ADVANTAGE MARKETING SYSTEMS INC/OK
Form 10-Q
August 12, 2002

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

FORM 10-Q

(Mark One)

(X) QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the quarterly period ended June 30, 2002

or

( ) TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT OF 1934

For the transition period from   to

Commission File Number: 001-13343

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

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

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

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

Indicate by check mark whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

On July 31, 2002, we had outstanding 4,423,879 shares of our common stock, $.0001 par value.

ADVANTAGE MARKETING SYSTEMS, INC.
QUARTERLY REPORT ON FORM 10-Q
FOR THE SIX MONTHS ENDED JUNE 30, 2002

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

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

PART I -FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS
JUNE 30, 2002 AND DECEMBER 31, 2001

ASSETS	JUNE 30, 2002

	(Unaudited)	
CURRENT ASSETS:		
Cash and cash equivalents	$ 1,379,393	$
Marketable securities, available for sale, at fair value	1,656,809	
Receivables - net of allowance of $0 and $92,931, respectively	239,424	
Receivable from affiliates	100,000	
Prepaid income taxes	99,064	
Inventory	1,132,802	
Deferred income taxes	65,546	
Other assets	288,990	
Total current assets	4,962,028	
RECEIVABLES, Net	787,757	
PROPERTY AND EQUIPMENT, Net	4,115,663	
GOODWILL, Net	3,788,374	
OTHER INTANGIBLES, Net	674,729	
OTHER ASSETS	306,171	
TOTAL	$ 14,634,722	$
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 202,690	$
Accrued commissions and bonuses	299,391	
Accrued other expenses	163,822	
Accrued income tax	107,996	
Accrued sales tax liability	155,297	
Notes payable	604,737	
Capital lease obligations	112,493	
Total current liabilities	1,646,426	
LONG-TERM LIABILITIES:		
Notes payable	2,071,677	
Capital lease obligations	165,936	
Deferred income taxes	23,639	
Total liabilities	3,907,678	
COMMITMENTS AND CONTINGENCIES (NOTE 7)		
STOCKHOLDERS' EQUITY		
Common stock - $.0001 par value; authorized 495,000,000 shares; issued 4,896,674 and 4,882,174 shares, outstanding 4,423,879 and 4,409,379 shares, respectively	490	
Paid-in capital	11,793,241	
Notes receivable for exercise of options	(31,088)	
Retained earnings	1,255,093	
Accumulated other comprehensive loss, net of tax	(46,216)	
Total capital and retained earnings	12,971,520	
Less cost of treasury stock (472,795 shares, common)	(2,244,476)	
Total stockholders' equity	10,727,044	
TOTAL	$ 14,634,722	$

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME
FOR THE PERIODS ENDED JUNE 30, 2002 AND 2001
(UNAUDITED)

	THREE MONTHS ENDED JUNE 30,		SIX
	2002	2001	2002
Net sales	$ 5,865,850	$ 7,140,458	$ 12,147,
Cost of sales	3,775,179	4,748,598	8,065,
Gross profit	2,090,671	2,391,860	4,081,
Marketing, distribution and administrative expenses:			
Marketing	467,062	397,241	967,
Distribution and administrative	1,441,132	1,690,751	2,788,
Total marketing, distribution and administrative expenses	1,908,194	2,087,992	3,755,
Income from operations	182,477	303,868	326,
Other income (expense):			
Interest and dividends, net	(18,769)	(28,560)	(40,
Other, net	(36,779)	(2,227)	(9,
Total other income (expense)	(55,548)	(30,787)	(49,
Income before taxes	126,929	273,081	276,
Income tax expense	49,502	107,722	107,
Net income	$ 77,427	$ 165,359	$ 168,
Net income per common share - basic	$ .02	$ .04	$
Net income per common share - assuming dilution	$ .02	$ .04	$
Weighted average common shares outstanding - basic	4,439,566	4,364,885	4,423,
Weighted average common shares outstanding -			

assuming dilution	4,590,275	4,704,696	4,562,
	============	============	=========

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2002 AND 2001
(UNAUDITED)

	JUNE 30,	
	2002	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 168,915	$
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	468,629	
Realized loss on sale of marketable securities	4,630	
Deferred taxes	--	
(Gain) loss on sale of property and equipment	13,209	
Changes in assets and liabilities which provided (used) cash (not including the effect of business acquisition):		
Receivables	155,151	
Prepaid taxes	--	
Inventory	202,649	
Other assets	(194,688)	
Accounts payable and accrued expenses	69,642	
Net cash provided by operating activities	888,137	
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(490,392)	(1
Sales of property and equipment	283,238	
Purchases of marketable securities, available for sale	(23,648)	
Sales of marketable securities, available for sale	--	1
Acquisition of business, net of cash acquired	--	(1
Payments of acquisition costs	--	
Repayment of receivable from affiliates	--	
Net cash used in investing activities	(230,802)	
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock	29,061	
Proceeds from note payable	--	
Principal payment on notes payable	(223,509)	
Principal payment on capital lease obligations	(65,682)	

Net cash provided by (used in) financing activities	(260,130)	
NET INCREASE IN CASH AND CASH EQUIVALENTS	397,205	
CASH AND CASH EQUIVALENTS, BEGINNING	982,188	
CASH AND CASH EQUIVALENTS, ENDING	$ 1,379,393	$

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

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ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2002 AND 2001
(UNAUDITED)

1. UNAUDITED INTERIM FINANCIAL STATEMENTS

The unaudited condensed consolidated financial statements and related notes have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted pursuant to such rules and regulations. The accompanying condensed consolidated financial statements and related notes should be read in conjunction with the audited consolidated financial statements of the Company, and notes thereto, for the year ended December 31, 2001.

The information furnished reflects, in the opinion of management, all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the results of the interim periods presented. Operating results of the interim period are not necessarily indicative of the amounts that will be reported for the year ending December 31, 2002.

2. SIGNIFICANT ACCOUNTING POLICIES

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets". This standard requires companies to stop amortizing existing goodwill and intangible assets with indefinite lives effective January 1, 2002. Under the new rules, companies would only adjust the carrying amount of goodwill or indefinite life intangible assets upon an impairment of the goodwill or indefinite life intangible assets. The Company implemented these standards effective January 1, 2002. No impairment of goodwill resulted from this implementation, and there was no material impact on consolidated results of operations, financial position or cash flows.

The table below shows the reconciliation between reported net income and earnings per share and adjusted net income and earnings per share, adjusted for goodwill amortization (tax-effected):

	FOR THE THREE MONTHS ENDED JUNE 30,		FOR THE SIX MONTHS ENDED JUNE 30,	
	2002	2001	2002	2001
Reported net income	$ 77,427	$ 165,359	$ 168,915	$ 183,006
Add back: Goodwill amortization ...	--	58,087	--	116,174
Adjusted net income	$ 77,427	$ 223,446	$ 168,915	$ 299,180
BASIC EARNINGS PER SHARE:				
Reported net income	$ .02	$ .04	$ .04	$ .04
Goodwill amortization	--	.01	--	.03
Adjusted net income	$ .02	$ .05	$ .04	$ .07
DILUTED EARNINGS PER SHARE:				
Reported net income	$ .02	$ .04	$ .04	$ .04
Goodwill amortization	--	.01	--	.02
Adjusted net income	$ .02	$ .05	$ .04	$ .06

In August 2001, SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", was issued and is effective for fiscal years beginning after December 15, 2001. SFAS No.

144 addresses accounting and reporting for the impairment or disposal of long-lived assets. SFAS No. 144 supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" and Accounting Principles Board ("APB") Opinion No. 30, "Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business". SFAS No. 144 retains the fundamental provisions of SFAS No. 121 and expands the reporting of discontinued operations to include all components of an entity with operations that can be distinguished from the rest of the entity and that will be eliminated from the ongoing operations of the entity in a disposal transaction. The Company implemented this standard effective January 1, 2002. Implementation did not have a material impact on consolidated

results of operations, financial position, or cash flows.

3. MARKETABLE SECURITIES

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

Net unrealized loss, net of tax, included in accumulated other comprehensive loss for the three and six months ended June 30, 2002 was approximately $17,000 and $16,000, respectively.

4. ACQUISITION

On January 4, 2001 the Company and one of its wholly owned subsidiaries, LifeScience Technologies Holdings, acquired LifeScience Technologies Holding Limited Partnership, LifeScience Technologies Limited, LifeScience Technologies of Japan, LST Fullfillment Limited Partnership, and LifeScience Technologies of Canada, Inc. (the "LifeScience Technologies Acquisition"). The purchase price to the Company was approximately $1.2 million cash plus $41,667 per month or 5% of LifeScience Technology product sales, whichever is greater, payable for 60 months commencing in January 2001. The seller, at its option, has the right to take shares of the Company's common stock at an option price of $3.00 per share in lieu of cash for the monthly payment. However, such option is limited to a total of 860,000 shares.

The LifeScience Technologies Acquisition was accounted for as a purchase under Accounting Principles Board Opinion No. 16 ("APB No. 16"). In accordance with APB No. 16, the Company allocated the purchase price of the LifeScience Technologies Acquisition based on the fair value of the assets acquired and liabilities assumed.

ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2002 AND 2001
(UNAUDITED)

5. NOTES PAYABLE

Notes payable consists of the following:

	JUNE 30, 2002	DECEMBE 2001

Notes payable to RMS Limited Partnership, 7.5% effective rate, payable in 60 monthly installments (See Note 4)	$ 1,566,872	$ 1,754
Note payable to bank, with interest at prime less .25% (4.5% at June 30, 2002 and December 31, 2001), payable in monthly installments of principal and interest, due on September 30, 2006, collateralized by warehouse and equipment	1,099,556	1,131
Other	9,986	14
Total	2,676,414	2,899
Less: current maturities	604,737	579
Long-term notes payable	$ 2,071,677	$ 2,320

6. EARNINGS PER SHARE

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

ADVANTAGE MARKETING SYSTEMS, INC.
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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2002 AND 2001
(UNAUDITED)

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

	INCOME (NUMERATOR)
Weighted average common shares outstanding: For the three months ended June 30, 2002:	
Earnings per common share:	
Income available to common stockholders	$ 77,427
Earnings per common share - assuming dilution:	
Options	--
Income available to common stockholders plus assumed conversions	$ 77,427

For the three months ended June 30, 2001: Earnings per common share:	
Income available to common stockholders	$ 165,359
Earnings per common share - assuming dilution:	
Options	--
Income available to common stockholders plus assumed conversions	$ 165,359
For the six months ended June 30, 2002: Earnings per common share:	
Income available to common stockholders	$ 168,915
Earnings per common share - assuming dilution:	
Options	--
Income available to common stockholders plus assumed conversions	$ 168,915
For the six months ended June 30, 2001: Earnings per common share:	
Income available to common stockholders	$ 183,006
Earnings per common share - assuming dilution:	
Options	--
Income available to common stockholders plus assumed conversions	$ 183,006

Options to purchase 693,376 shares of common stock at exercise prices ranging from $2.60 to $6.13 per share and 472,004 shares of common stock at exercise prices ranging from $3.00 to $6.13 per share were outstanding at June 30, 2002 and 2001, respectively, but were not included in the computation of earnings per common share - assuming dilution for the three month ended because the options' exercise price was greater than the average market price of the common shares.

Options to purchase 693,376 shares of common stock at exercise prices ranging from $2.60 to $6.13 per share and 428,998 shares of common stock at exercise prices ranging from $3.00 to $6.13 per share were outstanding at June 30, 2002 and 2001, respectively, but were not included in the computation of earnings per common share - assuming dilution for the six months ended because the options' exercise price was greater than the average market price of the common shares.

Warrants to purchase 1,874,768 shares of common stock at exercise prices ranging from $3.40 to $5.40 per share were outstanding at June 30, 2002 and 2001 but were not included in the computation of earnings per common share - assuming dilution for the three or six months ended because the warrants' exercise price was greater than the average market price of the common shares.

As part of the LifeScience Technologies Acquisition, the sellers receive monthly cash payments in an amount equal to the greater of $41,667 or 5% of LifeScience Technologies product sales. The sellers may elect to take each monthly payment in shares of common stock rather than cash at $3.00 per share exercise price, but cannot acquire more than 860,000 shares pursuant to elections. To date the sellers have not elected to take stock rather than cash. None of the shares of common stock subject to this election right were included in the computation of earnings per common share - assuming dilution for the six months ended June 30, 2001 or 2002 because the exercise price was greater than the average market price of the common shares.

7. COMMITMENTS AND CONTINGENCIES

RECENT REGULATORY DEVELOPMENTS - A significant portion of the Company's net sales continues to be dependent upon the Company's AM-300 product. The Company's net sales of AM-300 represented 44.6% and 53.5% of net sales for the six months ended June 30, 2002 and 2001, respectively. One of the ingredients in the Company's AM-300 products is ephedra, an herb which contains naturally-occurring ephedrine. The Company's manufacturer uses a powdered extract of that herb when manufacturing AM-300. The Company markets AM-300 principally as an aid in weight management. The extract is an 8% extract which means that every 100 milligrams of the powdered extract contains approximately eight milligrams of naturally occurring ephedrine alkaloids. Ephedrine containing products have been the subject of adverse publicity in the United States and other countries relating to alleged harmful effects.

On April 3, 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 on June 4, 1997, would have significantly limited the Company's ability to sell AM-300 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 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 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 the Company's opinion, it is unlikely that a final regulation will be issued by the FDA during 2002. Consequently, management is unable at the present time to predict the ultimate resolution of these issues, nor their ultimate impact on the Company's results of operations or financial condition.

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ADVANTAGE MARKETING SYSTEMS, INC.
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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2002 AND 2001
(UNAUDITED)

PRODUCT LIABILITY - The Company, 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. The Company maintains a claims made policy, with limited (excluding ephedra) product liability insurance coverage. The limits of this coverage are $1,000,000 per occurrence and $4,000,000 aggregate. The Company generally does not obtain contractual indemnification from parties manufacturing its products. However, all of the Company's product manufacturers carry product liability insurance which covers the Company's products. The Company has agreed to indemnify a supplier against claims arising from claims made by associates for products manufactured by the supplier and marketed by the Company. Although a product liability claim has not been asserted against the Company, such claims could result in material losses.

LEGAL PROCEEDINGS - The Company was sued in Feather v. LifeScience Technologies, Ltd., Case No. C10-01-422, Circuit Court of the Ninth Judicial Circuit in and for Orange County, Florida, on January 16, 2001. Plaintiff alleged that LifeScience Technologies breached a contract between the parties requiring LifeScience Technologies to pay plaintiff a master distributor fee and a monthly royalty fee upon LifeScience Technologies sales of adaptogen products. Plaintiff additionally alleged that LifeScience Technologies breached the contract by assigning the contract to the Company without his express written consent. On February 8, 2002, the Company executed a settlement agreement regarding this litigation with Mr. Feather. Pursuant to the settlement agreement, Mr. Feather will continue to receive a monthly royalty fee equal to 5% of the gross wholesale revenue derived from adaptogen products. No other payments have been or will be made to Mr. Feather. The case was dismissed with prejudice on July 3, 2002.

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors and Stockholders
Advantage Marketing Systems, Inc.

We have reviewed the accompanying condensed consolidated balance sheet of

Advantage Marketing Systems, Inc. and Subsidiaries as of June 30, 2002, and the related condensed consolidated statements of income for the three- and six-month periods ended June 30, 2002 and 2001, and the statement of cash flows for the six months ended June 30, 2002 and 2001. These financial statements are the responsibility of the Company's management.

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

Based on our review, we are not aware of any material modifications that should be made to the condensed consolidated financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet of Advantage Marketing Systems, Inc. and Subsidiaries as of December 31, 2001 and the consolidated statements of income, stockholders' equity and cash flows for the year then ended (not presented herein) and, in our report dated February 22, 2002, we expressed an unqualified opinion on those statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2001 is fairly stated, in all material respects.

GRANT THORNTON LLP

Oklahoma City, Oklahoma
July 25, 2002

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

GENERAL

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

On January 4, 2001, we purchased the LifeScience Technologies ("LST") group of companies for $1.2 million in cash and a five year payment of $41,667 per month or 5% of the gross sales of LifeScience Technologies products, whichever is greater. The seller has the option to take up to 860,000 shares of common stock in lieu of cash at an option price of $3.00 per share. As a result of this acquisition we added 14 products and over 5,000 associates.

Throughout this report, "net sales" represents the gross sales amounts reflected on our invoices to our associates less associate discounts, sales returns, and freight income. Beginning June 1, 2001, we adopted a new accounting policy, which requires billing customers a portion of freight costs, which is included in net sales. All of our products include a customer satisfaction guarantee. Our products may be returned within 30 days of purchase for a full refund or credit toward the purchase of another product. We also have a buy-back program whereby we repurchase products sold to an independent associate (subject to a restocking fee), provided the associate terminates his/her associateship agreement with us and returns the product within 12 months of original purchase in marketable condition. We receive our net sales price in cash or through credit card payments upon receipt of orders from associates. Our "gross profit" consists of net sales less (1) "commissions and bonuses", consisting of commission payments to associates based on their current associate level within their organization, and other one-time incentive cash bonuses to qualifying associates, (2) "cost of products", consisting of the prices we pay to our manufacturers for products and royalty overrides earned by qualifying associates on sales within their associate organizations and (3) "cost of shipping", consisting of costs related to shipments, duties and tariffs, freight expenses relating to shipment of products to associates, and similar expenses.

RESULTS OF OPERATIONS

The following table sets forth, as a percentage of our net sales, selected results of operations for the three and six months ended June 30, 2002 and 2001. The selected results of operations are derived from our unaudited condensed consolidated financial statements. The results of operations for the periods presented are not necessarily indicative of our future operations.

	FOR THE THREE MONTHS ENDED JUNE 30,				FOR THE	
	2002		2001		2002	
	AMOUNT	PERCENT	AMOUNT	PERCENT	AMOUNT	PE
Net Sales	$ 5,865,850	100.0%	$ 7,140,458	100.0%	$ 12,147,223	
Cost of sales:						
Commissions and bonuses	2,379,851	40.6	3,010,598	42.2	4,977,898	
Cost of products	959,885	16.4	1,586,452	22.2	2,211,859	
Cost of shipping	435,443	7.4	151,548	2.1	875,533	
Total cost of sales	3,775,179	64.4	4,748,598	66.5	8,065,290	
Gross profit	2,090,671	35.6	2,391,860	33.5	4,081,933	
Marketing, distribution and administrative expenses:						
Marketing	467,062	7.9	397,241	5.5	967,069	
Distribution and						

administrative	1,441,132	24.6	1,690,751	23.7	2,788,731
Total marketing, distribution and administrative expenses	1,908,194	32.5	2,087,992	29.2	3,755,800
Income (loss) from operations	182,477	3.1	303,868	4.3	326,133
Other income (expense):					
Interest, net	(18,769)	(0.3)	(28,560)	(0.5)	(40,111)
Other income (expense)	(36,779)	(0.6)	(2,227)	0.0	(9,112)
Total other income (expense) .	(55,548)	(0.9)	(30,787)	(0.5)	(49,223)
Income before taxes	126,929	2.2	273,081	3.8	276,910
Tax expense	49,502	0.9	107,722	1.5	107,995
Net income	$ 77,427	1.3%	$ 165,359	2.3%	$ 168,915

We expect to continue to expand our network of independent associates, which may result in increased sales volume. However, there is no assurance that increased sales volume will be achieved through expansion of our network of independent associates or that, if sales volume increases, we will realize increased profitability.

COMPARISON OF THE THREE MONTHS ENDED JUNE 30, 2002 AND 2001

Our net sales during the three months ended June 30, 2002 decreased by $1,274,608, or 17.9%, to $5,865,850 from $7,140,458 during the three months ended June 30, 2001.

Our cost of sales during the three months ended June 30, 2001 decreased by $973,419, or 20.5%, to $3,775,179 from $4,748,598 during the same period in 2001. Total cost of sales, as a percentage of net sales, decreased to 64.4% during the three months ended June 30, 2002 from 66.5% during the same period in 2001. The decrease in cost of sales was attributable to:

- A decrease of $630,747 in associate commissions and bonuses due to the decreased level of sales;

- A decrease of $626,567 in the cost of products sold due to the consolidation of product lines; and

- An increase of $283,895 in shipping costs primarily due to increased shipping rates by U.P.S. and U.S.P.S.

The factors discussed above resulted in a decrease in gross profit of $301,189, or 12.6%, to $2,090,671 for the three months ended June 30, 2002 from $2,391,860 for the same period in 2001.

Marketing, distribution and administrative expenses decreased $179,798, or 8.6%, to $1,908,194 during the three months ended June 30, 2002, from $2,087,992 during the same period in 2001. This decrease was primarily attributable to:

- A decrease in depreciation and amortization expense of approximately $58,000 due to cessation of goodwill amortization in 2002 per FASB 142 (See Note 2 to our financial statements);

- Non-recurring expenses in 2001 of approximately $29,000 related to the operation of the LifeScience Technologies Florida offices and LifeScience Technologies California warehouse in January and February of 2001 plus the transition costs related to the LifeScience Technologies acquisition in January, 2001; and

- A decrease in contract services of $106,000 from 2001, due to an increase in 2001 of our technical staff during the LifeScience Technologies acquisition transition.

The marketing, distribution and administrative expenses as a percentage of net sales increased to 32.5% during the three months ended June 30, 2002 from 29.2% during the same period in 2001. Management expects marketing, distribution and administrative expenses to continue at or near the current level.

Our other expense (reduced by other income) increased by $24,761 to net other expense of $55,548 at June 30, 2002, from a net other expense of $30,787 during the same period in 2001. This increase was primarily attributable to a loss on sale of assets of approximately $38,000.

COMPARISON OF THE SIX MONTHS ENDED JUNE 30, 2002 AND 2001

Our net sales during the six months ended June 30, 2002 decreased by $2,089,125, or 14.7%, to $12,147,223 from $14,236,348 during the six months ended June 30, 2001.

Our cost of sales during the six months ended June 30, 2002 decreased by $1,471,961, or 15.4%, to $8,065,290 from $9,537,251 during the same period in 2001. Total cost of sales, as a percentage of net sales decreased to 66.4% during the six months ended June 30, 2002, from 67.0% during the same period in 2001. This decrease was attributed to:

- A decrease of $1,000,135 in distributor commissions and bonuses due to the decreased level of sales;

- A decrease of $797,396 in the cost of products sold due to the consolidation of product lines; and

- An increase of $325,570 in shipping expenses primarily due to increased shipping rates by U.P.S. and U.S.P.S.

The factors discussed above resulted in a decrease in gross profit of $617,164, or 13.1%, to $4,081,933 for the six months ended June 30, 2002 from $4,699,097 for the same period in 2001.

Marketing, distribution and administrative expenses decreased $651,774, or 14.8%, to $3,755,800 during the six months ended June 30, 2002, from $4,407,574 during the same period in 2001. This decrease was primarily attributable to:

- A decrease in promotion costs of approximately $103,000;

- A decrease in staffing and related payroll cost of approximately $220,000 due to a reduction in staff related to the LifeScience Technologies acquisition;

- Non-recurring expenses in 2001 of approximately $244,000 related to the operation of the LifeScience Technologies Florida offices and LifeScience Technologies California warehouse in January and February of 2001, plus the transition costs related to the LifeScience Technologies acquisition in January 2001;

- A decrease in depreciation and amortization expense of approximately $116,000, due to cessation of goodwill amortization in 2002 per FASB 142 (See Note 2 to our financial statements); and
- A decrease in contract services for 2001 of approximately $240,000 incurred to supplement the Company's technical staff during the LifeScience Technologies acquisition transition.

The marketing, distribution and administrative expenses as a percentage of net sales remained flat at 31.0% during the six months ended June 30, 2002 compared to the same period in 2001.

Our other income (reduced by other expense) decreased by $57,518 to net other expense of $49,223 at June 30, 2002, from a net other income of $8,295 during the same period in 2001. This decrease was primarily due to:

- A decrease in investment income of $27,000 related to marketable securities offset by an increase in interest income of $18,000;
- A decrease in collection of written off accounts receivable of $25,000 related to collection of old, outstanding debt;
- An increase in interest expense of $8,000 related to the warehouse and equipment loans (See Note 5 to our financial statements); and
- A loss on sale of assets of $14,000.

RECENTLY ISSUED ACCOUNTING STANDARDS

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 142, "Goodwill and Other Intangible Assets". This standard requires companies to stop amortizing existing goodwill and intangible assets with indefinite lives effective January 1, 2002. Under the new rules, companies would only adjust the carrying amount of goodwill or indefinite life intangible assets upon an impairment of the goodwill or indefinite life intangible assets. The Company implemented these standards effective January 1, 2002. No impairment of goodwill resulted from this implementation, and there was no material impact on consolidated results of operations, financial position or cash flows.

The table below shows the reconciliation between reported net income and earnings per share and adjusted net income and earnings per share, adjusted for goodwill amortization (tax-effected):

	FOR THE THREE MONTHS ENDED JUNE 30,		FOR THE SIX MONTHS ENDED JUNE 30,	
	2002	2001	2002	2001
Reported net income	$ 77,427	$ 165,359	$ 168,915	$ 183,006
Add back: Goodwill amortization .	--	58,087	--	116,174

Adjusted net income	$ 77,427	$ 223,446	$ 168,915	$ 299,180
BASIC EARNINGS PER SHARE:				
Reported net income	$ .02	$ .04	$ .04	$ .04
Goodwill amortization	--	.01	--	.03
Adjusted net income	$ .02	$ .05	$ .04	$ .07
DILUTED EARNINGS PER SHARE:				
Reported net income	$ .02	$ .04	$ .04	$ .04
Goodwill amortization	--	.01	--	.02
Adjusted net income	$ .02	$ .05	$ .04	$ .06

In August 2001, SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", was issued and is effective for fiscal years beginning after December 15, 2001. SFAS No. 144 addresses accounting and reporting for the impairment or disposal of long-lived assets. SFAS No. 144 supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" and Accounting Principles Board ("APB") Opinion No. 30, "Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business". SFAS No. 144 retains the fundamental provisions of SFAS No. 121 and expands the reporting of discontinued operations to include all components of an entity with operations that can be distinguished from the rest of the entity and that will be eliminated from the ongoing operations of the entity in a disposal transaction. The Company implemented this standard effective January 1, 2002. Implementation did not have a material impact on consolidated results of operations, financial position, or cash flows.

SEASONALITY

No pattern of seasonal fluctuations exists due to the patterns that we are currently experiencing. However, there is no assurance that we will not become subject to seasonal fluctuations in operations.

LIQUIDITY AND CAPITAL RESOURCES

Our primary source of liquidity has been cash provided by our operating activities, sales of our common stock, and sales of our marketable securities. At June 30, 2002, we had working capital of $3,315,602, compared to $3,110,607 at December 31, 2001. We believe our cash and cash equivalents, current marketable securities, cash flows from operations and expected cash flows from financing activities will be sufficient to fund our working capital and capital expenditure needs over the foreseeable future. During the six months ended June 30, 2002, net cash provided by operating activities was $888,137, net cash used in investing activities was $230,802 and net cash used in financing activities was $260,130. This represented a net increase in cash during this period of

$397,205. Our working capital needs over the next 12 months consist primarily of marketing, distribution and administrative expenses.

In 2001, we completed construction of a 23,346 square foot distribution and call center facility in Oklahoma City. This project was funded, in part, with bank loans of $980,000 for the land and building and $166,216 for the warehouse equipment. Both loans are with Bank One Oklahoma, N.A. and accrue interest at an annual rate of .25% under the prime rate.

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

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

The loans also contain financial covenants requiring us to maintain:

- Tangible Net Worth (total assets excluding intangible assets less total liabilities excluding subordinated debt) of at least $5,500,000;
- Debt coverage ratio (net income plus amortization, depreciation and interest expense, divided by current maturities of long term debt and capital leases plus interest expense) of at least 125%; and
- Debt to EBITDA ratio (current and long term maturities of debt and capital leases, divided by net income plus amortization, depreciation, income tax and interest expense) of less than 250% through December 31, 2002, less than 225% for 2003 and less than 200% thereafter.

The following summarizes our contractual obligations at June 30, 2002 and the effect such obligations are expected to have on our liquidity and cash flow in future periods.

	TOTAL	2002	2003	2004	2
Bank Loans and Notes (1)	$2,676,414	$356,351	$645,355	$682,061	$7
Capital Lease Obligations	329,184	79,614	143,344	61,824	
Operating Leases	230,551	95,845	99,375	32,607	
Total	$3,236,149	$531,810	$888,074	$776,492	$7

(1) See Note 5 to our financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our balance sheet includes marketable securities, which we believe are a conservative blend of income and growth investments resulting in moderate market risk. We invest in equity marketable securities to generate capital growth, and fixed-income marketable securities to provide current income. Because of the nature of these investments, total return and risk will be affected by both current interest rates and equity market movements. Our fixed income investments of approximately $1,200,000 are subject to interest risk only. We have approximately $460,000 of equity investments that are exposed to market risk.

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

The following table lists our cash equivalents and our short-term fixed-income marketable securities at June 30, 2002 and December 31, 2001:

	JUNE 30, 2002			DECE	
	AVERAGE INTEREST RATE (1)	COST	FAIR VALUE	AVERAGE INTEREST RATE (1)	
Cash equivalents	--%	$ 589,309	$ 589,309	--%	$
Short-term Investments ..	6.17%	603,019	610,548	6.45%	
		$ 1,192,328	$ 1,199,857		$

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

Average interest rates for the six months ended June 30, 2002 decreased ..28% from December 31, 2001 due to the redemption of 100,000 units of 7.52% U.S. Government Agency securities in the first quarter 2002, which represented 25% of our total fixed-income marketable securities at December 31, 2001.

Fair value of the cash equivalents and fixed-income marketable securities decreased $205,943 during the six months ended June 30, 2002 to $1,199,857 from $1,405,800 at December 31, 2001. This decrease was due to: a reduction of short-term investments of approximately $132,000, along with the redemption in the first quarter 2002 of fixed-income securities resulting in a reduction of $100,00, partially offset by the purchase of fixed-income securities net of amounts due brokers of $32,000.

EQUITY MARKET RISKS. We currently maintain an investment portfolio of equity securities. All securities are available for sale and recorded in the balance sheet at fair value with fluctuations in fair value reported as a component of accumulated other comprehensive income in stockholders equity. We do not engage in hedging our equity portfolio or otherwise purchase derivative securities. Because of the quality of our portfolio and liquid nature of our equity investments, we do not consider the market risk related to these investments to be material. At June 30, 2002, our equity investments had a value of $456,952 compared to $257,850 at December 31, 2001, primarily due to the purchase of mutual fund equity investments in the second quarter of 2002.

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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We were sued in Feather v. LifeScience Technologies, Ltd., Case No. C10-01-422, Circuit Court of the Ninth Judicial Circuit in and for Orange County, Florida, on January 16, 2001. Plaintiff alleged that LifeScience Technologies breached a contract between the parties requiring LifeScience Technologies to pay plaintiff a master distributor fee and a monthly royalty fee upon LifeScience Technologies sales of adaptogen products. Plaintiff additionally alleged that LifeScience Technologies breached the contract by assigning the contract to us without his express written consent. On February 8, 2002, we executed a settlement agreement regarding this litigation with Mr. Feather. Pursuant to the settlement agreement, Mr. Feather will continue to receive a monthly royalty fee equal to 5% of the gross wholesale revenue derived from adaptogen products. No other payments have been or will be made to Mr. Feather. The case was dismissed with prejudice on July 3, 2002.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

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

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

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

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

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

(b) Form 8-K

None

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ADVANTAGE MARKETING SYSTEMS, INC.

Dated: August 12, 2002

By: /s/ REGGIE B. COOK
Reggie B. Cook, Vice President and
Chief Financial Officer

INDEX TO EXHIBITS

EXHIBIT NUMBER	DESCRIPTION
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15	Letter of independent accountants as to unaudited interim financial information.