 2004.

Our cost of sales during the nine months ended September 30, 2003 decreased by $2,310,181, or 19.4%, to $9,605,356 from $11,915,537 during the same period in 2002. Total cost of sales, as a percentage of net sales increased to 67.7% during the nine months ended September 30, 2003, from 67.4% during the same period in 2002. The decrease in cost of sales was attributed to:

- A decrease of $1,229,358 in distributor commissions and bonuses due to the decreased level of sales;

- A decrease of $925,702 in the cost of products sold due to the decreased level of sales; and

- A decrease of $155,121 in shipping expenses primarily due to decreased sales.

The factors discussed above resulted in a decrease in gross profit of $1,178,751, or 20.5%, to $4,578,636 for the nine months ended September 30, 2003 from $5,757,387 for the same period in 2002.

Marketing, distribution and administrative expenses decreased $242,077, or 4.2%, to $5,501,979 during the nine months ended September 30, 2003, from $5,744,056 during the same period in 2002. The marketing, distribution and administrative expenses as a percentage of net sales increased to 38.8% during the nine months ended September 30, 2003 from 32.5% during the same period in 2002. The decrease in expense was primarily attributable to:

- A decrease in insurance costs of approximately $78,000 related to better rates for liability insurance;

- A decrease in travel costs of approximately $50,000 related to lower airfare and hotel expense due to the purchase of a motor home for use by our herbalist;

- A decrease in rental expense of approximately $22,000 due to the lease expiration on our old warehouse building; and

- A decrease of approximately $74,000 in other variable costs such as postage, telephone, bank service charges and supplies.

Management expects marketing, distribution and administrative expenses to continue at or near the current dollar level.

Our net other income (reduced by other expense) increased by $60,597 to net other expense of $116,875 at September 30, 2003, from a net other expense of $56,278 during the same period in 2002, primarily due to an increased loss on sale of marketable securities of approximately $44,000, along with a decrease in investment income of approximately $18,000.

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 adopted 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. There was no material impact on our financial statements as a result of adoption of FIN 46. As of September 30, 2003, we had no variable interest entities.

SEASONALITY

No pattern of seasonal fluctuations exists due to the patterns that we are currently experiencing. 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 September 30, 2003, we had working capital of $2,226,889, 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 nine months ended September 30, 2003, net cash used in operating activities was $142,304, net cash used in investing activities was $457,336 and net cash used in financing activities was $457,246. This represented a net decrease in cash during this period of $1,056,886. Our working capital needs over the next 12 months consist primarily of marketing, distribution and administrative expenses, and will be provided by our operating activities. We expect our cash to increase in the fourth quarter, as a result of reduced operating expenses and anticipated revenues.

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 an annual rate of .25% under the prime rate.

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

- Transferring, selling or otherwise disposing of any assets;
- Making any loans to any persons or entity in excess of $500,000 in the aggregate;
- Engaging in any merger or acquisition in which we are not the surviving corporation;
- Changing executive management personnel; and
- Purchasing or acquiring any interest in any other entity.

The loan is collateralized 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 $802,000 are subject to interest risk only. We have approximately $963,000 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 September 30, 2003 and December 31, 2002:

	SEPTEMBER 30, 2003			DECEMBER 31, 2002		
	AVERAGE INTEREST RATE	COST	FAIR VALUE	AVERAGE INTEREST RATE (1)	COST	
Cash equivalents...	--	$ 21,527	$ 21,527	--	$ 18,208	$
Short-term Investments......	--	774,998	780,186	6.0%	787,180	
		$ 796,525	$ 801,713		$ 805,388	$

(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.

At September 30, 2003 all of our fixed income securities were in mutual funds, creating no average interest rates for fixed income securities, due to the redemption of 10,000 shares of our 5.75% Bell Atlantic securities during the second quarter of 2003.

The fair value of the cash equivalents and fixed-income marketable securities decreased $17,834 during the nine months ended September 30, 2003 to $801,713 from $819,547 at December 31, 2002. This decrease was primarily due to a net redemption of fixed-income securities resulting in a reduction of $21,000, offset by an increase in cash equivalents of approximately $3,000.

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 September 30, 2003, our equity investments had a value of $962,739 compared to $801,595 at December 31, 2002, primarily due to the purchase of mutual fund equity investments in 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

As of the end of the period covered by 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-15(e) under the Securities Exchange Act of 1934) as required by Rule 13a-15(b). 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.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

On October 14, 2003, we approved the extension of the exercise period of our 1997-A Warrants and our Redeemable Common Stock Purchase Warrants from November 12, 2003 to November 12, 2004. The extension of the exercise period is effective on November 12, 2003.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

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

At our annual meeting held July 26, 2003, Steven M. Dickey and Reggie B. Cook were re-elected directors for a three-year term, shareholders approved the Advantage Marketing Systems 2003 Stock Incentive Plan and Grant Thornton LLP was ratified as our independent auditor for the 2003 fiscal year. A total of 4,808,702 shares were cast in favor of Messrs. Dickey and Cook's re-election and no shares were cast against. Abstentions were 132,122. A total of 1,209,438 shares were cast in favor of approval of the Stock Incentive Plan, and 161,514 shares were cast against. Abstentions were 22,206. A total of 2,434,122 shares were cast in favor of Grant Thornton's ratification and 3,251 shares were cast against. Abstentions were 33,039. Messrs. John Hail, David

D'Arcangelo, Steven Hague, Harland Stonecipher and M. Thomas Buxton III continued as directors following our annual meeting.

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.

15 Letter of independent accountants as to unaudited interim financial information, filed herewith.

31.1 Rule 13a-14(a) Certification by our Chairman and Chief Executive Officer, filed herewith.

31.2 Rule 13a-14(a) Certification by our Chief Financial Officer, filed herewith.

32.1 Section 1350 Certification of our Chief Executive Officer, filed herewith.

32.2 Section 1350 Certification of our Chief Financial Officer, filed herewith.

(b) Form 8-K

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

- August 1, 2003 - Item 7 and Item 12 filing disclosing the press release announcing financial results for the three and six months ended June 30, 2003.

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: November 4, 2003

By: /S/ REGGIE B. COOK

Reggie B. Cook, Vice President and
Chief Financial Officer
(Duly Authorized Officer of
Registrant and Principal Financial Officer)

Index of Exhibits

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32.2	Section 1350 Certification of our Chief Financial Officer, filed herewith.