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HEALTH & NUTRITION SYSTEMS INTERNATIONAL INC
Form 10KSB
April 01, 2003

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

FORM 10-KSB

- Annual report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2002
- Transition report under section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _____ to _____

Commission file number 0-29245

Health & Nutrition Systems International, Inc.
(Name of small business issuer in its charter)

FLORIDA

(State or other jurisdiction of incorporation or organization)

65-0452156

(IRS Employer Identification No.)

3750 INVESTMENT LANE, SUITE 5
WEST PALM BEACH, FLORIDA
(Address of principal executive offices)

33407
(Zip Code)

Issuer's telephone number, including area code: (561) 863-8446

Securities registered under Section 12(b) of the Exchange Act:
NONE

Name of each exchange on which registered:
NONE

Securities registered under Section 12(g) of the Exchange Act:
COMMON STOCK, PAR VALUE \$.001 PER SHARE
(Title of Class)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference to Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

State issuer's revenues for its most recent fiscal year. \$3,567,848.

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was sold, or the average bid and asked price of such common equity, as of a specified date within the past 60 days. The aggregate market

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value of the voting stock held by non-affiliates on March 29, 2002 was \$145,193 (computed at the closing price of the common stock of the issuer outstanding on March 17, 2002)

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 3,629,813 shares of common stock were outstanding as of March 20, 2003.

Documents Incorporated by Reference: certain portions of the registrant's Definitive Proxy Statement relating to the Annual Meeting of Shareholders to be held on July 7, 2003 are incorporated by reference into Part III of this Form 10-KSB.

Transitional Small Business Disclosure Format: Yes [] No [X]

HEALTH & NUTRITION SYSTEMS INTERNATIONAL, INC.

FORM 10-KSB
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FORWARD-LOOKING INFORMATION MAY PROVE INACCURATE

This annual report on Form 10-KSB contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Act of 1934, as amended, and is subject to the safe harbor created by those sections. These forward looking statement concern the Company's operations, economic performance and financial condition, including but not limited to the information under the caption "Management's Discussion and Analysis or Plan of Operation." These statements are based on management's beliefs as well as assumptions made by and information currently available to management, including statements regarding future economic performance and financial condition, liquidity and capital resources and management's plans and objectives. Any statements that are not statements of historical fact should be regarded as forward-looking statements. For example, the words "intends," "believes," "anticipates," "plans," and "expects" are intended to identify forward-looking statements. There are a number of important factors that could cause our actual results to differ materially from those indicated by such forward-looking statements. These factors include without limitation those factors described under "Certain Factors Which May Affect Future Results" in this annual report. In addition, the recent terrorist attacks on the United States, current and future responses by the U.S. government, the war in the Persian Gulf, the effects of these events on consumer confidence and demand, the introduction of products that compete with the Company's products, the loss of significant customers, and the availability to the Company and deployment by the Company of capital, increase the uncertainty inherent in forward-looking statements. In addition, recent government action and the surrounding negative publicity regarding ephedra-containing products have caused us to discontinue selling products containing ephedra. These factors, among others, could cause our actual results to differ materially from those indicated by such forward-looking statements.

PART I

ITEM 1 DESCRIPTION OF BUSINESS

GENERAL

Health & Nutrition Systems International, Inc. (the "Company," "HNS," "we" or "us") was organized as a Florida corporation on October 25, 1993. Our fiscal year end is December 31. Our corporate offices are located at 3750 Investment Lane Building, Building #5, West Palm Beach, FL 33404. Our phone number is (561) 863-8446.

We develop, market and sell weight management, energy and sport nutrition products to national and regional, food, drug, health, pharmacy and mass-market accounts, as well as to independent health and pharmacy accounts. Our product formulations are not proprietary and therefore, our strategy is to create market awareness and sales through the name branding each of our products as well as the "Health and Nutrition Systems" name.

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PRODUCTS

We market and sell the following products:

- o ACUTRIM(R) NATURAL -- This is a dietary supplement that uses a special blend of natural ingredients to help the consumer burn fat by supporting healthy carbohydrate and fat metabolism.
- o THIN TAB(R)MAHUANG FREE -- Thin Tab(R)Mahuang Free offers the same benefits as Thin Tab(R)in an ephedra-free formula.
- o CARBCUTTER(R) -- CarbCutter(R) helps convert carbohydrates into energy. The Carb Free Blend activates a Cellular Transport System (CTS) that shuttles newly consumed carbohydrates into the cells where it then can be metabolized for energy instead of being stored as fat

As of March 15, 2003, we stopped selling two products, ThinTab(R) and Fat Cutter Plus, which contained ephedra, because of negative publicity related to the use of ephedra. Retailers who purchased those products from us may, however, continue to sell them from their inventory. A third product, Carbolizer(TM), was transferred to a third party as part of a larger general settlement of pending litigation. Carbolizer(TM) also contained ephedra. In 2002, these three products accounted for 19% of our total revenue.

Acutrim(R) Natural was introduced into our product line in 2001. The Acutrim(R) trademark was purchased by us in the first quarter of 2001. After we purchased the trademark, we completely reformulated the Acutrim(R) product to our current product, Acutrim(R) Natural.

CERTIFICATES OF ANALYSIS

Garden State Nutritional, a division of Vitaquest International Inc., is the only manufacturer of our products. See "Manufacturing and Shipping." GSN provides a certificate of analysis for each of our products which gives laboratory test results performed by GSN that verify product quality and ingredients. We deliver these certificates to our customers, and to consumers, upon request.

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CLINICAL TESTING

In order to enhance consumer confidence in our products, during 2001, we initiated and completed independent clinical testing of each of our products. These double blind placebo trials were conducted by Marshall-Blum LLC, an independent research company with twenty years of experience in product testing. Marshall-Blum follows strict clinical guidelines to assist with product compliance with applicable regulations and scientific standards.

MARKETING

We currently design and develop all of our products, marketing and advertising in house. We strive to create market awareness and sales through name-brand recognition of our trademarked products We target print advertising to develop brand awareness and recognition. During 2002 and 2001, we spent 8.4% and 14.8% respectively, of our total revenues advertising our products in consumer magazines such as Cosmopolitan, Mademoiselle, Glamour, Fitness, Redbook, Allure, Muscle and Fitness, and others. We intend to continue promoting our products through the print media.

In addition to print advertising, we have ongoing "co-op" programs with

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all of the major retailers who sell our products. These programs obligate us to spend a certain percentage of projected revenue to be generated by sales of our products on targeted advertising for that retailer through marketing vehicles such as Sunday newspaper inserts and 10-30 day price specials. We are obligated to spend these co-op dollars irrespective of the actual revenue generated by the sales of our products with that retailer. These co-op programs allow us to target several million consumers and drive sales to the specific retailer. In 2002 and 2001, we spent approximately \$823,481, 16.2% and \$1,252,000, 21.1%, respectively of our total gross revenues on advertising and promotion, on these "co-op" programs.

All of our products are included in the "plan-o-gram" marketing programs of the major retailers who sell our products. These programs give our products identical shelf and aisle positions in all locations in a particular chain of stores using a pre-planned, in-store display format. The plan-o-gram program guarantees consistent distribution and location of our products in all stores. The major retailers periodically review the products that participate in their plan-o-gram programs, sometimes as often as quarterly. There can be no assurance that our products will remain in any given retailer's plan-o-gram program. If one of our products is removed from a retailer's plan-o-gram program, it is likely that the sales volume of that product by that retailer will decline.

MANUFACTURING AND SHIPPING

We obtain 100% of our manufacturing from Garden State Nutritional, a division of Vitaquest International Inc. GSN is a state-of-the-art supplement, liquid and powder manufacturer which owns a 200,000 square foot manufacturing facility in West Caldwell, New Jersey. GSN has been known as an industry leader for more than 25 years. GSN has the capacity to support the production of all of HNS's product line. During 2001, we did not have a term contract with GSN, but rather acquired our needed inventory on a purchase order basis. In early April 2002, we entered into a two year exclusive manufacturing contract with GSN under which we purchase all of our products requirements from GSN. Although back-up suppliers are identified and available, the loss of this supplier would have a material adverse affect on us. GSN's research and development personnel, in conjunction with our in-house team, develop our product formulations. Pursuant to the terms of our exclusive manufacturing agreement with GSN, we have a \$450,000 line of credit with GSN with 60 day terms. GSN informally allowed the Company to purchase up to \$1,000,000 on the line of credit. At December 31, 2002, the balance owed to GSN under this line of credit is \$892,878.

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Our production/assembly personnel package products received from GSN. Our production/assembly personnel fill out shipping documents and oversee quality control and inventory flow. Our large retailer orders are shipped on pallets using the preferred freight company of the retailer's choice.

INTELLECTUAL PROPERTY

Our policy is to pursue registration of all of the trademarks associated with our key products. We currently own trademarks registered with the United States Patent and Trademark Office for our Acutrim(R), and CarbCutter(R) products and for our "On the Move(R)" advertising slogan. We have also applied for trademark protection in the United States relating to several of our advertising phrases, such as "I cheat," "We cheat," "Do you cheat?," Joint Lube, Fat Drops, Come Together, Thin Tab Carb Blocker, Thin Shake and Carb Blocker. Federally registered trademarks have a perpetual life, provided that they are renewed on a timely basis and are used properly as trademarks, subject to certain rights of third parties to seek cancellation of the marks.

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We also rely on common law trademark rights to protect our unregistered trademarks. Common law trademark rights do not provide us with the same level of protection as afforded by a United States federal registration of a trademark. In addition, common law trademark rights are limited to the geographic area in which the trademark is actually used.

We regard our trademarks and other proprietary rights as valuable assets and believe that such rights have significant value in the marketing of our products. We have in the past, and intend to continue in the future to, vigorously protect our trademarks against infringement, both in the United States and in foreign countries.

EMPLOYEES

We currently have twelve (12) full-time employees; four (4) are managerial, four (4) are engaged in sales and marketing, two (2) are administrative personnel and two (2) are assembly personnel. We believe our relationship with our employees is good.

PRODUCT DISTRIBUTION

GENERAL

Our customers are predominantly drug, health food, and mass retailers who then sell our products to the retail consumer. We do not have contracts with our customers to purchase our products. All of our customers purchase our products on a purchase order basis.

DRUG, HEALTH FOOD AND MASS RETAILERS

During 2002, we continued to diversify our customer base by establishing one or more of our products in more than eighteen (18) different drug, health food, and mass retailers. Each of our products has achieved "full distribution" in each of the chains that sell it, which means that if one of our products is sold by a retailer, it is sold in every location operated by that retailer. We estimate that CarbCutter(R) and Acutrim(R) Natural are now available in more than 25,000 store locations nationwide. Because our customers purchase our products on a purchase order basis, there can be no assurance that our products will continue to have "full distribution" (or any distribution) by the retailers that carry them.

One or more of our products are currently sold in the following mass retailers: Wal-Mart (2048 locations), Walgreens (3,520 locations), Rite-Aid (3,631 locations), CVS (4,123 locations), Brooks (Maxi

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Drug) (330 locations), Vitamin World (600 locations), H. E. Butt Grocery Co. (280 locations), Wakefern (200 locations), Sav-On (1,300 locations), Giant Landover (180 locations), Giant Eagle (188 locations), Eckerd's (2,650 locations), GNC (4,000 locations), Target (968 locations), Albertsons (2,128 locations), Duane Reade (193 locations), Long's (430 locations) and Vitamin Shoppe (78 locations).

In 2002, we derived approximately \$4,835,691 (or 95.2%) of gross revenues from these customers. In 2001, we derived \$5,524,760 (or 92.9%) of gross revenues from drug, health food, and mass retailer customers. The term "gross revenues" as used in this document relates to revenues excluding sales returns, allowances and discount, slotting fees paid, co-op advertising and promotion

expense.

INDEPENDENT RETAIL HEALTH AND PHARMACY STORES

Our in-house staff of telemarketers (HNS Direct) has opened 4,000 new accounts with independent retail health and pharmacy stores since we began this program in January, 1999. These stores are not owned by a chain but are independently owned and operated. We also participate in trade shows attended by buyers for these independent retail health and pharmacy stores. In 2002, we derived \$246,456 (or 4.8%) of revenues from independent health and pharmacy accounts. In 2001, we derived \$419,827 (or 7.1%) of revenues from independent health and pharmacy accounts. We believe that our revenue from the independent customers declined in 2002 in part due to many independents going out of business, our concentration of distribution efforts on our mass retailer distribution network, and our focus on re-orders with existing independent customers rather than on generating new accounts through special promotions. Although we intend to work to expand the HNS Direct program using our existing web site, HNSDirect.com and our in-house telemarketing program, we can offer no assurance that we will be able to maintain or expand our number of independent retail accounts in the future.

SIGNIFICANT CUSTOMERS

We currently have approximately 15 drug, health food, and mass retailer customers which collectively comprised 87.0% of our gross revenues in 2002. We depend on several significant customers for a large percentage of our sales. Our largest customers are GNC, Wal-Mart, Walgreens, Rite Aid, Target, and Eckerd Drugs. We do not have written agreements with any of these customers or any of our other customers.

During the fiscal year ending 2002, GNC represented approximately 20.5% of our gross sales, Wal-Mart represented approximately 12.2 % of our gross sales, Walgreens represented approximately 10.6% of our gross sales, Rite Aid represented approximately 10.1% of our gross sales, Target represented approximately 7.0% of our gross sales, Eckerd's represented approximately 5.1% of our gross sales. The loss of any one or more of our significant customers would have a material adverse effect on our operations.

GOVERNMENT REGULATIONS

The processing, formulation, packaging, labeling and advertising of our products are subject to regulation by one or more federal agencies, including the Food and Drug Administration ("FDA"), the Federal Trade Commission ("FTC"), the Consumer Product Safety Commission, the United States Department of Agriculture and the United States Environmental Protection Agency. These activities are also regulated by various agencies of the states, localities, and countries in which its products are sold. In addition, we manufacture and market certain of our products in substantial compliance with the guidelines promulgated by the United States Pharmacopoeia Convention, Inc. ("USP") and other voluntary standard organizations.

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The Dietary Supplemental Health and Education Act ("DSHEA") recognizes the importance of good nutrition and the availability of safe dietary supplements in preventive health care. DSHEA amends the Federal Food, Drug and Cosmetic Act ("FFD&CA") by defining dietary supplements, which include vitamins, minerals, nutritional supplements and herbs, as a new category of food, separate from conventional food. Under DSHEA, the FDA is generally prohibited from regulating such dietary supplements as food additives or drugs. It requires the FDA to regulate dietary supplements so as to guarantee consumer access to

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beneficial dietary supplements, allowing truthful and proven claims. Generally, dietary ingredients that were on the market before October 15, 1994 may be sold without FDA pre-approval and without notifying the FDA. However, new dietary ingredients (those not used in dietary supplements marketed before October 15, 1994) require pre-market submission to the FDA of evidence of a history of their safe use, or other evidence establishing that they are reasonably expected to be safe. There can be no assurance that the FDA will accept the evidence of safety for any new dietary ingredient that we may decide to use, and the FDA's refusal to accept such evidence could result in regulation of such dietary ingredients as food additives, requiring the FDA pre-approval based on newly conducted, costly safety testing. Also, while DSHEA authorizes the use of statements of nutritional support in the labeling of dietary supplements, the FDA is required to be notified of such statements, and there can be no assurance that the FDA will not consider particular labeling statements we use to be drug claims rather than acceptable statements of nutritional support, necessitating approval of a costly new drug application, or re-labeling to delete such statements. It is also possible that FDA could allege false statements were submitted to it if structure/function claim notifications was either non-existent or so lacking in scientific support as to be plainly false.

FFD&CA also authorizes the FDA to promulgate good manufacturing practice regulations ("GMP") for dietary supplements, which would require special quality controls for the manufacture, packaging, storage and distribution of supplements. Although the final version of the GMP rules has not yet been issued, we anticipate we will be in substantial compliance with the proposed regulations, once they are enacted. FFD&CA further authorizes the FDA to promulgate regulations governing the labeling of dietary supplements. Such rules, which were issued on September 23, 1997, entail specific requirements relative to the labeling of our dietary supplements. The rules, which took effect in March 1999, also require additional record keeping and claim substantiation, reformulation, or discontinuance of certain products. We believe we are in substantial compliance with these new requirements.

All of our products are classified as dietary supplements under the FFD&CA. In September 1997, the FDA issued regulations governing the labeling and marketing of dietary supplement products. These regulations cover:

- o the identification of dietary supplements and their nutrition and ingredient labeling;
- o the wording used for claims about nutrients, health claims and statements of nutritional support;
- o labeling requirements for dietary supplements for which "high potency" and "anti-oxidant" claims are made;
- o notification procedures for statements on dietary supplements; and
- o pre-market notification procedures for new dietary ingredients in dietary supplements.

The notification procedures became effective in October 1997. The labeling requirements became effective on March 23, 1999. Where required, we revised our product labels as necessary to reflect the requirements. We believe we substantially comply with these requirements. In addition, we are required to continue our ongoing program of providing evidence for our product performance claims, and notify the FDA of certain types of performance claims made for our products. Our substantiation program

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involves ongoing compilation and review of scientific literature pertinent to the ingredients contained in our products and the claims we make about them.

In certain markets, including the United States, claims made with respect to dietary supplements, personal care or any of our other products may change the regulatory status of our products. For example, in the United States, the FDA could possibly take the position that claims made for some of our products make those products new drugs requiring preliminary approval. The FDA could also place those products within the scope of its a Food and Drug Administration over-the-counter (OTC) drug regulations and require it to comply with a published FDA OTC monograph. OTC monographs dictate permissible ingredients, appropriate labeling language and require the marketer or supplier of the products to register and file annual drug listing information with the Food and Drug Administration. We do not at present sell OTC drug products. If the FDA were to assert that our product claims cause them to be considered new drugs or fall within the scope of over-the-counter regulations, we would be required to either file a new drug application, comply with the applicable monographs, or change the claims made in connection with our products.

Additionally, dietary supplements are subject to the Nutrition, Labeling and Education Act (NLEA), which regulates health claims, ingredient labeling and nutrient content claims characterizing the level of a nutrient in a product. NLEA prohibits the use of any health claim for dietary supplements unless the health claim is supported by significant scientific agreement and is pre-approved by the FDA.

The FTC regulates the marketing practices and advertising of all our products. In the past several years, the FTC instituted enforcement actions against several dietary supplement companies for false and misleading marketing practices and advertising of certain products. These enforcement actions have resulted in consent decrees and monetary payments by the companies involved. Under FTC standards, the dissemination of any false advertising constitutes an unfair or deceptive act or practice actionable under Section 45 of the Fair Trade Commission Act and a false advertisement actionable under Section 52 of that act. A false advertisement is one that is "misleading in a material respect." In determining whether an advertisement or labeling information is misleading in a material respect, FTC determines not only whether overt representations and implied representations are false but also whether the advertisement fails to reveal material facts. Under FTC's standard, any health benefit representation made in advertising must be backed by "competent and reliable scientific evidence" by which FTC means:

tests, analyses, research studies, or other evidence based upon the expertise of professionals in the relevant area, that have been conducted and evaluated in an objective manner by persons qualified to do so, using procedures generally accepted by the profession to yield accurate and reliable results.

The FTC has increased its review of the use of the type of testimonials we use in our business. The Federal Trade Commission requires competent and reliable evidence substantiating claims and testimonials at the time that such claims of health benefit are first made. The failure to have this evidence when product claims are first made violates the Federal Trade Commission Act. Although the FTC has never threatened an enforcement action against us for the advertising of our products, there can be no assurance that the FTC will not question our advertising or other operations in the future.

We may be required to obtain an approval, license or certification from a foreign country's ministry of health or comparable agency prior to entering a new foreign market. We work with local authorities in order to obtain the requisite approvals, license or certification before entering a foreign market.

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The approval process generally requires us to present each of our products and product ingredients to appropriate regulators and, in some instances, arrange for testing of our products by local technicians for ingredient analysis. Such approvals may be conditioned on reformulation of our products

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or may be unavailable with respect to certain of our products or certain ingredients contained in our products. We must also comply with product labeling and packaging regulations that are different from country to country. In markets where a formal approval license or certification is not required, we will rely upon the advice of local counsel, in each country, to help us ensure we comply with the law.

In addition, we cannot predict whether new legislation or regulations governing our activities will be enacted by legislative bodies or promulgated by agencies regulating our activities, or what the effect of any such legislation or regulations on our business would be. We may be subject to additional laws or regulations administered by the FDA or other federal, state or foreign regulatory authorities, the repeal of laws or regulations which we consider favorable, such as the DSHEA, or more stringent interpretations of current laws or regulations, from time to time in the future. We cannot predict the content of any future laws, regulations, interpretations or applications. We also cannot predict the future impact of the different governmental regulations; however, any or all of such requirements could be a burden and costly, to us. Future regulations could, however:

- o require us to change the way we conduct business;
- o require us to change the contents of our products;
- o make us keep additional records;
- o make us increase the available documentation of the properties of our products; or
- o make us increase or use different labeling and scientific proof of product ingredients, safety or usefulness.

COMPETITION

The diet industry is highly competitive. We compete directly with the following companies who sell to our customers and their diet product brands: Atkins Nutritional, Twinlabs, Metabolife International, Inc, Rexall Sundown, Dexatrim, Natures Bounty (NBTY) and Slim Fast. We also compete indirectly with companies that use direct marketing to distribute diet products directly to the retail consumer without the use of an intermediary such as a mass retailer. These companies use television and radio advertising which can range from thirty second commercials to full length thirty minute infomercials. Many of these companies also attempt to bring their best selling brands to the retail market and such products then also compete directly with our products.

Our product formulas are not proprietary. Similar formulations are currently being developed and marketed by our competitors. Substantially all of our competitors have greater resources and name recognition than we do. Many of our competitors sell, in addition to diet products, a broad range of health and nutrition products. In addition, many of our competitors sell to the same customers as we do. In addition, GSN, our sole manufacturer, sells similar products to our competitors, often with similar formulations. We strive to differentiate our products through the mixture of ingredients in our products and the amounts of such ingredients contained in our products. We also trademark

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our proprietary brand names such as, the "Carb Free Blend" in CarbCutter(R) See "Intellectual Property." We believe that this allows us to maintain consumer loyalty to our brand rather than to a specific ingredient or combination of ingredients. We also strive to differentiate our products by providing distinctive packaging.

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The most significant barrier to entry within our industry is the difficulty of establishing a new product. This involves a major capital commitment to advertise, participate in trade shows, build inventory, and pay the cost of entry with slotting fees and or free merchandise. Test marketing also requires a significant commitment of time and capital.

FINANCING

FACTORING

During 2002, we factored certain of our accounts receivable with Alliance Financial Capital, Inc. On March 15, 2002, we terminated our factoring agreement with Alliance and entered into a factoring agreement with LSQ Funding Group, L.C. (LSQ). We only factor certain large accounts, and we do not factor the accounts serviced through HNS Direct. The agreement with LSQ provides that LSQ will purchase certain of our receivables and advance to us 85% of the face amount of such receivables. The term of this agreement is one year. The maximum amount of receivables we may factor under our agreement with LSQ is \$750,000, and there is no minimum amount required to be factored. In connection with the factoring agreement, we granted to LSQ a blanket lien on our assets. In connection with the LSQ Factoring Agreement, our President and Chief Executive Officer was required to deliver a personal indemnity agreement to LSQ. The LSQ contract expired in March of 2003 and the Company did not renew it.

GSN FINANCING

In early April 2002, we entered into an agreement with GSN, our sole manufacturer, pursuant to which we agreed to repay to GSN amounts owed to them as of the date of the agreement which were approximately \$700,000. Our repayment schedule requires equal monthly payments over the next twenty four months, without interest. In connection with this agreement, we granted a blanket second priority lien on our assets to GSN.

Also, in early April 2002, we entered into an exclusive manufacturing agreement with GSN pursuant to which GSN has provided us with a \$450,000 line of credit, on current invoices, with 60 day terms. GSN informally allowed the Company to purchase up to \$1,000,000 on the line of credit. At December 31, 2002 the balance owed to GSN under this line of credit is \$892,878.

VENDOR FINANCING

We consider our relationships with our vendors to be good. During 2002, we were able to increase our credit limits as well as improve our payment terms with certain vendors.

PRODUCTS LIABILITY INSURANCE

We are currently insured for products liability claims up to an aggregate of \$6,000,000. While our products liability policy currently covers our products which contain ephedra, there can be no assurance that this coverage will be available in the future at premium rates that were consider acceptable, or at all.

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We are also an additional named insured on GSN's products liability policy which have aggregate coverage of up to \$5,000,000.

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ITEM 2. DESCRIPTION OF PROPERTY

Our corporate offices and finished product warehouse is located in a 6,000 square foot facility at 3750 Investment Lane, Building 5, West Palm Beach, Florida, 33404. This lease expires on October 31, 2003 and provides for lease payments of approximately \$2,172 per month. We also have leased a 4,000 square foot storage facility with lease payments of \$1,767 per month. The lease expires on October 31, 2003. All packaging and shipping is performed at this location.

During the first quarter of 2002, we entered into a sublease of 4,000 square feet of excess warehouse space for approximately \$1,800 per month.

ITEM 3. LEGAL PROCEEDINGS

NEW YORK CITY DEPARTMENT OF CONSUMER AFFAIRS

In January 2001, the New York City Department of Consumer Affairs ("DCA") issued a Notice of Violation ("NOV") relating to certain claims made by the Company relating to CarbCutter(R). In January 2002, HNS reached a settlement with the DCA which provided for the payment to DCA of \$10,000 and no admission of guilt, liability or misconduct of any kind by HNS.

J.C. HERBERT BRYANT, III AND KMS-THIN TAB 100, INC.

The Company was involved in the litigation with J.C. Herbert Bryant, III ("Bryant") and KMS-Thin Tab 100, Inc. ("KMS,") which was settled in September 2002. The settlement agreement generally provided for Bryant and KMS to transfer the registration and ownership of the domain names Thintab.com, Thintab.CC, and Carbcutter.cc to HNS and to take other action to eliminate confusion over the ownership of the Thin Tab@ name. Additionally, each of the adverse parties generally released the others. As part of the settlement, HNS entered into a distribution agreement with Bryant, beginning on September 26, 2002 and ending on September 25, 2007, permitting Bryant to purchase certain of its products from HNS and to exclusively distribute those products in Florida from Orlando south. HNS also has agreed not to sell its products directly to certain KMS customers. HNS booked a legal settlement expense of \$58,836 associated with this settlement.

The Company has been sued by six unaffiliated plaintiffs alleging that the Company's Acutrim(R) products contain Phenylpropanolamine ("PPA") and that those products have caused damage to the plaintiffs. The Company believes it can demonstrate that none of the Company's Acutrim(R) products has ever contained, or currently contains, PPA. To date, one of these cases has been dismissed after delivery to plaintiff's counsel of information substantiating the fact that HNS's products do not presently contain, and have not contained, PPA. While the Company does not believe that HNS has material liability based upon the substantive allegations set forth in these cases, the legal costs that the Company has incurred, and may incur in the future, in obtaining dismissals from these cases could have a material adverse effect on the Company.

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

During the fourth quarter of 2002, we did not submit any matters to the

vote of our security holders.

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PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The common stock of the Company trades on the OTC Bulletin Board under the trading symbol "HNNS." The prices set forth below reflect the quarterly high and low bid information for shares of our common stock during the last two fiscal years as reported by CSI, Inc. These quotations reflect inter-dealer prices, without retail markup, markdown or commission, and may not represent actual transactions.

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There were no trades of our securities on the OTCBB prior to October 4, 2000.

| Fiscal Year 2002 ----- | High ---- | Low --- |
|-------------------------------|------------------|----------------|
| Fourth Quarter | 0.08 | 0.04 |
| Third Quarter | 0.15 | 0.08 |
| Second Quarter | 0.17 | 0.05 |
| First Quarter | 0.55 | 0.05 |
| Fiscal Year 2001 ----- | High ---- | Low --- |
| Fourth Quarter | 0.28 | 0.10 |
| Third Quarter | 0.51 | 0.14 |
| Second Quarter | 1.03 | 0.23 |
| First Quarter | 2.06 | 0.63 |

As of March 20, 2002, there were 83 holders of record of our common stock.

Our common stock is covered by an SEC rule that imposes additional sales practice requirements on broker-dealers who sell such securities to persons other than established customers and accredited investors, which are generally institutions with assets in excess of \$5,000,000, or individuals with net worth in excess of \$1,000,000 or annual income exceeding \$200,000 or \$300,000 jointly with their spouse. For transactions covered by the rule, the broker-dealer must make a special suitable determination for the purchaser and transaction prior to the sale. Consequently, the rule may affect the ability of broker-dealers to sell our securities, and also may affect the ability of purchasers of our stock to sell their shares in the secondary market. It may also cause fewer broker-dealers to be willing to make a market in our common stock, and it may affect the level of news coverage we receive.

Prior to June 29, 2000, we were not a reporting company and were not required to file quarterly, annual, and other reports with the SEC.

We have not declared or paid any cash dividends on our common stock since our inception, and our Board of Directors currently intends to retain all earnings for use in the business for the foreseeable future. Any future payment of dividends will depend upon our results of operations, financial condition, cash requirements and other factors deemed relevant by our Board of Directors.

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The following table provides information as of December 31, 2002 about our common stock that may be issued upon the exercise of options under our 1998 Stock Option Plan for employees, officers, directors and independent contractors.

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EQUITY COMPENSATION PLAN INFORMATION

| PLAN CATEGORY | NUMBER OF SECURITIES TO BE ISSUED UPON EXERCISE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS (A) | WEIGHTED-AVERAGE EXERCISE PRICE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS | NUMBER OF REMAINING FUTURE COMPENSATION SECURITIES COLUMN |
|--|---|---|---|
| Equity compensation plans approved by security holders | 506,500 | \$.14 | 322,000 |
| Equity compensation plans not approved by security holders (1) | | | |
| TOTAL | 506,500 | \$.14 | 322,000 |

(1) We do not maintain equity compensation plans that have not been approved by our stockholders.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION.

This annual report on Form 10-KSB contains forward-looking statements and information. Any statements that are not statements of historical fact should be regarded as forward-looking statements. For example, the words "intends," "believes," "anticipates," "plans," and "expects" are intended to identify forward-looking statements. There are a number of important factors that could cause our actual results to differ materially from those indicated by such forward-looking statements. These factors include without limitation those factors described under "Certain Factors That May Affect Future Operations" in this annual report. In addition, the recent terrorist attacks on the United States, possible responses by the U.S. government, the effects on consumer demand, the financial markets and other conditions increase the uncertainty inherent in forward-looking statements. Finally, recent government action and the surrounding publicity regarding ephedra-containing products may make it difficult for us to obtain and maintain product liability insurance for our products containing ephedra at current premiums. This could cause our actual results to differ materially from those indicated by such forward-looking statements.

The following discussion of our results of operations and financial condition should be read along with our Consolidated Financial Statements listed in Item 7 and the Notes to them appearing elsewhere in this Form 10-KSB.

CRITICAL ACCOUNTING POLICIES

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Financial Reporting Release No. 60, which was recently released by the U.S. Securities and Exchange Commission, encourages all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. Our financial statements include a summary of the significant accounting policies and methods used in the preparation of our financial statements.

Management believes the following critical accounting policies affect the significant judgments and estimates used in the preparation of the financial statements.

REVENUE RECOGNITION

Revenues are recognized at the time of shipment of the respective merchandise. Cost of sales includes freight cost. Included in the net sales in the accompanying financial statements for the twelve months ended December 31, 2002 and 2001 are returns and allowances and sales discounts in the amounts of \$612,700 and \$579,255, respectively.

APPLICATION OF EIFT 01-9, "ACCOUNTING FOR CONSIDERATION GIVEN BY A VENDOR TO CUSTOMER (INCLUDING A RESELLER OF THE VENDOR'S PRODUCTS) "

In accordance with EITF 01-9, we reclassified expenses relating to slotting fees paid, co-op advertising and promotions, from operating expenses to revenues. The term "gross revenues" as used in this document relates to the revenues excluding the above mentioned advertising expenses and sales returns, allowances and discounts. Gross revenues for 2002 and 2001 are \$5,082,147 and \$5,944,587 respectively, and the co-op advertising expenses are \$901,599 and \$1,524,943 respectively.

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USE OF ESTIMATES

Management's discussion and analysis of financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, management evaluates these estimates, including those related to valuation allowance for the deferred tax asset, estimated useful life of fixed assets and the carrying value of long-lived assets, intangible assets and allowances for sales returns, doubtful accounts, and obsolete and slow moving inventory and reserve for customer liabilities. Management bases these estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

OVERVIEW

Like most consumer businesses, our business is affected by general economic, political and public safety conditions that impact consumer confidence and spending. The impact of the terrorist attacks of September 11, 2001 and the government's response to them including the commencement of the Persian Gulf war, have had short-term and also have had, and may continue to have, long-term adverse effects on our revenues, results of operations, financial condition and

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prospects. The industry revenues reported in year 2002 were down approximately 25% percent from those reported in year 2001. We believe that this trend will reverse itself in the year 2003 and report an up turn in the industry.

During 2002, we continued to implement our strategic plan to diversify our product line through the development and promotion of two new products: Fat Cutter Plus and Acutrim(R) Natural as well as the promotion and expansion of the distribution of CarbCutter(R). This strategy is aimed at reducing the negative impact upon us of (i) a shift in consumer preferences with regard to any one of our products, (ii) a change in retailer preferences for our products, or (iii) any other cause of reduced sales either for a particular product or in a particular geographical region because of negative publicity. The Company announced on December 19, 2002 that it had made a strategic decision to discontinue the sales of all ephedra-based products. As a result, the Company discontinued sales of Thin Tab(R) and Fat Cutter Plus in the first quarter of 2003. Our retail customers, however, may continue to sell those products from their inventory. Alternatively, they may try to return the products to us. In 2002, sales of those products were \$965,608 or 19% of total revenue. At December 31, 2002, the Company recorded an allowance for sales returns of \$317,600, including \$200,000 for returns of products containing ephedra expected in 2003.

We cannot predict the effects of the discontinuance of these products on our revenues, results of operations, financial condition and prospects. See "Commitments and Contingencies."

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RESULTS OF OPERATIONS

NET SALES:

Year ended December 31, 2002 compared with Year ended December 31, 2001

Gross revenues for the twelve months ended December 31, 2002 decreased by \$862,440, to \$5,082,147, versus the comparable period in 2001 of \$5,944,587. The decrease was due to the decrease in sales to our major customers of \$689,069 and a decrease in our in-house telemarketing revenue of \$173,371. We believe these decreases were primarily based on a generally soft market and reduced advertising. During the twelve months ended December 31, 2002, six companies accounted for 65.5% of the gross revenues. GNC, our largest account, accounted for 20.5% of total sales versus the comparable period in 2001 of 20.8%. Net revenues for the twelve months ended December 31, 2002 decreased by \$272,541 to \$3,567,848 versus the comparable period in 2001 of \$3,840,389.

Year ended December 31, 2001 compared with Year ended December 31, 2000

Gross revenues for the twelve months ended December 31, 2001 decreased by \$298,943 to \$5,944,587 versus the comparable period in 2000 of \$5,645,644. The decrease was primarily due to the decrease in our in-house telemarketing revenue of \$603,550 in fiscal year 2001 versus the comparable period in fiscal 2000. During the twelve months ended December 31, 2001, six companies accounted for 73.5% of the total Company's revenues. GNC, our largest account, accounted for 20.8% of total sales versus the comparable period in 2000 of 45.0%. Net revenues for the twelve months ended December 31, 2001 decreased by \$954,465 to \$3,840,389 versus the comparable period in 2000 of \$4,794,854.

COST OF SALES

Year ended December 31, 2002 compared with Year ended December 31, 2001

Cost of sales for the twelve months ended December 31, 2002 was

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\$1,511,826 or 42.4% of net sales, compared to \$1,903,755 or 49.6% of net sales for the twelve months ended December 31, 2001. The decrease in cost of sales as a percentage of net sales is primarily attributed to higher sales of CarbCutter(R), which had a formula change decreasing the cost of goods sold on this product in fiscal year 2002. Additionally, the cost of sales was reduced by \$73,747 which represents imputed interest on the Company's Note with GSN. The cost of sales as a percentage of net sales without this discount is 44.4%.

Year ended December 31, 2001 compared with Year ended December 31, 2000

Cost of sales for the twelve months ended December 31, 2001 was \$1,903,755 or 49.6% of net sales, compared to \$1,472,528 or 30.7% of net sales for the twelve months ended December 31, 2000. The increase in cost of sales as a percentage of net sales is primarily attributed to higher sales of CarbCutter(R), which had a formula change increasing the cost of goods sold on this product in fiscal year 2001, and the reformulation of Acutrim Natural(R) that increased the cost of sales percentage.

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GROSS PROFIT:

Year ended December 31, 2002 compared with Year ended December 31, 2001

Gross profit for the twelve months ended December 31, 2002 was \$2,056,022 an increase of \$119,388, or 6.2%, compared to gross profit of \$1,936,634 for the twelve months ended December 31, 2001. As a percent of net sales, gross profit was 57.6% for the twelve months ending December 31, 2002, as compared to 50.4% for the twelve months ended December 31, 2001. The increase in gross profit dollars is primarily attributed to the decrease in cost of goods as explained above.

Year ended December 31, 2001 compared with Year ended December 31, 2000

Gross profit for the twelve months ended December 31, 2001 was \$1,936,634 a decrease of \$1,385,691 or 41.7%, compared to gross profit of \$3,322,325 for the twelve months ended December 31, 2000. As a percent of net sales, gross profit was 50.4% for the twelve months ending December 31, 2001, as compared to 69.2% for the twelve months ended December 31, 2000. The decrease in gross profit is primarily attributed to the increase in cost of goods for the CarbCutter(R) and also Acutrim(R) Natural, each of which were reformulated in 2001 and as a result of such reformulation, has a lower gross margin than the prior year.

OPERATING EXPENSES:

Year ended December 31, 2002 compared with Year ended December 31, 2001

Operating expenses were \$1,980,493 for the twelve months ended December 31, 2002, compared to \$3,313,837 for the twelve months ended December 31, 2001, representing a decrease of \$1,333,344. As a percent of net sales, operating expenses were 55.5% for the twelve months ended December 31, 2002, compared to 86.3% for the twelve months ended December 31, 2001. Advertising and promotion expenses were \$425,349 for the twelve months ended December 31, 2002, compared to \$881,541 for the twelve months ended December 31, 2001, representing a decrease of \$456,192. Expenditures of \$901,600 and \$1,523,943 for the years 2002 and 2001 respectively, which were previously classified as advertising and promotion expenses were classified to revenues. These expenses in 2001 were primarily due to expenses associated with the new product launches of Fat Cutter and Carbolizer as well as expenses associated with expanding the distribution of our other products. General and administration expenses were \$1,524,678 for the

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twelve months ended December 31, 2002, compared to \$2,400,680 for twelve months ended December 31, 2001, representing a decrease of \$876,002. This decrease was primarily a result of reductions in personnel expenditures, factoring expenditures offset in part by professional fees associated with litigation during 2002.

Year ended December 31, 2001 compared with Year ended December 31, 2000

Operating expenses were \$3,313,837 for the twelve months ended December 31, 2001, compared to \$3,238,121 for the twelve months ended December 31, 2000, representing an increase of \$75,716. As a percent of net sales, operating expenses were 86.3% for the twelve months ended December 31, 2001, compared to 67.5% for the twelve months ended December 31, 2000. Advertising and promotion expenses were \$881,541 for the twelve months ended December 31, 2001, compared to \$1,007,694 for the twelve months ended December 31, 2000, representing a decrease of \$126,153. General and administration expenses were \$2,400,680 for the twelve months ended December 31, 2001, compared to \$2,201,478 for the twelve months ended December 31, 2000, an increase of 9.0%. This increase was primarily a result of additional personnel expenditures and professional fees associated with litigation during 2001.

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NET INCOME FROM OPERATIONS

Year ended December 31, 2002 compared with Year ended December 31, 2001

Net income for the twelve months ended December 31, 2002, was \$27,606 or .01 per share compared to a net loss of \$(1,399,533) or \$(.39) per share for the twelve months ended December 31, 2001. The increase in income was a direct result of our commitment to reduce the operating expenses, resulting in a decrease of \$1,333,344 over the prior year.

Year ended December 31, 2001 compared with Year ended December 31, 2000

Net loss for the twelve months ended December 31, 2001, was \$(1,399,533) or (.39) per share compared to net income of \$70,562 or \$.02 per share for the twelve months ended December 31, 2000. The decrease in income was a direct result of our commitment to the advertising and promotion of our product lines. Advertising, Slotting Fees, Co-ops, Free Goods and Promotion Expenditures increased \$789,392 or 48.8% over the previous twelve months ended December 31, 2000.

CARRY FORWARD LOSS

We have a net operating loss carry forward, as of December 31, 2002, of \$895,346 for tax purposes to affect future taxable income. The net operating loss carry forwards expire in 2022.

LIQUIDITY & CAPITAL RESOURCES

At December 31, 2002, the Company had a working capital deficit of \$702,970 compared to the prior year end, at December 31, 2001, of \$900,663. This is an improvement of \$197,693. In early April 2002, we entered into an agreement with GSN, our sole manufacturer, pursuant to which we agreed to repay to GSN amounts we owed to them as of the date of the agreement which were approximately \$700,000 over the next twenty-four months. Our current liabilities from accounts payable and accrued expenses increased during 2002 by \$593,084.

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Net cash provided by operating activities for the year ended December 31, 2002 was \$190,329 and resulted primarily from decreased operating expenses. Net cash provided by investing activities was \$0 for the year ended December 31, 2002. Net cash used in financing activities for the year ended December 31, 2002 was \$(257,483) which includes repayment of notes payable of \$237,400 and \$20,083 for capital lease payments. Net cash used in operating activities for the year ended December 31, 2001 was \$(33,650) and resulted primarily from increased operating expenses. Net cash provided by investing activities was \$122,163 for the year ended December 31, 2001, which resulted from purchases of trademarks for \$25,000 and the release of a certificate of deposit as collateral for a bank loan of approximately \$150,000.

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During 2001, we factored certain of our accounts receivable with Alliance Financial Capital, Inc. On March 15, 2002, we terminated our factoring agreement with Alliance and entered into a factoring agreement with LSQ Funding Group, L.C. (LSQ). The term of this agreement is one year. The maximum amount of receivables we may factor under our agreement with LSQ is \$750,000, and there is no minimum amount required to be factored. In connection with the factoring agreement, we granted to LSQ a blanket lien on our assets. Our factoring arrangement provides us with cash at the time of shipment of the product. The Company decided not to renew the LSQ agreement in March 2003.

As stated above, in early April 2002, we entered into an agreement with GSN, our sole manufacturer, pursuant to which we agreed to repay to GSN amounts we owed to them as of the date of the agreement which were approximately \$700,000. In connection with this agreement, we granted to GSN a blanket second priority lien on our assets. Also, in early April 2002, we entered into an exclusive manufacturing agreement with GSN pursuant to which GSN has provided us with a \$450,000 line of credit with 60 day terms. At December 31, 2002, we owed GSN \$892,878.

COMMITMENTS AND CONTINGENCIES

Regulatory Matters - Our discontinued products, Fat Cutter Plus, Thin Tab(R), and formally owned Carbolizer(TM) product, contain ephedra, also known as "Ma Huang," an herb which contains naturally-occurring ephedrine. These products represented approximately 19% of our gross revenue for the twelve months ended December 31, 2002. Ephedra containing products have been the subject of adverse publicity in the United States and other countries relating to alleged harmful effects. The company has discontinued all sales of products containing ephedra.

In April 2000, the FDA withdrew most of the provisions of its proposed rule regarding dietary supplements that contain ephedrine alkaloids. The proposed rule, which was published in 1997, would have significantly limited our ability to sell Fat Cutter Plus, ThinTab and Carbolizer if it had been made effective. The FDA's withdrawal of the provisions removed most, but not all, of the limitations. This action was prompted largely by a report issued by the United States General Accounting Office (GAO) in which the GAO criticized as faulty 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 made available for public inspection most of the adverse event reports on April 3, 2000.

On October 25, 2000, several trade organizations for the dietary supplement industry submitted a petition to the FDA which concerned the remaining provisions of the proposed rule regarding dietary supplements that contain ephedrine alkaloids. The petition requested the FDA to: (1) withdraw the

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remaining provisions of the proposed rule, and (2) adopt new standards for dietary supplements that contain ephedrine alkaloids, which were set forth in the petition. The FDA has not publicly responded to this petition.

The FDA will, most likely, attempt to issue a new proposed rule with respect to dietary supplements that contain ephedrine alkaloids. However, it is uncertain what restrictions the new proposed rule might contain or when a new proposed rule will be issued. In our opinion, it is unlikely that a final regulation will be issued by the FDA during 2002. Consequently, we are unable at the present time to predict the ultimate resolution of these issues, or their ultimate impact on our results of operations or financial condition. In the event that these rules limit our ability to sell our products containing ephedra, we have already developed ephedrine-free formulae for those products. In addition, to the extent that sales of ephedra-containing products of our competitors decline as a result of any new rules, sales of our current non-ephedra products may be positively affected.

Product Liability - We, like other marketers of products that are intended to be ingested, face the inherent risk of exposure to product liability claims in the event that the use of our products results in injury. We currently

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maintain product liability insurance coverage of \$6,000,000. It may become increasingly difficult to obtain and maintain product liability insurance coverage for products containing ephedra at current premiums, or at all. Although we believe our current liability coverage is sufficient to cover claims which have been or may be asserted against us, if they are in the future, our product liability insurance coverage could prove to be inadequate and these claims could result in material losses.

CERTAIN FACTORS WHICH MAY AFFECT FUTURE RESULTS

If Garden State Nutritionals, our sole manufacturer, fails to supply our products in sufficient quantities and in a timely fashion, our business may suffer. We currently obtain 100% of our manufactured product from a single source of supply, Garden State Nutritionals. In 2002, we entered into a two year contract with GSN to manufacture all of our products. In the event that GSN is unable or unwilling to provide us with the products in accordance with the terms of our contract, delays in securing alternative sources of supply would result in a material adverse effect upon our operations.

The dietary supplement industry is highly competitive. The diet industry is highly competitive. Many of our competitors, particularly manufacturers of nationally advertised brand name products, are larger and have resources substantially greater than we do. In the future, if not currently, one or more of these companies could seek to compete more directly with us by manufacturing and distributing their own or others' products, or by significantly lowering the prices of their existing national brand products. If one or more of our competitors significantly reduce their prices on existing products in an effort to gain market share or aggressively promote new products in an effort to enter a market, our results of operations or market position could be adversely affected. In addition, because the formulations of our products are not proprietary, similar formulations are currently being developed and marketed by these competitors.

Our products may also face competition in the future from diet-related drugs introduced by pharmaceutical companies.

We currently have a limited number of products. We currently market

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seven products. The loss of, or deterioration in the popularity of any one or more of our other brands will have a material adverse effect on our Company.

Our failure to develop and introduce new products could have an adverse effect on our Company. We believe our ability to grow in our existing market is partially dependent upon our ability to introduce new and innovative products into these markets. Although we seek to introduce additional products in our existing markets, the success of new products is subject to a number of variables, including developing products that will appeal to customers and competing with product launches by our competitors. We cannot assure you that our efforts to develop and introduce new products will be successful or that customers will accept new products.

We could be adversely affected if any of our products or any similar products distributed by other companies should prove or be asserted to be harmful to consumers or should scientific studies provide unfavorable findings regarding the effectiveness of our products. All of our products have certificates of analysis supplied by our manufacturer, and we have completed independent clinical testing of all of our products. We are highly dependent upon our customers' and the retail consumers' perception of the overall integrity of our business, as well as the safety and quality of our products and similar products distributed by other companies, which may not adhere to our quality standards. Our ability to attract and retain customers who, in turn, attract retail consumers, could be adversely affected by negative publicity regarding our products or one or more ingredients in our products or by the announcement by any governmental agency of a regulatory initiative relating to ingredients in our products.

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Our customers may discontinue use of our products at any time. Our customers order products on a purchase order basis and may discontinue the sale of our products at any time. If product sales are discontinued, we may not receive payment for units that are not paid for as of the time of discontinuation. Additionally, certain of our customers have the right to take a credit in an amount equal to the unpaid balance of the discontinued product against other products of ours that they may purchase.

Our success largely depends upon national media attention. We believe that the historical growth experienced by the nutritional supplement market is based in part on the national media attention regarding recent scientific research suggesting potential health benefits from regular consumption of certain vitamins and other nutritional products. Such research has been described in major medical journals, magazines, newspapers and television programs. The scientific research to date is preliminary, and there can be no assurance of future favorable scientific results and media attention or of the absence of unfavorable or inconsistent findings. While public awareness of the positive effects of vitamins and nutritional supplements on health was heightened by widely publicized reports of scientific findings supporting such claims during 1997-1998, we believe that negative media attention focusing on questions of efficacy, safety and label claim content have had a significant adverse impact on the supplement industry over the past two years. In particular, negative publicity with respect to ephedrine products has impacted our business. The lack of growth in the nutritional supplement industry has also been caused by the lack of new "blockbuster" products and increasing competition, including intense private label expansion. There can be no assurance that these factors will not be present in the future.

We, like other sellers of products that are ingested, face an inherent risk of exposure to product liability claims if, among other things, the use of our products results in injury. We currently have product liability insurance

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for our operations in amounts we believe are adequate for our operations. There can be no assurance, however, that such insurance will continue to be available at a reasonable costs, if at all, or, if available, will be adequate to cover such liabilities.

Restrictive governmental regulations govern the manufacturing and distribution of our products. We are subject to numerous governmental regulations, including but not limited to regulations promulgated by FDA, FTC and the Consumer Product Safety Commission, regarding the distribution, labeling and promotion of our products. All of the ingredients that we use in our products have been reviewed by the FDA upon submission of information by others. If we intend to use any ingredient in our products that has not already been reviewed by the FDA, we would be required to submit the new dietary ingredient to the FDA and to demonstrate a history of safe use. If the FDA does not accept the evidence of safety we present for the new dietary ingredient, the FDA could determine that such result ingredient should be regulated as a food additive and require time consuming and costly FDA approval. Additionally, under the FD&CA (including NLEA and DSHEA), the FDA has issued regulations regarding labeling and marketing of our products, and the NLEA regulates nutrient and ingredient labeling. The FTC regulates marketing practices and advertising of our products. Our business and financial results could be materially harmed by our failure to comply with these labeling and marketing regulations.

The laws and regulations relating to our products are subject to frequent and substantial changes resulting from legislation, adoption of rules and regulations and administrative and judicial interpretation of existing laws. These changes may have a dramatic effect on our business. Such changes may be applied retroactively. The ultimate timing or effect of such changes cannot be predicted. Our failure to comply with such laws, requirements and regulations could adversely affect our business and finances.

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We depend on significant customers for a large percentage of our net sales. Our largest customers are GNC, Wal-Mart, Walgreens, Rite Aid, Target, Eckerd's and CVS. We do not have written agreements with any of these customers. We cannot assure you that these customers will continue as major customers of the Company. The loss of any of these customers, or a significant reduction in purchase volume by any of these customers, could have a material adverse effect on our results of operations or financial condition.

We believe that trademarks and other proprietary rights are among our most important assets. In fiscal 2002, substantially all of our net sales were from products bearing proprietary brand names, including Acutrim(R) Natural Thin Tab(R) and CarbCutter(R). Accordingly, our future success depends upon the goodwill associated with these brand names. Although our principal brand names are registered in the United States, we cannot assure you that the steps we have taken to protect our proprietary rights in our brand names will be adequate to prevent the misappropriation of these registered brand names in the United States or abroad. In addition, the laws of some foreign countries do not protect proprietary rights in brand names to the same extent as do the laws of the United States. In addition, to the extent that we rely on common law trademark rights to protect our unregistered trademarks, such common law trademark rights do not provide us with the same level of protection as afforded by a United States federal registration of a trademark. In addition, common law trademark rights are limited to the geographic area in which the trademark is actually used. Additionally, the sales of certain of our products rely on our ability to maintain and extend our licensing agreements with third parties, and we cannot assure you that these third parties can successfully maintain their intellectual property rights or that we will be successful in maintaining these licensing agreements. If we lose the right to use these licenses, our business could be

materially adversely affected.

Although we are committed to enforce our various trademarks and other intellectual property rights against infringement, we cannot assure you that we will be able to successfully do so. The loss of, or deterioration in, our intellectual property rights could adversely affect our business.

We depend substantially on the continued services and performance of our senior management. Our business may be hurt if Chris Tisi, our President and Chief Executive Officer, leaves us. Although we have an employment agreement with Mr. Tisi, this does not guarantee that he will remain with us. If we lose his services, we may not be able to attract and retain additional qualified personnel to fill his position in the future.

Control of our company is concentrated among a limited number of stockholders who can exercise significant influence over all matters requiring stockholder approval. As of December 31, 2002, our present directors, executive officers and their respective affiliates and related entities beneficially owned approximately 33% of our outstanding common stock and common stock equivalents. In addition, our President and Chief Executive Officer has agreed with certain other significant shareholders to vote together on certain matters. These stockholders can exercise significant influence over all matters requiring stockholder approval, including the election of directors and the approval of significant corporate transactions. This concentration of ownership may also potentially delay or prevent a change in control of our company.

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Our stock price is likely to remain volatile. The stock market has, from time to time, experienced significant price and volume fluctuations that may be unrelated to the operating performance of particular companies. In addition, the market price of our common stock, like the stock price of many publicly traded dietary and nutritional product companies, has been and will likely continue to be volatile. Prices of our common stock may be influenced by many factors, including:

- o investor perception of us;
- o analyst recommendations;
- o market conditions relating to dietary and nutritional product companies;
- o announcements of new products by us or our competitors;
- o publicity regarding actual or potential developments relating to products under development by us or our competitors;
- o developments or disputes concerning proprietary rights;
- o regulatory developments;
- o period to period fluctuations in financial results of us and our competitors;
- o future sales of substantial amounts of common stock by shareholders; and o economic and other external factors.

We are not likely to pay dividends. We have not paid any cash dividends on our common stock and we do not plan to pay any cash dividends in the foreseeable future. We plan to retain any earnings for the operation of our business.

ITEM 7. FINANCIAL STATEMENTS

The financial statements are included beginning at F-1. See Index to the Financial Statements.

ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING

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AND FINANCIAL DISCLOSURE

None.

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PART III

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS;
COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT

We have adopted a written code of ethics that applies to our senior financial officers and persons performing similar functions, which Code has been filed as Exhibit 14 hereto. We intend to disclose any amendments to, or waivers from, the Code on our website, www.hnsglobal.com. Upon written request to our corporate secretary by U.S. mail, we will provide, at no charge, a copy of such Code to any person requesting a copy.

The other information required by this Item will be included in our Proxy Statement which will be filed with the Securities and Exchange Commission in connection with our 2003 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 10. EXECUTIVE COMPENSATION

The information required by this Item will be included in our Proxy Statement which will be filed with the Securities and Exchange Commission in connection with our 2003 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS
AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

EQUITY COMPENSATION PLAN INFORMATION

| PLAN CATEGORY | NUMBER OF SECURITIES TO BE ISSUED UPON EXERCISE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS (A) | WEIGHTED-AVERAGE EXERCISE PRICE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS | NUMBER REMAINING FUTURE EQUITY (EXCLUDING REFLECTED) |
|--|--|--|---|
| Equity compensation plans approved by security holders | 506,500 | \$.14 | 322,000 |
| Equity compensation plans not approved by security holders (1) | | | |
| TOTAL | 506,500 | \$.14 | 322,000 |

(1) We do not maintain equity compensation plans that have not been approved by our stockholders.

The other information required by this Item will be included in our

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Proxy Statement which will be filed with the Securities and Exchange Commission in connection with our 2003 Annual Meeting of Shareholders and is incorporated herein by reference.

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ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this Item will be included in our Proxy Statement which will be filed with the Securities and Exchange Commission in connection with our 2003 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K

(a) Documents filed as part of this Form 10-KSB

FINANCIAL STATEMENTS:

- o Independent Auditors' Report
- o Balance Sheets as of December 31, 2002 and 2001
- o Statements of Operations for the years ended December 31, 2002 and 2001
- o Statements of Changes in Stockholders' Equity for the years ended December 31, 2002 and 2001
- o Statements of Cash Flows for the years ended December 31, 2002 and 2001
- o Notes to Financial Statements

THE FOLLOWING EXHIBITS ARE FILED AS PART OF THIS FORM 10-KSB

The exhibits to this Form 10-KSB appear following the Company's Financial Statements included in this report.

- 3.1(a) Articles of Incorporation of the Registrant (incorporated by reference to registration statement on Form 10-SB, filed on January 31, 2000; Commission
- 3.1(b) Articles of Amendment to the Articles of Incorporation (incorporated by ref Registrant's registration statement on Form 10-SB, filed on January 31, 200 Commission File Number 0000-29245).
- 3.1(c) Articles of Amendment to Articles of Incorporation (incorporated by referen Registrant's registration statement on Form 10-SB, filed on January 31, 200 Commission File Number 000-29245).
- 3.1(d) Articles of Amendment to Articles of Incorporation (incorporated by referen Registrant's Annual Report on Form 10-KSB, filed on April 16, 2001; Commiss
- 3.2 By-Laws of the Registrant (incorporated by reference to Exhibit 3 registration statement on Form 10-SB, filed on January 31, 2000; Com 000-29245).
- 3.3 Amendment to the Restated Bylaws of the Company dated September 25, 200 reference to Exhibit 3.3 of Registrant's Annual Report on Form 10-KSB, 2000; Commission File Number 000-29245).
- 3.4 Amendment to the Restated Bylaws of the Company dated November 10, 200 reference to Exhibit 3.4 of Registrant's Annual Report on form 10-KSB, 2000; Commission File Number 000-29245).
- 10.1 Employment Agreement between the Company and Chris Tisi effective as of Jan (incorporated by reference to Exhibit 10.1 of Registrant's Current Report o

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filed on February 13, 2002; Commission File Number 000-29245).

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- 10.2 Severance Agreement between the Company and Steven Pomerantz effective a (incorporated by reference to Exhibit 10.3 of Registrant's Current Report February 13, 2002; Commission File Number 000-29245).
- 10.3 Factoring and Security Agreement between LSQ Funding Group L.C. and Health International, Inc. effective as of March 15, 2002 (incorporated by referen Registrant's Annual Report on Form 10-KSB, filed on April 12, 2002; Commiss 000-29245).
- 10.4 Indemnification Agreement dated March 15, 2002 between LSQ Funding Group Tisi (incorporated by reference to Exhibit 10.4 of Registrant's Annual Re filed on April 12, 2002; Commission File Number 000-29245).
- 10.5 Indemnification Agreement between the Company and Chris Tisi date (incorporated by reference to Exhibit 10.2 of Registrant's Current Report February 13, 2002; Commission File Number 000-29245).
- 10.6 Indemnification Agreement between the Company and Steven Pomerantz dated Ja by reference to Exhibit 10.4 of Registrant's Current Report on Form 8-K fil Commission File Number 000-29245).
- 10.7 Lease Agreement between the Company and Fred Keller, Trustee dated (incorporated by reference to Exhibit 10.5 of Registrant's Annual Report on on April 16, 2001; Commission File Number 000-29245).
- 10.8 Lease Agreement between the Company and Fred Keller, Trustee date (incorporated by reference to Exhibit 10.6 of Registrant's Annual Report on on April 16, 2001; Commission File Number 000-29245).
- 10.9 Secured Party's Bill of Sale between Fleet National Bank and the Compan 2001 (incorporated by reference to Exhibit 10.1 of Registrant's Current filed on January 26, 2001; Commission File Number 000-29245).
- 10.10 Trademark Assignment from Heritage Consumer Products, LLC to the Compa 2001 (incorporated by reference to Exhibit 10.2 of Registrant's Current filed on January 26, 2001; Commission File Number 000-29245).
- 10.11 Agreement between the Company and Steven Pomerantz dated January 12, 200 reference to Exhibit 10.3 of Registrant's Current Report on Form 8-K f 2001; Commission File Number 000-29245).
- 10.12 Shareholders' Agreement among Tony D'Amato, Chris Tisi, and the Company (incorporated by reference to Exhibit 1 of Christopher Tisi, Steven Pomeran Tony D'Amato's Schedule 13D, filed on January February 14, 2001; Com 0-29245).
- 10.13 Irrevocable Proxy dated July 13, 2000 (incorporated by reference to Exhi Tisi, Steven Pomerantz, Tony Musso, and Tony D'Amato's Schedule 13D, filed 14, 2001; Commission File Number 0-29245).
- 10.14 Waiver dated January 31, 2001 (incorporated by reference to Exhibit 3 of Ch Steven Pomerantz, Tony Musso, and Tony D'Amato's Schedule 13D, filed on Jan February 14, 2001; Commission File Number 0-29245).
- 10.15 Joint Filing Agreement dated February 13, 2001 (incorporated by refer Christopher Tisi, Steven Pomerantz, Tony Musso, and Tony D'Amato's Sc January February 14, 2001; Commission File Number 0-29245).

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- 10.16 Exclusive Manufacturing Agreement dated April 11, 2002 between the Company Nutritionals, a division of VitaQuest International, Inc. (incorporated by

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- 10.16 of Registrant's Annual Report on Form 10-KSB, filed on April 12, 2002 (Commission File Number 000-29245).
- 10.17 Security Agreement dated April 11, 2002 between the Company and Garden State Nutritionals division of VitaQuest International, Inc. (incorporated by reference to Registrant's Annual Report on Form 10-KSB, filed on April 12, 2002; Commission File Number 000-29245).
- 10.18 Health & Nutrition Systems International, Inc. 1998 Stock Option Plan (incorporated by reference to Exhibit 10.18 of Registrant's Annual Report on Form 10-KSB, filed on April 12, 2002; Commission File Number 000-29245).
- 10.19 Promissory Note dated April 11, 2002 between the Company as borrower and Garden State Nutritionals as lender (incorporated by reference to Exhibit 10.19 of Registrant's Annual Report on Form 10-KSB, filed on April 12, 2002; Commission File Number 000-29245).
- 10.20 Subordination Agreement dated April 11, 2002 among the Company, LSQ Fund and Garden State Nutritionals (incorporated by reference to Exhibit 10.20 of Registrant's Annual Report on Form 10-KSB, filed on April 12, 2002; Commission File Number 000-29245).
- 10.21 Amendment No. 1 dated April 29, 2002 to the Employment Agreement between the Company and Tisi effective as of January 1, 2002 (incorporated by reference to Registrant's Annual Report on Form 10-KSB/A-1, filed on April 30, 2002; Commission File Number 000-29245).
- 10.22 Amendment No. 1 dated April 29, 2002 to the Severance Agreement between the Company and Pomerantz effective as of January 1, 2002 (incorporated by reference to Registrant's Annual Report on Form 10-KSB/A-1, filed on April 30, 2002; Commission File Number 000-29245).
- 10.23 First Amendment to Shareholders' Agreement among Tony D'Amato, Christopher Pomerantz and Tony D'Amato's Schedule 13D, filed on April 29, 2002; Commission File Number 000-29245).
- 10.24 Irrevocable Proxy dated April 24, 2002 (incorporated by reference to Exhibit 10.24 of Registrant's Annual Report on Form 10-KSB, filed on April 30, 2002; Commission File Number 000-29245).
- 10.25 Option Agreement effective as of February 12, 2002 between the Company and Christopher Pomerantz (incorporated by reference to Exhibit 10.25 of Registrant's Annual Report on Form 10-KSB, filed on April 30, 2002; Commission File Number 000-29245).
- 10.26 Indemnification Agreement between Ted Alflen and the Company dated and filed on November 14, 2002 (incorporated by reference to Exhibit 10.1 of Registrant's Quarterly Report on Form 10-Q, filed on November 14, 2002; Commission File Number 000-29245).
- 10.27 Indemnification Agreement between Darryl Green and the Company dated and filed on November 14, 2002 (incorporated by reference to Exhibit 10.2 of Registrant's Quarterly Report on Form 10-Q, filed on November 14, 2002; Commission File Number 000-29245).
- 14.1 Code of Ethics
- 16.1 Letter from Butner & Kahle, CPA dated September 6, 2000 (incorporated by reference to Exhibit 16.4 of Registrant's Current Report on Form 8-K filed on September 7, 2000; Commission File Number 000-29245).

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- 24 Power of attorney (included on signature page)
- 99.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to the Sarbanes-Oxley Act of 2002.
- 99.2 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K

1. Form 8-K filed on December 10, 2001 reporting an Item 5 event.

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2. Form 8-K filed on December 18, 2001 reporting an Item 5 event.

ITEM 14. CONTROLS AND PROCEDURES

(a) Evaluation of disclosure controls and procedures.

Our principal executive officer and controller and principal accounting officers have participated in and supervised the evaluation of our disclosure controls and procedures that are designed to ensure that information required to be disclosed by us in the reports that we file is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that the information required to be disclosed by us in the reports that we file or submit under the Act is accumulated and communicated to our management, including our principal executive officer or officers and principal financial officer, to allow timely decisions regarding required disclosure. Based on their evaluation of those controls and procedures as of a date within 90 days of the date of this filing, and of the filing of our original 10-KSB for the year ended December 31, 2002, our CEO and Controller and accounting officer determined that the controls and procedures are adequate and effective.

(b) Changes in internal controls.

There were no significant changes, including any corrective actions with regard to significant deficiencies and material weaknesses, in our internal controls or in other factors that could significantly affect internal controls since the date of the most recent evaluation of these controls by our chief executive officer and chief financial officer.

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SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: March 31, 2003

Health & Nutrition Systems International, Inc.

By: /s/ Christopher Tisi

Christopher Tisi
Interim Chairman of the Board,
Chief Executive Officer and President
(Principal Executive Officer)

Each person whose signature appears below hereby constitutes and appoints Chris Tisi his true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this report, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying all that said attorney-in-fact and agent or his substitute or substitutes, or any of them, may lawfully do or cause to be done by virtue hereof.

In accordance with the requirements of the Exchange Act, this report has been signed by the following persons in the capacities and on the dates

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indicated.

| SIGNATURE | TITLE |
|---|--|
| /s/ Christopher Tisi ----- Christopher Tisi | Interim Chairman of the Board, Chief Executive Officer and President (Principal Executive Officer) |
| /s/ Al Dugan ----- Al Dugan | Controller (Principal Accounting Officer) |
| /s/ Steven A. Pomerantz ----- Steven A. Pomerantz | Director |
| /s/ Ted Alflen ----- Ted Alflen | Director |

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CERTIFICATIONS

I, Christopher Tisi, certify that:

1. I have reviewed this annual report on Form 10-KSB of Health & Nutrition Systems International, Inc.;
2. Based on my knowledge, this annual 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 annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual 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 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 annual 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 annual report (the "Evaluation Date"); and
 - c) presented in this annual report our conclusions about the

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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 functions):

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 annual report whether 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.

Date March 31, 2003

/s/ Christopher Tisi, Chief Executive Officer

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CERTIFICATIONS

I, Al Dugan, certify that:

1. I have reviewed this annual report on Form 10-KSB of Health & Nutrition Systems International, Inc.;

2. Based on my knowledge, this annual 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 annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual 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 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 annual report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls

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and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

c) presented in this annual 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 functions):

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 annual report whether 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.

Date March 31, 2003

/s/ Al Dugan, Controller and Chief Accounting Officer

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Financial Statements:

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 December 31, 2002 and 2001.....

 Statements of Cash Flows for the years ended December 31, 2002 and 2001.....

Notes to Financial Statements

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Stockholders
Health & Nutrition Systems International, Inc.

We have audited the accompanying balance sheets of Health & Nutrition Systems International, Inc. as of December 31, 2002 and 2001, and the related statements of operations, changes in stockholders' deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Health & Nutrition Systems International, Inc. as of December 31, 2002 and 2001, and the results of its operations and its cash flows for the years then ended in conformity with auditing principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 3 to the financial statements, the Company had a significant loss from operations and had negative cash flows from operations, which raises substantial doubt about the Company's ability to continue as a going concern. Management's plans regarding those matters are also described in Note 3. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Daszkal Bolton LLP

Boca Raton, Florida
February 17, 2003

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HEALTH & NUTRITION SYSTEMS INTERNATIONAL, INC.
BALANCE SHEETS
DECEMBER 31, 2002 AND 2001

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| | ASSETS | |
|---|---------------------------------------|--------------|
| | ----- | ----- |
| | 2002 | 2001 |
| | ----- | ----- |
| Current assets: | | |
| Cash | \$ 14,778 | \$ 81,932 |
| Accounts receivable, net | 344,700 | 194,792 |
| Inventory | 438,375 | 165,168 |
| Prepays and other current assets | 2,373 | -- |
| | ----- | ----- |
| Total current assets | 800,226 | 441,892 |
| | ----- | ----- |
| Property and equipment, net | 39,302 | 66,949 |
| | ----- | ----- |
| Other assets: | | |
| Other assets, net | 30,516 | 33,335 |
| | ----- | ----- |
| Total other assets | 30,516 | 33,335 |
| | ----- | ----- |
| Total assets | \$ 870,044 | \$ 542,176 |
| | ===== | ===== |
| | | |
| | LIABILITIES AND STOCKHOLDERS' DEFICIT | |
| | ----- | |
| Current liabilities: | | |
| Accounts payable | \$ 1,117,407 | \$ 1,105,116 |
| Accrued expenses | 64,680 | 183,887 |
| Capital leases, current portion | 714 | 19,152 |
| Notes payable | 320,395 | 34,400 |
| | ----- | ----- |
| Total current liabilities | 1,503,196 | 1,342,555 |
| | ----- | ----- |
| Notes payable, less current portion | 141,266 | 1,645 |
| | ----- | ----- |
| Total liabilities | 1,644,462 | 1,344,200 |
| | ----- | ----- |
| Stockholders' deficit: | | |
| Common stock, \$ 0.001 par value, authorized 30,000,000 shares; 3,629,813 and 3,629,813 shares issued and outstanding at December 31, 2002 and 2001, respectively | 3,630 | 3,630 |
| Additional paid-in capital | 834,812 | 834,812 |
| Accumulated deficit | (1,612,860) | (1,640,466) |
| | ----- | ----- |
| Total stockholders' deficit | (774,418) | (802,024) |
| | ----- | ----- |
| Total liabilities and stockholders' deficit | \$ 870,044 | \$ 542,176 |
| | ===== | ===== |

See accompanying notes for financial statements

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HEALTH & NUTRITION SYSTEMS INTERNATIONAL, INC.
 STATEMENTS OF OPERATIONS
 YEARS ENDED DECEMBER 31, 2002 AND 2001

| | 2002 | 2001 |
|---|--------------|----------------|
| | ----- | ----- |
| Revenue | \$ 3,567,848 | \$ 3,840,389 |
| Cost of sales | 1,511,826 | 1,903,755 |
| | ----- | ----- |
| Gross profit | 2,056,022 | 1,936,634 |
| | ----- | ----- |
| Operating expense: | | |
| General and administrative expense | 1,524,678 | 2,400,680 |
| Advertising and promotion | 425,349 | 881,541 |
| Depreciation and amortization | 30,466 | 31,616 |
| | ----- | ----- |
| Total operating expense | 1,980,493 | 3,313,837 |
| | ----- | ----- |
| Income (loss) from operations | 75,529 | (1,377,203) |
| | ----- | ----- |
| Other income (expense): | | |
| Interest income | -- | 5,902 |
| Interest expense | (47,923) | (23,347) |
| Other income (expense) | -- | 3,003 |
| | ----- | ----- |
| Total other income (expense) | (47,923) | (14,442) |
| | ----- | ----- |
| Income (loss) before income taxes | 27,606 | (1,391,645) |
| | ----- | ----- |
| Benefit (provision) for income taxes | -- | (7,888) |
| Net income (loss) | \$ 27,606 | \$ (1,399,533) |
| | ===== | ===== |
| Net income per share - basic | \$ 0.01 | \$ (0.39) |
| | ===== | ===== |
| Net income per share - diluted | \$ 0.01 | \$ (0.39) |
| Weighted average number of shares - basic | 3,629,813 | 3,612,472 |
| | ===== | ===== |
| Weighted average number of shares - diluted | 3,629,813 | 3,612,472 |
| | ===== | ===== |

See accompanying notes for financial statements

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HEALTH & NUTRITION SYSTEMS INTERNATIONAL, INC.
 STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (DEFICIT)

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YEARS ENDED DECEMBER 31, 2002 AND 2001

| | Common Stock | | Additional Paid-In Capital | Stock Subscription Receivable |
|---|--------------|----------|----------------------------------|-------------------------------------|
| | Shares | Amount | | |
| Balance, December 31, 2000 | 3,604,813 | 3,605 | 831,537 | -- |
| Common stock issued for legal settlement | 20,000 | 20 | 1,980 | -- |
| Common stock issued for services | 5,000 | 5 | 1,295 | -- |
| Net loss - December 31, 2001 | -- | -- | -- | -- |
| <hr style="border-top: 1px dashed black;"/> | | | | |
| Balance, December 31, 2001 | 3,629,813 | 3,630 | 834,812 | -- |
| Net income - December 31, 2002 | -- | -- | -- | -- |
| <hr style="border-top: 1px dashed black;"/> | | | | |
| Balance, December 31, 2002 | 3,629,813 | \$ 3,630 | \$ 834,812 | \$ -- |
| | ===== | ===== | ===== | ===== |

See accompanying notes for financial statements

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HEALTH & NUTRITION SYSTEMS INTERNATIONAL, INC.
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2002 AND 2001

| | 2002 | 2001 |
|--|-----------|---------------|
| Cash flows from operating activities: | | |
| Net income (loss) | \$ 27,606 | \$(1,399,533) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Allowance for doubtful debts | (14,431) | (7,173) |
| Allowance for obsolete and slow moving inventory | (70,362) | 6,407 |
| Depreciation and amortization | 30,466 | 31,616 |
| Imputed interest expense on note payable | 42,272 | -- |
| Deferred tax asset | -- | 7,888 |
| Common stock issued for services | -- | 3,300 |
| (Increase) decrease in: | | |
| Accounts receivable | (135,477) | 310,216 |
| Inventory | (202,845) | 127,981 |
| Prepays and other current assets | (2,373) | 168,454 |
| Other assets | -- | (1,828) |
| Increase (decrease) in: | | |

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| | | |
|---|-----------|-----------|
| Accounts payable | 634,680 | 657,512 |
| Accrued expenses | (119,207) | 61,510 |
| | ----- | ----- |
| Net cash provided by (used in) operating activities | 190,329 | (33,650) |
| | ----- | ----- |
| Cash flows from investing activities: | | |
| Investment in trademarks | -- | (25,000) |
| Proceeds from certificates of deposit | -- | 150,687 |
| Purchases of property and equipment | -- | (3,524) |
| | ----- | ----- |
| Net cash provided by investing activities | -- | 122,163 |
| | ----- | ----- |
| Cash flows from financing activities: | | |
| Repayments on notes payable | (237,400) | (115,600) |
| Repayments on capital leases | (20,083) | (21,533) |
| Proceeds from related parties | -- | 4,967 |
| | ----- | ----- |
| Net cash used in financing activities | (257,483) | (132,166) |
| | ----- | ----- |
| Net decrease in cash | (67,154) | (43,653) |
| Cash, beginning of year | 81,932 | 125,585 |
| | ----- | ----- |
| Cash, end of year | \$ 14,778 | \$ 81,932 |
| | ===== | ===== |

See accompanying notes for financial statements

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HEALTH & NUTRITION SYSTEMS INTERNATIONAL, INC.
NOTES TO FINANCIAL STATEMENTS

NOTE 1 - DESCRIPTION OF BUSINESS

Health & Nutrition Systems International, Inc. ("HNS" or "the Company") markets and distributes weight management, energy and sports nutrition products to numerous national and regional health, food, drug and mass market accounts as well as independent health and pharmacy accounts. The Company was incorporated in Florida on October 25th, 1993. HNS product sales consist of six primary dietary supplements: Acutrim Natural(R), Thin Tab(R), Carb Cutter(TM), Carbolizer(TM), Thin Tab Mahuang Free(TM), and Fat Cutter(R). The current markets are concentrated in North America and Puerto Rico. One manufacturer produces all of the HNS dietary supplements.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents. There are no cash equivalents at December 31, 2002 and 2001.

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Use of Estimates

The preparation of financial statements in conformity with general accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Inventories

Inventories are stated at the lower of cost or market with cost being determined on a standard cost basis, net of allowances for slow-moving or obsolete inventory. Inventory allowances at December 31, 2002 and 2001 was \$88,376 and \$18,014, respectively. Freight is included in inventory and expensed as a component of cost of sales.

Depreciation and Amortization

Property and equipment are carried at cost. Depreciation is provided using the straight-line or accelerated methods, over the estimated economic lives of the assets, which range from three to seven years. Leasehold improvements are amortized over the expected lease term. The Company reviews the valuation of fixed and other assets and their remaining economic lives annually and adjusts depreciation and amortization accordingly.

Trademarks

The Company records the costs of trademarks as intangible assets and amortizes their value over their estimated economic life.

Revenue Recognition

Revenue is recognized at the date of shipment to customers. Provision is made for an estimate of product returns and doubtful accounts and is based on historical experience.

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HEALTH & NUTRITION SYSTEMS INTERNATIONAL, INC.
NOTES TO FINANCIAL STATEMENTS

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

Advertising Costs

The Company expenses advertising production costs as they are incurred and advertising communication costs the first time the advertising event takes place. Advertising and promotion expenses for the years ending December 31, 2002 and 2001 were \$425,349 and \$881,541, respectively.

Basic Earnings Per Share

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Basic income per common share is computed by dividing the net income by the weighted average number of shares of common stock outstanding during the year.

Diluted Earnings Per Shares

Diluted earnings per share reflect the potential dilution that could occur if dilutive securities (stock options and stock warrants) to issue common stock were exercised or converted into common stock that then shared in the earnings of the Company.

New Accounting Pronouncements

In April 2002, the FASB issued SFAS 145, Rescission of FASB Statements No. 4, 44, and 64, Amendment of the FASB Statement No. 13, and Technical Corrections. SFAS 145 rescinds the provisions of SFAS No. 4 that requires companies to classify certain gains and losses from debt extinguishments as extraordinary items, eliminates the provisions of SFAS No. 44 regarding transition to the Motor Carrier Act of 1980 and amends the provisions of FASB No. 13 to require that certain lease modifications be treated as sale leaseback transactions. The provisions of FASB 145 related to classification of debt extinguishments are effective for fiscal years beginning after May 15, 2002. The provisions of SFAS 145 related to lease modifications is effective for transactions occurring after May 15, 2002. Earlier application is encouraged. The Company believes that the adoption of SFAS 145 will not have a material impact on its financial statements.

In July 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. The standard requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Examples of costs covered by the standard include lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing, or other exit or disposal activity. The Company believes that the adoption of SFAS 146 will not have a material impact on its financial statements.

In July 2002, the FASB issued SFAS No. 147, Acquisitions of Certain Financial Institutions. The provisions of this Statement institute the application of the purchase method of accounting to all acquisitions of financial institutions, except transactions between two or more mutual enterprises. Further, the provisions of the Statement that relate to the application of Statement 144 apply to certain long-term customer-relationship intangible assets recognized in an acquisition of a financial institution, including those acquired in transactions between mutual enterprises. The Company believes that the adoption of SFAS 147 will not have a material impact on its financial statements.

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HEALTH & NUTRITION SYSTEMS INTERNATIONAL, INC.
NOTES TO FINANCIAL STATEMENTS

NOTE 3 - MANAGEMENT'S PLANS AND ISSUES AFFECTING LIQUIDITY

The Company's financial statements have been prepared assuming that the Company will continue as a going concern. During 2002, the Company has successfully controlled costs and has attained profitability, including net income of \$27,606 and cashflow from operations of \$190,329. However, at December 31, 2002, the

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Company has a working capital deficit of \$702,970 and adverse liquidity ratios.

Management intends to continue to control costs and monitor financing capabilities. Management believes these factors will contribute toward achieving sustained profitability.

There remains substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments to reflect the possible effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

NOTE 4 - FACTORING ARRANGEMENTS

In 2002, the Company factored certain of its accounts receivable, without recourse, with a commercial finance company. The factor purchases the receivables for the face amount of certain invoices, less a discount rate fee of 2.125%. The Company maintains a reserve account with the factor of 15%.

On March 15, 2002, the Company terminated their factoring agreement with Alliance Financial Capital, Inc. and entered into a factoring agreement with LSQ Funding Group, L.C. (LSQ). The agreement provides that LSQ will purchase certain receivables and advance 85% of the face amount of such receivables. The term of this agreement is one year. The maximum amount of receivables the Company may factor under the agreement is \$750,000, and there is no minimum amount required to be factored. In connection with the factoring agreement, the Company granted LSQ a blanket lien on Company assets and the President/Chief Executive Officer was required to deliver a personal guarantee. The LSQ contract expired in March 2003 and the Company did not renew it.

In 2001, the Company factored certain of its accounts receivable, without recourse, with a commercial finance company. The factor purchases the receivables for the face amount of certain invoices, less a discount rate fee of 1.75%. The Company maintains a reserve account with the factor of 20% to 50%, depending on the customer, of the outstanding receivables held by the factor. The reserve account may be charged additional fees from 3.35% to 4.75% on invoices paid beyond the agreed to terms.

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HEALTH & NUTRITION SYSTEMS INTERNATIONAL, INC.
NOTES TO FINANCIAL STATEMENTS

NOTE 5 - ACCOUNTS RECEIVABLE

| | 2002 | 2001 |
|---------------------------------------|------------|------------|
| | ----- | ----- |
| Accounts receivable | \$ 685,078 | \$ 352,002 |
| Less: allowance for doubtful accounts | (22,778) | (37,210) |
| Less: allowance for sales returns | (317,600) | (120,000) |
| | ----- | ----- |
| Accounts receivable, net | \$ 344,700 | \$ 194,792 |
| | ===== | ===== |

Accounts receivable consisted of the following at December 31, 2002 and 2001:

At December 31, 2002, the Company recorded an allowance for sales returns of

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\$317,600, including \$200,000 for returns of products containing ephedra expected in 2003.

At December 31, 2001, the allowance for sales returns of \$120,000 results from expected returns of one product with expiration dates in March and May 2002.

NOTE 6 - RELATED PARTY TRANSACTIONS

For years ended December 31, 2002 and 2001, a certain related party made aggregate purchases of approximately \$2,423 and \$63,881, respectively.

In 2001, a former officer of the Company and a member of the Board of Directors guaranteed a short-term loan from a bank. See Note 10.

NOTE 7 - SUPPLEMENTAL CASH FLOW INFORMATION

| | 2002 ----- | 2001 ----- |
|---|---------------------|-------------------|
| Cash paid for interest | \$ 9,514 ===== | \$23,347 ===== |
| Cash paid for income taxes | \$ -- ===== | \$ -- ===== |
| Non-cash investing and financing activities: | | |
| Common stock issued for services | \$ -- ===== | \$ 3,300 ===== |
| Conversion of accounts payable to notes payable | \$ 700,000 ===== | \$ -- ===== |

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HEALTH & NUTRITION SYSTEMS INTERNATIONAL, INC.
NOTES TO FINANCIAL STATEMENTS

NOTE 8 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying value of cash, accounts receivables, loans receivable, accounts payable and other payables approximates fair value because of their short maturities.

NOTE 9 - PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at December 31, 2002 and 2001:

| | 2002 ----- | 2001 ----- |
|-------------------------|----------------|----------------|
| Furniture and equipment | \$ 38,713 | \$ 38,713 |
| Office equipment | 31,536 | 31,536 |
| Warehouse equipment | 24,349 | 24,349 |
| Computer equipment | 51,815 | 51,815 |
| Software | 40,126 | 40,126 |
| Website development | 2,155 | 2,155 |
| Leasehold improvements | 1,860 ----- | 1,860 ----- |

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| | | |
|--------------------------------|-----------|-----------|
| | 190,554 | 190,554 |
| Less: accumulated depreciation | (151,252) | (123,605) |
| | ----- | ----- |
| Property and equipment, net | \$ 39,302 | \$ 66,949 |
| | ===== | ===== |

Depreciation expense for the years ended December 31, 2002 and 2001 was \$27,647 and \$28,795, respectively.

NOTE 10 - NOTES PAYABLE

On April 11, 2002, the Company entered into an agreement with Garden State Nutritionals (GSN), sole manufacturer, to repay \$700,000 owed to GSN as of the date of the agreement. The repayment schedule requires eight equal quarterly payments, without interest, starting June 1, 2002. In connection with this agreement, the Company granted to GSN a blanket second priority lien on the Company's assets under a Security Agreement, which may only be, foreclosed upon the event the Company fails to make (3) consecutive quarterly principle payments in accordance with the terms of the promissory note. The GNS debt has been recorded as a note payable with an imputed interest rate of 9% per annum and with the interest calculated over the term on the loan in the amount of \$73,747. The cost of sales was reduced in the amount of \$73,747, which represents imputed interest on the note. GNS granted the Company a waiver on the first quarterly payment due June 1, 2002 of \$87,500. This amount shall be due and payable on March 1, 2004. At December 31, 2002, the balance owed to GSN is \$497,000.

Also, on April 11, 2002, the Company entered into an exclusive manufacturing agreement with GSN pursuant to which GSN has provided a \$450,000 line of credit with 60-day terms to the Company. During 2002, GSN informally allowed the Company to purchase up to \$1,000,000 on the line of credit. At December 31, 2002, the balance owed to GSN under this line of credit is \$892,878.

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HEALTH & NUTRITION SYSTEMS INTERNATIONAL, INC.
NOTES TO FINANCIAL STATEMENTS

NOTE 10 - NOTES PAYABLE, CONTINUED

On January 15, 2002, the Company received a short-term loan from a bank in the amount of \$23,400. Interest accrues at a rate of 4.75% per annum and is collateralized by a certificate of deposit in the amount of \$23,400 owned by a former officer of the Company and member of the Board of Directors. The loan was paid in full on July 15, 2002.

On January 12, 2001, the Company received a short-term loan from a bank in the amount of \$100,000. Interest accrued at a rate of 7.73% per annum and was collateralized by a certificate of deposit in the amount of \$100,000 owned by a former officer of the Company and member of the Board of Directors. The loan was paid in full on January 12, 2002.

On December 15, 2000, the Company received a short-term loan from a bank in the amount of \$150,000. Interest accrued at a rate of 8.1% per annum and the note was collateralized by two certificates of deposits totaling \$150,687. This note was paid in full on December 15, 2001.

NOTE 11 - LEASE COMMITMENTS

The Company leases office and warehouse space in Riviera Beach, Florida. Rent expense for the years ended December 31, 2002 and 2001 was \$54,044 and \$64,664, respectively. The Company also leases various equipment. Lease expense for the years ended December 31, 2002 and 2001 was \$34,340 and \$29,952, respectively.

In April 2002, the Company began sub-leasing part of its warehouse space for \$1,800 per month.

Certain non-cancelable leases are classified as capital leases, and the leased assets are included as part of property and equipment. Other leases are classified as operating leases and are not capitalized. The obligations under capital leases are at fixed rates ranging from 10% to 23% and are collateralized by the corresponding equipment.

Property under capital leases at December 31, 2002 and 2001 consisted of the following:

| | 2002 ----- | 2001 ----- |
|--------------------------------|-------------------|--------------------|
| Machinery and equipment | \$ 15,104 | \$ 59,902 |
| Less: accumulated amortization | (13,841) | (27,442) |
| | ----- | ----- |
| Total | \$ 1,263 ===== | \$ 32,460 ===== |

Future minimum rentals for property under operating and capital leases at December 31 are as follows:

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HEALTH & NUTRITION SYSTEMS INTERNATIONAL, INC.
NOTES TO FINANCIAL STATEMENTS

| Year Ending December 31, ----- | Capital Leases ----- | Operating Leases ----- |
|---|----------------------------|------------------------------|
| 2003 | \$ 790 | \$ 82,704 |
| 2004 | -- | 23,008 |
| 2005 | -- | 6,214 |
| 2006 | -- | -- |
| | ----- | ----- |
| Total minimum lease obligation | 790 | 111,926 |
| Less: interest | 76 | -- |
| | ----- | ----- |
| Present value of total minimum lease payments | 714 | \$111,926 |
| | ----- | ===== |
| Less: current portion | 714 | |
| | ----- | |
| Non-current portion | \$ -- ===== | |

NOTE 12 - STOCKHOLDERS EQUITY

During the year ended December 31, 2002, the Company issued no common stock for

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cash or in exchange of services.

During the year ended December 31, 2001, the Company issued its common stock for cash and in exchange of services as follows:

The Company issued 20,000 shares of common stock as settlement of a lawsuit, as disclosed in Note 13, valued at \$2,000.

The Company issued 5,000 shares of common stock to consultants for professional services rendered, valued at \$1,300.

NOTE 13 - LEGAL MATTERS

The Company has been sued by six unaffiliated plaintiffs alleging that the Company's Acutrim(R) products contain PPA and that those products have caused damage to the plaintiffs. The Company's position on these matters is that none of the Company's Acutrim(R) products has ever contained, or currently contains, PPA. To date, twelve out of the twenty of these cases has been dismissed after delivery to plaintiff's counsel of information substantiating the fact that the Company's products do not presently contain, and have not contained, PPA. While, the Company does not believe that it has material liability based upon the substantive allegations set forth in these cases, the legal costs that the Company has incurred, and may incur in the future, in obtaining dismissals from these cases could have a material adverse effect on the Company.

In 2000, the Company sued a former officer and director of the Company and KMS Thin-Tab 100, Inc., a corporation controlled by the former director, for trademark infringement, unfair competition and cyber piracy. The former director and KMS Thin-Tab 100, Inc. counterclaimed alleging a breach of distribution agreement with the Company. On September 19, 2002, the Company announced the settlement of all litigation between the Company, the former director and KMS Thin-Tab 100, Inc.

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HEALTH & NUTRITION SYSTEMS INTERNATIONAL, INC. NOTES TO FINANCIAL STATEMENTS

The settlement agreement generally requires the former director and KMS to transfer the registration and ownership of the domain names Thintab.com, Thintab.cc and Carbcutter.cc to HNS and to take other actions to eliminate confusion over the ownership of the Thin Tab(R) name. Additionally, it provides for each of the adverse parties to generally release the others. As part of the settlement, HNS entered into a distribution agreement with Bryant, beginning on September 26, 2002 and ending September 25, 2007, permitting Bryant to purchase certain of its products from HNS and to exclusively distribute those products in Florida from Orlando south. HNS has agreed not to sell its products directly to certain KMS customers. The Company recorded a legal settlement expense of \$58,836 associated with this settlement.

During the year ended December 31, 2000, the Company filed a Complaint for Declaratory Relief in reference to the effectiveness of various Stock Purchase Agreements among shareholders, the cancellation of certain shares and the rightful ownership of these shares. On December 21, 2001, a settlement agreement was reached in which the Company issued 20,000 shares of common stock, valued at \$2,000 and a net cash settlement of \$18,750. At December 31, 2001, \$11,000 of the cash settlement amount had been paid, with the remaining amount included in

accounts payable.

The Company from time to time is a party of various legal proceedings. In the opinion of management, none of the proceedings are expected to have a material impact on its financial position or results of operations.

NOTE 14 - CONCENTRATIONS

Credit Risk

Financial instruments, which potentially expose the Company to concentrations of credit risk, as defined by Statement of Financial Accounting Standards No. 105, consist primarily of trade receivables. The Company's officers have attempted to minimize this risk by monitoring the companies for which it provided credit.

The Company maintains bank accounts at various financial institutions. At times during the year, balances in these accounts exceeded the amount insured by the FDIC. At December 31, 2002 and 2001, no amounts exceeded the insured limit.

Product Liability

The Company is currently insured to the extent of \$6 million for product liability claims and uses vendors who are also insured. There is a risk that certain vendors may not have sufficient product liability insurance or may lose their insurance, or the Company may not be able to insure at reasonable cost. In any of these events, there could be a material adverse effect on the financial condition, results of operations or cash flows of the Company.

Significant Customers

During the year ended December 31, 2002, sales to six customers represented sixty-six percent (66%) of the Company's revenue.

During the year ended December 31, 2001, sales to six customers represented seventy-four percent (74%) of the Company's revenue.

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HEALTH & NUTRITION SYSTEMS INTERNATIONAL, INC.
NOTES TO FINANCIAL STATEMENTS

NOTE 14 - CONCENTRATIONS, CONTINUED

Significant Supplier

During the years ended December 31, 2002 and 2001, the Company received 100% of its products from one manufacturer of herbal and dietary supplements, located in Caldwell, New Jersey. The Company is dependent on the ability of its supplier to provide products on a timely basis and on favorable pricing terms. The loss of the supplier or a significant reduction in product availability from the supplier could have a material adverse effect on the Company. The Company believes that its relationship with its supplier is satisfactory.

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NOTE 15 - INCOME TAXES

The Company's evaluation of the tax benefit of its net operating loss carryforward is presented in the following table. At December 31, the tax amounts have been calculated using the 34% federal and 5.5% state income tax rates.

| | 2002 ----- | 2001 ----- |
|--------------------------------------|--------------------|--------------------|
| Income tax (benefit) consists of: | | |
| Current | \$ -- | \$ -- |
| Deferred | -- | -- |
| Provision (benefit) for income taxes | \$ -- ===== | \$ -- ===== |

Reconciliation of the Federal statutory income tax rate to the Company's effective tax rate is as follows:

| | 2002 ----- | 2001 ----- |
|---|--------------------|-------------------|
| Taxes computed at combined federal and state tax rate | \$ 9,386 | \$ (473,159) |
| Non-deductible expenses | 2,719 | 3,835 |
| State income taxes, net of federal income tax benefit | 1,292 | (50,107) |
| Other | 28,845 | (20,135) |
| Effect of change in income tax rate | -- | 6,953 |
| Increase (decrease) in deferred tax asset valuation allowance | (42,242) | 540,501 |
| Provision (benefit) for income taxes | \$ -- ===== | \$ 7,888 ===== |

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HEALTH & NUTRITION SYSTEMS INTERNATIONAL, INC.
NOTES TO FINANCIAL STATEMENTS

NOTE 15 - INCOME TAXES, CONTINUED

The components of the deferred tax asset were as follows at December 31:

| | 2002 ----- | 2001 ----- |
|-------------------------------------|------------------|------------------|
| Deferred tax assets: | | |
| Net operating loss carryforward | \$ 336,919 | \$ 464,427 |
| Allowance for receivables | 128,084 | 69,295 |
| Allowance for inventory | 33,256 | 6,779 |
| Litigation costs related to capital | -- | -- |
| Total deferred tax assets | 498,259 ----- | 540,501 ----- |
| Deferred tax liabilities: | | |
| Net deferred tax asset | 498,259 ----- | 540,501 ----- |

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| | | |
|---------------------------------|-----------|-----------|
| Valuation allowance: | | |
| Beginning of year | (540,501) | -- |
| Decrease (increase) during year | 42,242 | (540,501) |
| | ----- | ----- |
| Ending balance | (498,259) | (540,501) |
| Net deferred taxes | \$ -- | \$ -- |
| | ===== | ===== |

As of December 31, 2002, the Company has an unused net operating loss carryforward of \$895,346 available for use on its future corporate income tax returns. This net operating loss carryforward expires in 2022.

NOTE 16 - STOCK OPTIONS

The non-qualified stock option plan adopted by the Company in May 1998 authorized the Company to grant 1,250,000 of its common shares.

The Company has elected to account for the stock options under the Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Accordingly, no compensation expense has been recognized on the employee stock options. The Company accounts for stock options granted to consultants under Financial Accounting Standards Board Statement No. 123, "Accounting for Stock-Based Compensation." The Company recognized \$443 and \$847 in compensation expense at December 31, 2002 and 2001, respectively.

During the year ended December 31, 2002, 50,000 options were granted to officers, directors and employees of the Company.

During the year ended December 31, 2001, no options were granted to officers, directors and employees of the Company.

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HEALTH & NUTRITION SYSTEMS INTERNATIONAL, INC.
NOTES TO FINANCIAL STATEMENTS

NOTE 16 - STOCK OPTIONS, CONTINUED

A summary of options during the years ended December 31, 2002 and 2001 is shown below:

| | December 31, 2002 | | December 31, 2001 | |
|----------------------------------|-------------------|---------------------------------|-------------------|---------------------------------|
| | Number of Shares | Weighted-Average Exercise Price | Number of Shares | Weighted-Average Exercise Price |
| | ----- | ----- | ----- | ----- |
| Outstanding at beginning of year | 540,500 | \$ 0.14 | 710,000 | \$ 0.14 |
| Granted | 50,000 | -- | -- | -- |
| Exercised | -- | -- | -- | -- |
| Forfeited | (84,000) | (0.14) | (169,500) | (0.14) |
| | ----- | ----- | ----- | ----- |
| Outstanding at December 31 | 506,500 | \$ 0.14 | 540,500 | \$ 0.14 |
| | ===== | ===== | ===== | ===== |
| Exercisable at December 31 | 354,500 | | 252,750 | |

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| | | |
|---------------------------------------|---------|---------|
| Available for issuance at December 31 | ===== | ===== |
| | 322,000 | 372,000 |
| | ===== | ===== |

Had the compensation expense for the stock option plan been determined based on the fair value of the options at the grant date consistent with the methodology prescribed under Statement of Financial Standards No. 123, "Accounting for Stock Based Compensation," at December 31, the Company's net income and earnings per share would have been reduced to the proforma amounts indicated below:

| | 2002 | 2001 |
|--------------------|-----------|----------------|
| | ----- | ----- |
| Net income (loss) | | |
| As reported | \$ 27,606 | \$ (1,399,533) |
| | ===== | ===== |
| Pro forma | \$ 20,636 | \$ (1,417,186) |
| | ===== | ===== |
| Earnings per share | | |
| As reported | \$ 0.01 | \$ (0.39) |
| | ===== | ===== |
| Pro forma | \$ 0.01 | \$ (0.39) |
| | ===== | ===== |

The fair value of each option is estimated on the date of grant using the fair market value option pricing model with the assumptions:

| | |
|-------------------------|-------------|
| Risk-free interest rate | 4.5% - 6.5% |
| Expected life (years) | Various |
| Expected volatility | 1.23 |
| Expected dividends | None |

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HEALTH & NUTRITION SYSTEMS INTERNATIONAL, INC.
NOTES TO FINANCIAL STATEMENTS

NOTE 17 - RECLASSIFICATIONS

Certain reclassifications have been made to the 2001 financial statements to conform to the 2002 financial statement presentation. These reclassifications have no effect on reported net income. In 2002 and 2001, the Company reclassified \$901,599 and \$1,524,943, respectively, of promotion and co-operative advertising fees to revenues from the operating expense "Advertising and promotion."

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Index to Exhibits

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| Exhibit Number ----- | Description ----- |
|----------------------------|--|
| 3.1(a) | Articles of Incorporation of the Registrant (incorporated by reference to registration statement on Form 10-SB, filed on January 31, 2000; Commission |
| 3.1(b) | Articles of Amendment to the Articles of Incorporation (incorporated by ref Registrant's registration statement on Form 10-SB, filed on January 31, 200 Commission File Number 0000-29245). |
| 3.1(c) | Articles of Amendment to Articles of Incorporation (incorporated by referen Registrant's registration statement on Form 10-SB, filed on January 31, 200 Commission File Number 000-29245). |
| 3.1(d) | Articles of Amendment to Articles of Incorporation (incorporated by referen Registrant's Annual Report on Form 10-KSB, filed on April 16, 2001; Commiss |
| 3.2 | By-Laws of the Registrant (incorporated by reference to Exhibit 3 registration statement on Form 10-SB, filed on January 31, 2000; Com 000-29245). |
| 3.3 | Amendment to the Restated Bylaws of the Company dated September 25, 200 reference to Exhibit 3.3 of Registrant's Annual Report on Form 10-KSB, 2000; Commission File Number 000-29245). |
| 3.4 | Amendment to the Restated Bylaws of the Company dated November 10, 200 reference to Exhibit 3.4 of Registrant's Annual Report on form 10-KSB, 2000; Commission File Number 000-29245). |
| 10.1 | Employment Agreement between the Company and Chris Tisi effective as of Jan (incorporated by reference to Exhibit 10.1 of Registrant's Current Report o filed on February 13, 2002; Commission File Number 000-29245). |
| 10.2 | Severance Agreement between the Company and Steven Pomerantz effective a (incorporated by reference to Exhibit 10.3 of Registrant's Current Report February 13, 2002; Commission File Number 000-29245). |
| 10.3 | Factoring and Security Agreement between LSQ Funding Group L.C. and Health International, Inc. effective as of March 15, 2002 (incorporated by referen Registrant's Annual Report on Form 10-KSB, filed on April 12, 2002; Commiss 000-29245). |
| 10.4 | Indemnification Agreement dated March 15, 2002 between LSQ Funding Group Tisi (incorporated by reference to Exhibit 10.4 of Registrant's Annual Re filed on April 12, 2002; Commission File Number 000-29245). |
| 10.5 | Indemnification Agreement between the Company and Chris Tisi date (incorporated by reference to Exhibit 10.2 of Registrant's Current Report February 13, 2002; Commission File Number 000-29245). |
| 10.6 | Indemnification Agreement between the Company and Steven Pomerantz dated Ja by reference to Exhibit 10.4 of Registrant's Current Report on Form 8-K fil Commission File Number 000-29245). |
| 10.7 | Lease Agreement between the Company and Fred Keller, Trustee dated (incorporated by reference to Exhibit 10.5 of Registrant's Annual Report on on April 16, 2001; Commission File Number 000-29245). |
| 10.8 | Lease Agreement between the Company and Fred Keller, Trustee date (incorporated by reference to Exhibit 10.6 of Registrant's Annual Report on on April 16, 2001; Commission File Number 000-29245). |
| 10.9 | Secured Party's Bill of Sale between Fleet National Bank and the Compan 2001 (incorporated by reference to Exhibit 10.1 of Registrant's Current filed on January 26, 2001; Commission File Number 000-29245). |
| 10.10 | Trademark Assignment from Heritage Consumer Products, LLC to the Compa 2001 (incorporated by reference to Exhibit 10.2 of Registrant's Current filed on January 26, 2001; Commission File Number 000-29245). |
| 10.11 | Agreement between the Company and Steven Pomerantz dated January 12, 200 |

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- reference to Exhibit 10.3 of Registrant's Current Report on Form 8-K filed on January 14, 2001; Commission File Number 000-29245).
- 10.12 Shareholders' Agreement among Tony D'Amato, Chris Tisi, and the Company (incorporated by reference to Exhibit 1 of Christopher Tisi, Steven Pomerantz, Tony D'Amato's Schedule 13D, filed on January 14, 2001; Commission File Number 0-29245).
- 10.13 Irrevocable Proxy dated July 13, 2000 (incorporated by reference to Exhibit 10.13 of Christopher Tisi, Steven Pomerantz, Tony Musso, and Tony D'Amato's Schedule 13D, filed on January 14, 2001; Commission File Number 0-29245).
- 10.14 Waiver dated January 31, 2001 (incorporated by reference to Exhibit 3 of Christopher Tisi, Steven Pomerantz, Tony Musso, and Tony D'Amato's Schedule 13D, filed on January 14, 2001; Commission File Number 0-29245).
- 10.15 Joint Filing Agreement dated February 13, 2001 (incorporated by reference to Exhibit 10.15 of Christopher Tisi, Steven Pomerantz, Tony Musso, and Tony D'Amato's Schedule 13D, filed on January 14, 2001; Commission File Number 0-29245).
- 10.16 Exclusive Manufacturing Agreement dated April 11, 2002 between the Company and Garden State Nutritionals, a division of VitaQuest International, Inc. (incorporated by reference to Exhibit 10.16 of Registrant's Annual Report on Form 10-KSB, filed on April 12, 2002; Commission File Number 000-29245).
- 10.17 Security Agreement dated April 11, 2002 between the Company and Garden State Nutritionals, a division of VitaQuest International, Inc. (incorporated by reference to Exhibit 10.17 of Registrant's Annual Report on Form 10-KSB, filed on April 12, 2002; Commission File Number 000-29245).
- 10.18 Health & Nutrition Systems International, Inc. 1998 Stock Option Plan (incorporated by reference to Exhibit 10.18 of Registrant's Annual Report on Form 10-KSB, filed on April 12, 2002; Commission File Number 000-29245).
- 10.19 Promissory Note dated April 11, 2002 between the Company as borrower and Garden State Nutritionals as lender (incorporated by reference to Exhibit 10.19 of Registrant's Annual Report on Form 10-KSB, filed on April 12, 2002; Commission File Number 000-29245).
- 10.20 Subordination Agreement dated April 11, 2002 among the Company, LSQ Fund, and Garden State Nutritionals (incorporated by reference to Exhibit 10.20 of Registrant's Annual Report on Form 10-KSB, filed on April 12, 2002; Commission File Number 000-29245).
- 10.21 Amendment No. 1 dated April 29, 2002 to the Employment Agreement between the Company and Christopher Tisi effective as of January 1, 2002 (incorporated by reference to Exhibit 10.21 of Registrant's Annual Report on Form 10-KSB/A-1, filed on April 30, 2002; Commission File Number 000-29245).
- 10.22 Amendment No. 1 dated April 29, 2002 to the Severance Agreement between the Company and Steven Pomerantz effective as of January 1, 2002 (incorporated by reference to Exhibit 10.22 of Registrant's Annual Report on Form 10-KSB/A-1, filed on April 30, 2002; Commission File Number 000-29245).
- 10.23 First Amendment to Shareholders' Agreement among Tony D'Amato, Chris Tisi, and the Company dated April 24, 2002 (incorporated by reference to Exhibit 4 of Christopher Tisi, Steven Pomerantz and Tony D'Amato's Schedule 13D, filed on April 29, 2002; Commission File Number 0-29245).
- 10.24 Irrevocable Proxy dated April 24, 2002 (incorporated by reference to Exhibit 10.24 of Christopher Tisi, Steven Pomerantz and Tony D'Amato's Schedule 13D, filed on April 29, 2002; Commission File Number 0-29245).
- 10.25 Option Agreement effective as of February 12, 2002 between the Company and Christopher Tisi (incorporated by reference to Exhibit 10.25 of Registrant's Annual Report on Form 10-KSB/A-1, filed on April 30, 2002; Commission File Number 000-29245).
- 10.26 Indemnification Agreement between Ted Alflen and the Company dated April 11, 2002 (incorporated by reference to Exhibit 10.1 of Registrant's Quarterly Report on Form 10-Q, filed on November 14, 2002; Commission File Number 000-29245).
- 10.27 Indemnification Agreement between Darryl Green and the Company dated April 11, 2002 (incorporated by reference to Exhibit 10.2 of Registrant's Quarterly Report on Form 10-Q, filed on November 14, 2002; Commission File Number 000-29245).

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- 14.1 Code of Ethics
- 16.1 Letter from Butner & Kahle, CPA dated September 6, 2000 (incorporated by 16.4 of Registrant's Current Report on Form 8-K filed on September 7, 2000 Number 000-29245).
- 24 Power of attorney (included on signature page)
- 99.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Sarbanes-Oxley Act of 1002.
- 99.2 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Sarbanes-Oxley Act of 1002.