ADVANTAGE MARKETING SYSTEMS INC/OK
Form 10-Q
May 11, 2004

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 March 31, 2004

or

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

For the transition period from _______ to _______

Commission File Number: 001-13343

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

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

711 NE 39th Street Oklahoma City, Oklahoma	73105
(Address of principal executive offices)	(Zip Code)

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

Indicate by check mark whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes (X) No ( )

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

Yes ( ) No (X)

On April 30, 2004, we had outstanding 6,736,856 shares of our common stock, $.0001 par value.

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ADVANTAGE MARKETING SYSTEMS, INC.
QUARTERLY REPORT ON FORM 10-Q
FOR THE THREE MONTHS ENDED MARCH 31, 2004

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

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

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PART I -FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
MARCH 31, 2004 AND DECEMBER 31, 2003

	MARCH 31, 2004 (Unaudited)
ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents	$ 870,810
Marketable securities, available for sale, at fair value	5,434,191
Receivables	174,934
Prepaid taxes and income tax receivable	464,975
Inventory	887,801
Deferred income taxes	4,854
Other assets	266,969
Total current assets	8,104,534
RECEIVABLES	237,780
PROPERTY AND EQUIPMENT, net	3,486,359
COVENANTS NOT TO COMPETE and other intangibles, net	538,550
DEFERRED INCOME TAXES	1,832,553
OTHER ASSETS	49,520
TOTAL	$ 14,249,296
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Accounts payable	$ 200,721
Accrued commissions and bonuses	326,350
Accrued other expenses	182,925
Accrued sales tax liability	123,763
Notes payable	---
Capital lease obligations	69,462
Total current liabilities	903,221
LONG-TERM LIABILITIES:	
Notes payable	---
Capital lease obligations	133,395
Deferred compensation	668,073
Total liabilities	1,704,689
COMMITMENTS AND CONTINGENCIES (NOTE 7)	
STOCKHOLDERS' EQUITY (NOTE 9)	
Common stock - $.0001 par value; authorized 495,000,000 shares; issued 7,163,265 and 5,905,307 shares, outstanding 6,690,470 and 5,432,512 shares, respectively	716
Paid-in capital	19,330,207
Notes receivable for exercise of options	(31,000)
Accumulated deficit	(4,633,650)
Accumulated other comprehensive gain, net of tax	122,810
Total capital and accumulated deficit	14,789,083
Less cost of treasury stock (472,795 shares, common)	(2,244,476)
Total stockholders' equity	12,544,607
TOTAL	$ 14,249,296

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

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ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE PERIODS ENDED MARCH 31, 2004 AND 2003
(UNAUDITED)

	THREE MONTHS ENDED MARCH 31,	
	2004	2003
Net sales	$ 4,473,249	$ 4,614,153
Cost of sales	2,823,629	3,226,525
Gross profit	1,649,620	1,387,628
Marketing, distribution and administrative expenses:		
Marketing	225,221	391,525
Distribution and administrative	1,392,276	1,395,949
Total marketing, distribution and administrative expenses	1,617,497	1,787,474
Income (loss) from operations	32,123	(399,846)
Other income (expense):		
Interest and dividends, net	46,099	(22,692)
Other, net	10,414	(21,298)
Total other income (expense)	56,513	(43,990)
Income (loss) before taxes	88,636	(443,836)
Income tax expense (benefit)	34,568	(173,096)
Net income (loss)	$ 54,068	$ (270,740)
Net income (loss) per common share - basic	$ 0.01	$ (.06)
Net income (loss) per common share - assuming dilution	$ 0.01	$ (.06)

Weighted average common shares outstanding - basic	6,487,463	4,424,314
Weighted average common shares outstanding - assuming dilution	7,957,966	4,424,314

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

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ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31, 2004 AND 2003
(UNAUDITED)

	MARCH 31, 2004
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net income (loss)	$ 54,06
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:	
Depreciation and amortization	220,99
Gain (loss) on sale of assets	(8,70
Realized loss on sale of marketable securities	3,75
Deferred taxes	34,56
Stock issued for services	14,00
Employee compensation recognized upon exercise of stock options	25,06
Changes in assets and liabilities which provided (used) cash:	
Receivables	257,93
Inventory	13,72
Other assets	(225,75
Accounts payable and accrued expenses	(197,31
Net cash provided by (used in) operating activities	192,32
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchases of property and equipment	(247,62
Sales of property and equipment	33,19
Receipts on notes receivable	(20,91
Purchases of marketable securities, available for sale	(7,032,86
Sales of marketable securities, available for sale	3,514,47
Payments on advances to affiliates	-
Net cash used in investing activities	(3,753,73
CASH FLOWS FROM FINANCING ACTIVITIES:	
Proceeds from issuance of common stock	152,87
Proceeds from exercise of warrants	3,978,21
Principal payment on notes payable	(1,989,17
Principal payment on capital lease obligations	(18,97
Net cash provided by (used in) financing activities	2,122,94

NET DECREASE IN CASH AND CASH EQUIVALENTS	(1,438,47
CASH AND CASH EQUIVALENTS, BEGINNING	2,309,28
CASH AND CASH EQUIVALENTS, ENDING	$ 870,81

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE THREE
MONTHS ENDED MARCH 31, 2004 AND 2003
(UNAUDITED)

1. UNAUDITED INTERIM FINANCIAL STATEMENTS

The unaudited consolidated financial statements and related notes have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). 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 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, 2003.

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, 2004.

2. SIGNIFICANT ACCOUNTING POLICIES

In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation No. 46 (FIN 46), "Consolidation of Variable Interest Entities" (VIEs), which is an interpretation of Accounting Research Bulletin (ARB) No. 51, "Consolidated Financial Statements." FIN 46, as revised by FIN 46 (R), addresses the application of ARB No. 51 to VIEs, and generally would require that assets, liabilities and results of the activity of a VIE be consolidated into the financial statements of the enterprise that is considered the primary beneficiary. This interpretation applies immediately to VIEs created after January 31, 2003, and to VIEs in which a company obtains an interest after that date. The Company has not created or obtained an interest in any VIEs. In addition, the interpretation became applicable on December 31, 2003 for special purpose entities (SPEs) created prior to February 1, 2003. As of March 31, 2004, the Company had no SPEs for which it was considered the primary beneficiary. For non-SPEs in which a company holds a variable interest that it acquired before February 1, 2003, the FASB has postponed the date on which the interpretation will become applicable to March 31, 2004. The Company has determined the adoption of the provisions of FIN 46, as revised by FIN 46 (R), does not have a material effect on its financial condition or results of operations.

In December 2003, the Staff of the SEC issued Staff Accounting Bulletin (SAB) No. 104, "Revenue Recognition," which supersedes SAB No. 101. The primary purpose of SAB No. 104 is to rescind accounting guidance contained in SAB No. 101 and the SEC's "Revenue Recognition in Financial Statements Frequently Asked Questions and Answers" related to multiple element revenue arrangements in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The Company does not expect the issuance of SAB No. 104 to significantly impact its current revenue recognition policies.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure", which amended SFAS No. 123, "Accounting for Stock-Based Compensation". The standard provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In compliance with SFAS No. 148, the Company elected to continue to follow the intrinsic value method in accounting for its stock-based employee compensation arrangement as defined by APB No. 25. Accordingly, no compensation cost has been recognized for stock options granted in the accompanying consolidated financial statements. The following pro forma data is calculated net of tax as if compensation cost for the Company's stock-based compensation awards was determined based upon the fair value at the grant date consistent with the methodology prescribed under SFAS No. 123.

ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE THREE MONTHS ENDED MARCH 31, 2004 AND 2003
(UNAUDITED)

	THREE MONTHS ENDED MARCH 31,	
	2004	2003
Net income (loss) as reported	$ 54,068	$ (270,740)
Adjustment, net of tax	(56,134)	(37,792)
Proforma net loss	$ (2,066)	$ (308,532)
Net income (loss) per common share as reported	$ .01	$ (.06)
Adjustment, net of tax	(.01)	(.01)
Proforma net income (loss) per common share	$ ---	$ (.07)
Proforma net income (loss) per common share - assuming dilution	$ ---	$ (.07)
Weighted average common shares outstanding	6,487,463	4,424,314

Weighted average common shares outstanding - assuming dilution	7,957,966	4,424,314
	============	============

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants in 2004 and 2003, respectively: risk-free interest rates of 2.72 and 2.77 percent; no dividend yield or assumed forfeitures; an expected life of five years; and volatility of 82.1 and 64.0 percent. The pro forma amounts above are not likely to be representative of future years because there is no assurance that additional awards will be made each year. In January 2003, the Company adopted a new stock incentive plan, under which options were issued in the first quarter of 2004. This plan was approved at the 2003 annual meeting of shareholders.

3. MARKETABLE SECURITIES

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

Net unrealized gains, net of tax, of approximately $27,000 were included in accumulated other comprehensive gain/loss for the three months ended March 31, 2004 and net unrealized losses, net of tax, of approximately $8,285 were included in accumulated other comprehensive loss for the three months ended March 31, 2003. Total comprehensive income for the three months ended March 31, 2004 was $96,645, and total comprehensive loss for the three months ended March 31, 2003 was $284,038.

4. NOTES PAYABLE

Notes payable consists of the following:

	MARCH 31, 2004
Note payable to bank, with interest at prime less .25% (3.75% at December 31, 2003), payable in monthly installments of principal and interest, due on September 30, 2006, collateralized by warehouse and equipment	$ ----
Note payable to bank, with interest at prime less .25% (3.75% at December 31, 2003), payable in monthly installments of principal and	

interest, due on September 30, 2006, collateralized by certain assets	----
Note payable to RMS Limited Partnership, 7.5% effective rate, payable in 60 monthly installments net of discount of $80,069 at December 31, 2003	----
5.0% note payable to Lexus Motor Credit, payable in monthly installments of $588.59	----
	----
Less current maturities	----
	$ ----

All of the notes payable and long-term debt was paid in full in January 2004, using proceeds from the exercise of outstanding warrants.

5. INCOME (LOSS) PER SHARE

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

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

	INCOME (NUMERATOR)	SHAR (DENOMIN
Weighted average common shares outstanding: For the three months ended March 31, 2004:		
Income per common share:		
Income available to common stockholders.........................	$ 54,068	6,487
Income per common share - assuming dilution:		
Options...	--	1,470
Income available to common stockholders plus assumed conversions...	$ 54,068	7,957
For the three months ended March 31, 2003:		
Loss per common share:		
Loss available to common stockholders..........................	$ (270,740)	4,424
Loss per common share - assuming dilution:		
Options...	--	
Loss available to common stockholders plus assumed conversions...	$ (270,740)	4,424

Options to purchase 143,925 shares of common stock at exercise prices ranging from $4.50 to $6.13 per share were outstanding for the three months ended March 31, 2004, but were not included in the

computation of income (loss) per common share - assuming dilution because inclusion of the options was antidilutive.

Options to purchase 2,620,115 shares of common stock at exercise prices ranging from $1.31 to $6.13 per share were outstanding for the three months ended March 31, 2003, but were not included in the computation of income (loss) per common share - assuming dilution because there was a net loss for the quarter.

Warrants to purchase 1,874,768 shares of common stock at exercise prices ranging from $3.40 to $5.40 per share were outstanding at March 31, 2003, but were not included in the computation of earnings per common share - assuming dilution because there was a net loss for the quarter.

As part of the LifeScience Technologies Acquisition, the sellers received monthly cash payments in an amount equal to the greater of $41,667 or 5% of LifeScience Technologies product sales. The sellers had the election to take each monthly payment in shares of common stock rather than cash at $3.00 per share exercise price, but could not acquire more than 860,000 shares pursuant to elections. None of the shares of common stock subject to this election right were included in the computation of earnings (loss) per common share - assuming dilution for the three months ended March 31, 2003 because there was a net loss for the quarter. The balance of the acquisition price, including interest, was paid in full on January 29, 2004.

6. DEFERRED TAXES

On a regular basis, management evaluates all available evidence, both positive and negative, regarding the ultimate realization of the tax benefits of its deferred tax assets. Valuation allowances have been established for certain operating loss and credit carryforwards that reduce deferred tax assets to an amount that will, more likely than not, be realized. Uncertainties that may affect the realization of these assets include tax law changes and the future level of product prices and costs. The outlook for determination of this allowance is calculated on the Company's historical taxable income, its expectations for the future based on a rolling twelve quarters, and available tax-planning strategies. Based on this determination, management expects that the net deferred tax assets will be realized as offsets to reversing deferred tax liabilities and as offsets to the tax consequences of future taxable income. The Company has net operating loss carryforwards of $2,514,000 available to reduce future taxable income, which will begin to expire in 2023.

7. COMMITMENTS AND CONTINGENCIES

RECENT REGULATORY DEVELOPMENTS - As a marketer of products that are ingested by consumers, the Company is subject to the risk that one or more of the ingredients in its products may become the subject of adverse regulatory action. On February 11, 2004, the Food and Drug Administration, or FDA, issued and published in the Federal Register its Final Rule on Ephedrine-containing Supplements, stating that since an "unreasonable risk" had been determined, such supplements would be considered "adulterated" under the Federal Food, Drug and Cosmetic Act, or FFDCA, and thus may not be sold. In essence, this Final Rule (or regulation) imposes a national ban on ephedrine supplements.

The effective date of this regulation was April 12, 2004. The Company complied, and ceased all sales and advertisement of AM-300 and any other ephedra-containing supplement on April 12, 2004. The FDA has indicated that it will now consider whether alternatives to Ephedra and other weight loss and energy stimulants (such as bitter orange) similarly carry an unreasonable risk. These proposals to

limit stimulant ingredients, if finalized, may necessitate reformulations of some of the Company's weight loss products.

Finally, as the press, the FDA, and members of Congress and of the supplement industry have all predicted, the very issuance of the Final Rule on Ephedra may cause Congress to rethink and amend The Dietary Supplement Health and Education Act of 1994, or DSHEA, as to how safety in supplements may be ensured. In particular, there is growing sentiment (including from one herbal trade association) to make Adverse Event Reporting mandatory for all manufacturers and marketers of dietary supplements, so that FDA may take action more quickly than it did on Ephedra, when a harmful herb or other ingredient is suspected. The Company's regulatory counsel will keep it apprised of any challenges to DSHEA, especially any proposed bills that would amend this Act.

The Texas Department of Health promulgated a new regulation, which became effective on January 1, 2001. The regulation requires a warning to appear on the product label indicating that the sale of ephedra-containing products to minors is illegal. The Company's AM-300 labels comply with this regulation. Again, after April 12, 2004 no sales of ephedrine-containing supplements were allowed nationally, and thus state regulations such as this are superceded and moot.

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

Advertising and Website. The FDA considers website promotional content to constitute "labeling," and thus the Company's website must not contain disease claims or drug claims, but only permissible structure/function claims. The Federal Trade Commission, or FTC, governs the advertising of dietary supplements, in any medium or vehicle--print ads, radio spots, infomercials, etc.--including on Internet ads and websites. The fundamental FTC rule is that all material advertising claims, whether express (direct) or implied, must be substantiated by reliable and competent scientific evidence. Because the Company's website must comply with both FDA and FTC regulations, management routinely asks its regulatory compliance counsel to review certain web pages, especially the content of new product promotions. When necessary, regulatory counsel also reviews the scientific substantiation for particular claims (again, especially for new products such as Prime One, an anti-stress and weight loss product) to determine if it is sufficient, and also that there are no disease claims present, the main FDA issue. Any major website revision will be reviewed by counsel.

Finally, the Company wanted to address a potential liability or exposure problem stemming from some of its independent associates creating their own websites, which had not been subject to regulatory review. The Company was concerned that these "renegade" websites could contain impermissible disease claims as to dietary supplements, or false, unsubstantiated or misleading promotional claims in violation of the FTC. The solution, proposed and drafted by the Company's regulatory counsel, was that on February 24, 2004, the Company sent a notice to associates clearly stating that the policy of the Company is to be in full compliance with all applicable FDA and FTC regulations, and that to ensure Internet compliance, associates should simply copy or link to the corporate website. This Policy letter further stated that any independent websites were absolutely

unauthorized, and their creators would be solely liable for defending any regulatory enforcement actions.

PRODUCT LIABILITY - The Company, like other marketers of products that are intended to be ingested, faces an inherent risk of exposure to product liability claims in the event that the use of its products results in injury. The Company maintains a claims made policy, with limited liability insurance coverage. The limits of this coverage are $1,000,000 per occurrence and $2,000,000 in the aggregate. Products containing ephedra, which represented approximately 31.0% of the Company's first quarter 2004 net revenue, are not covered by the Company's product liability insurance. The Company generally does not obtain contractual indemnification from parties manufacturing its products. However, all of the manufacturers of the Company's products carry product liability insurance, which covers the Company's products. Although the Company has never had a product liability claim, such claims against the Company could result in material losses to the Company.

LEGAL PROCEEDINGS - The Company is currently involved in five products liability suits related to the ingestion of its ephedra-based products. Answers to these petitions have been or soon will be filed, and written discovery and responses have been or soon will be exchanged. The

Company has denied, and will continue to deny, any wrongdoing and intends to vigorously defend against the claims. The amounts of damages sought are unknown, but include compensatory and punitive damages.

8. DEFERRED COMPENSATION

On November 4, 2003 the Company entered into a written employment agreement with John W. Hail, Chief Executive Officer, or the Executive. The contract is for an initial two-year term, commencing November 4, 2003, and may be extended for up to five successive one-year terms if the Company and the Executive agree in writing. The contract calls for a base salary of $249,600 per year, a monthly variable salary equal to one percent (1%) of the Company's gross revenues, and a discretionary year-end bonus determined by a majority vote of the Board of Directors. The agreement also contains provisions for graduated severance payments if the Company terminates the Executive without cause. In addition, if the employment period is extended beyond November 11, 2005, the monthly variable salary will cease and be replaced by a fixed supplemental payment to the Executive, which will be in a gross amount necessary to cover all federal, state and local taxes and all employment taxes, and pay a net amount of $7,000 per month. At March 31, 2004, the discounted value of those fixed supplemental payments was approximately $668,000.

9. CHANGES IN STOCKHOLDERS' EQUITY

The following table sets forth changes in stockholder equity between December 31, 2003 and March 31, 2004:

	March 31, 2004	December 31, 2003
Common Stock	$ 716	$ 590
Paid in Capital	19,330,207	15,160,183

Common stock increased $126, or 21.4% to $716 at March 31, 2004 from $590 at December 31, 2003, due to the issuance of 5,000 shares of common stock for consulting services, the exercise of approximately 90,000 stock options and the exercise of approximately 1,170,000 outstanding warrants.

Paid in capital increased $4,170,024, or 27.5% to $19,330,207 at March 31, 2004 from $15,160,183 at December 31, 2003. The increase in paid in capital was due to:

- Approximately $14,000 related to issuance of stock for services;
- Approximately $178,000 related to exercise of stock options; and
- Approximately $4,000,000 related to the exercise of outstanding warrants.

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors and Stockholders
Advantage Marketing Systems, Inc.

We have reviewed the accompanying consolidated balance sheet of Advantage Marketing Systems, Inc. and Subsidiaries as of March 31, 2004, and the related consolidated statements of operations and cash flows for the three months ended March 31, 2004 and 2003. These financial statements are the responsibility of the Company's management.

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

Based on our reviews, we are not aware of any material modifications that should be made to the consolidated financial statements, as of March 31, 2004 and for the periods ended March 31, 2004 and 2003, 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, 2003 and the consolidated statements of operations, stockholders' equity and cash flows for the year then ended (not presented herein) and, in our report dated February 17, 2004, we expressed an unqualified opinion on those statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2003 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

GRANT THORNTON LLP

Oklahoma City, Oklahoma
April 21, 2004

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

GENERAL

We market a product line consisting of approximately sixty 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.

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

Throughout this report, "net sales" represents the gross sales amounts reflected on our invoices to our associates, including freight income, less associate discounts and sales returns. All of our products include a customer satisfaction guarantee. Our products may be returned within 30 days of purchase for a full refund or credit toward the purchase of another product. We also have a buy-back program whereby we repurchase products sold to an independent associate (subject to a restocking fee), provided the associate terminates his/her associateship agreement with us and returns the product within 12 months of original purchase in marketable condition. We receive our net sales price in cash or through credit card payments upon receipt of orders from associates.

Our "gross profit" consists of net sales less:

- Commissions and bonuses, consisting of commission payments to associates based on their current associate level within their organization, and other one-time incentive cash bonuses to qualifying associates;

- Cost of products, consisting of the prices we pay to our manufacturers for products and royalty overrides earned by qualifying associates on sales within their associate organizations; and

- Cost of shipping, consisting of costs related to shipments, duties and tariffs, freight expenses relating to shipment of products to associates, and similar expenses.

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

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

We account for contingencies in accordance with SFAS No. 5, "Accounting for Contingencies". SFAS 5 requires that we record an estimated loss from a loss contingency when information available prior to issuance of our financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. Accounting for contingencies such as legal and income tax matters requires us to use our judgment. Many legal and tax contingencies can take years to resolve. Generally, as the time period increases over which the uncertainties are resolved, the likelihood of changes to the estimate of the ultimate outcome increases. However, an adverse outcome in these matters could have a material impact on our results of operations, financial condition and cash flows. No amounts were accrued for such uncertainties as of March 31, 2004.

RESULTS OF OPERATIONS

The following table sets forth, as a percentage of our net sales, selected results of operations for the three months ended March 31, 2004 and 2003. The selected results of operations are derived from our unaudited consolidated financial statements. The results of operations for the periods presented are not necessarily indicative of our future operations.

	FOR THE THREE MONTHS ENDED MARCH 31,			
	2004		2003	
	AMOUNT	PERCENT	AMOUNT	PERCENT
Net sales	$ 4,473,249	100.0%	$ 4,614,153	100.0%
Cost of sales:				
Commissions and bonuses	1,771,856	39.6	2,038,236	44.2
Cost of products	713,029	15.9	780,133	16.9
Cost of shipping	338,744	7.6	408,156	8.8
Total cost of sales	2,823,629	63.1	3,226,525	69.9
Gross profit	1,649,620	36.9	1,387,628	30.1
Marketing, distribution and administrative expenses:				
Marketing	225,221	5.1	391,525	8.5
Distribution and administrative	1,392,276	31.1	1,395,949	30.2
Total marketing, distribution and administrative expenses	1,617,497	36.2	1,787,474	38.7
Income (loss) from operations	32,123	0.7	(399,846)	(8.6)
Other income (expense):				
Interest, net	46,099	1.0	(22,692)	(0.5)
Other, net	10,414	0.3	(21,298)	(0.5)
Total other income (expense)	56,513	1.3	(43,990)	(1.0)
Income (loss) before taxes	88,636	2.0	(443,836)	(9.6)
Tax expense (benefit)	34,568	0.8	(173,096)	(3.7)
Net income (loss)	$ 54,068	1.2%	$ (270,740)	(5.9)%

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COMPARISON OF THE THREE MONTHS ENDED MARCH 31, 2004 AND 2003

Our net sales during the three months ended March 31, 2004 decreased by $140,904, or 3.1%, to $4,473,249 from $4,614,153 during the three months ended March 31, 2003. The sales decrease is due to the decrease in number of associate autoships experienced by us in late 2003. We have historically earned a material portion of our revenues from our AM-300 product, which contains ephedra. In 2003, the FDA banned the use of ephedra in nutritional supplements. This ban was effective April 12, 2004. Sales of our AM-300 product totaled approximately $1.4 million in the first quarter of 2004, as compared to sales of approximately $1.9 million in the same period of 2003. While the FDA's decision had an adverse effect on our 2003 revenues, we had been preparing for this contingency. Over the last several years, through strategic acquisitions, product redevelopment and refocus of weight loss products, we have built a multi-product peak performance, weight loss and nutritional product line that is predominately non-ephedra. We have seen positive results in converting our AM-300 customers to AM-300 Ephedra Free or other weight loss products in states like New York, Illinois and California that have previously banned ephedra. A majority of the customers in those states have chosen one or more of our other performance-based weight loss and nutritional products. We anticipate the same positive results with our remaining AM-300 customers. As a result, we do not anticipate that the FDA ban on ephedra will materially impact our financial condition or results of operations.

On March 6, 2004, we announced the launch of our three-phase 2004 mass marketing preferred customer acquisition program using a free trial format. The three products, Prime One, AM-300 fat burning solution and the ToppFast meal replacement shake, are packaged in two free trial programs and represent the Company's core

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adaptogen and weight loss products, targeting consumer demand for increased energy, reduced belly fat and recognizable weight loss.

On April 5, 2004, we announced March results of our new customer acquisition program totaling 2,813 new preferred customers, far surpassing the initial projection of 1,500. The customer acquisition program is in the early stage of phase I of a three-phase rollout that will continue throughout 2004. Phase I started with the rollout of the program to the sales associates followed by phase II, a pending full Internet release and phase III, a mass marketing media campaign which the Company is currently exploring.

Product autoships from new associates increased 460% in March 2004 over February 2004. Also in March, 3,516 new sales associates and preferred customers joined AMS, compared to 743 in February 2004 and 979 in March 2003. Total sales for March were up 13% over the prior month and 3% over the same period in the prior year.

Our cost of sales during the three months ended March 31, 2004 decreased by $402,896, or 12.5%, to $2,823,629 from $3,226,525 during the same period in 2003. Total cost of sales, as a percentage of net sales, decreased to 63.1% during the three months ended March 31, 2004 from 69.9% during the same period in 2003. The decrease in cost of sales was attributable to:

- A decrease of $266,380 in associate commissions and bonuses, primarily due to a change in the compensation plan to accommodate the addition of bonus pools, along with the greater sales from newer downline business versus older downline business, which pays less commissions;

- A decrease of $67,104 in the cost of products sold due to the implementation of a perpetual inventory system in the second quarter of 2003 and decreased sales; and

- A decrease of $69,412 in shipping costs primarily due to decreased sales.

The factors discussed above resulted in an increase in gross profit of $261,992, or 18.9%, to $1,649,620 for the three months ended March 31, 2004 from $1,387,628 for the same period in 2003.

Marketing expenses decreased $166,304, or 42.5%, to $225,221 during the three months ended March 31, 2004, from $391,525 during the same period in 2003. The decrease in expense was primarily attributable to:

- A decrease in employee costs of approximately $30,000;

- A decrease in promotion expenses of approximately $51,000;

- A decrease in travel costs of approximately $37,000 related to less outside travel of executives and our nutition expert; and

- A decrease in general expenses such as postage, telephone expense, and office supplies of approximately $18,000.

Distribution and administrative expense was virtually flat at $1,392,276 for the three months ended March 31, 2004 compared to $1,395,949 for the three months ended March 31, 2003. The marketing, distribution and administrative expenses as a percentage of net sales decreased to 36.2% during the three months ended March 31, 2004 from 38.7% during the same period in 2003.

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

Our net other income (reduced by other expense) increased by $100,503 to net other income of $56,513 at March 31, 2004, from a net other expense of $43,990 during the same period in 2003, primarily due to a decrease in interest expense, related to the repayment of all outstanding debt in January 2004.

Our income (loss) before taxes increased $532,472 to income of $88,636 for the first three months of 2004, compared to a loss of $443,836 during the same period in 2003. Income (loss) before taxes as a percentage of net sales was 2.0% and (9.6%) for the three months ended March 31, 2004 and 2003, respectively. Income tax expense (benefit) for the first quarter 2004 and 2003 was $34,568 and ($173,096). Our net income (loss) increased $324,808, to net

income of $54,068 for the three months ended March 31, 2004, from a net loss of $270,740 for the same period in 2003. This increase was attributable to:

- The increase in gross profit to $1,649,620 during 2004 from $1,387,628 during 2003;

- The decrease in marketing, distribution and administrative expense to $1,617,497 during 2004 from $1,787,474 during 2003; and

- The increase in net other income to $56,513 during 2004 from net other expense of $43,990 during 2003.

Net income (loss) as a percentage of net sales increased to 1.2% for the three months ended March 31, 2004, from (5.9%) during the same period in 2003.

RECENTLY ISSUED ACCOUNTING STANDARDS

In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation No. 46 (FIN 46), "Consolidation of Variable Interest Entities" (VIEs), which is an interpretation of Accounting Research Bulletin (ARB) No. 51, "Consolidated Financial Statements." FIN 46, as revised by FIN 46 (R), addresses the application of ARB No. 51 to VIEs, and generally would require that assets, liabilities and results of the activity of a VIE be consolidated into the financial statements of the enterprise that is considered the primary beneficiary. This interpretation applies immediately to VIEs created after January 31, 2003, and to VIEs in which a company obtains an interest after that date. We have not created or obtained an interest in any VIEs. In addition, the interpretation becomes applicable on December 31, 2003 for special purpose entities (SPEs) created prior to February 1, 2003. As of March 31, 2004, we had no SPEs for which we were considered the primary beneficiary. For non-SPEs in which a company holds a variable interest that it acquired before February 1, 2003, the FASB has postponed the date on which the interpretation will become applicable to March 31, 2004. We have determined the adoption of the provisions of FIN 46, as revised by FIN 46 (R), does not have a material effect on our financial condition or results of operations.

In December 2003, the Staff of the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 104, "Revenue Recognition," which supersedes SAB No. 101. The primary purpose of SAB No. 104 is to rescind accounting guidance contained in SAB No. 101 and the SEC's "Revenue Recognition in Financial Statements Frequently Asked Questions and Answers" (the FAQ) related to multiple element revenue arrangements in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. We do not expect the issuance of SAB No. 104 to significantly impact our current revenue recognition policies.

LIQUIDITY AND CAPITAL RESOURCES

Our primary source of liquidity has been cash provided by sales of our marketable securities and our operating activities. In January 2004, we added cash of approximately $1.2 million from the exercise of outstanding warrants. Using a portion of the proceeds from the exercise of warrants, we repaid all debt, totaling $1,504,009, resulting in a decrease in interest expense of approximately $60,000. At March 31, 2004, we had working capital of $7,201,313, compared to $4,420,554 at December 31, 2003. Our working capital needs over the next 12 months consist primarily of marketing, distribution and administrative expenses, and will be provided by our operating activities and existing cash and cash equivalents. During the three months ended March 31, 2004, net cash provided by operating activities was $192,324, net cash used in investing activities was $3,753,735 and net cash provided by financing activities was $2,122,940. This represented a net decrease in cash during this period of $1,438,471.

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 were with Bank One Oklahoma, N.A. and accrued interest at an annual rate of .25% under the prime rate. The loans were retired in January 2004. As of January 31, 2004, we had no long-term debt outstanding.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our balance sheet includes marketable securities, which we believe are conservative blends 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 $2,600,000 are subject to interest risk only. We have approximately $2,800,000 of equity investments that are exposed to market risk.

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

The following table lists our cash equivalents and our short-term fixed-income marketable securities at March 31, 2004 and December 31, 2003:

	MARCH 31, 2004			DECEMBER 31,	
	AVERAGE INTEREST RATE	COST	FAIR VALUE	AVERAGE INTEREST RATE	COST
Cash equivalents...	--	$ 18,922	$ 18,922	--	$ 17,70
Short-term Investments......	--	2,642,270	2,642,238	--	787,55
		$ 2,661,192	$ 2,661,160		$ 805,26

The fair value of the cash equivalents and fixed-income marketable securities increased $1,856,596 during the three months ended March 31, 2004 to $2,661,192 from $804,564 at December 31, 2003. This increase was primarily due to the purchase of fixed-income securities of approximately $1,800,000, purchased with cash from the exercise of our outstanding warrants.

EQUITY MARKET RISKS. We currently maintain an investment portfolio of equity securities. All securities are available for sale and recorded in the balance sheet at fair value with fluctuations in fair value reported as a component of accumulated other comprehensive income in stockholders equity. We do not engage in hedging our equity portfolio or otherwise purchase derivative securities. Because of the quality of our portfolio and liquid nature of our equity investments, we do not consider the market risk related to these investments to be material. At March 31, 2004, our equity investments had a value of $2,773,031 compared to $1,072,414 at December 31, 2003, primarily due to the purchase of mutual fund equity investments, purchased with cash from the exercise of our outstanding warrants.

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

ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, an evaluation was carried out under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) as required by Rule 13a-15(b). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective. Our Chief Executive Officer and Chief Financial Officer have also concluded that there have not been any changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On March 5, 2004, we were sued in Ross v. Advantage Marketing Systems, Inc., Superior Court of the State of California for the County of Los Angeles, Case No. BC 309118. No answer or other responsive pleading has yet been filed. The plaintiff alleges that she took AM-300, which contains ephedra, and was injured as a result. She seeks actual, compensatory and punitive damages, plus an accounting and disgorgement of profits we purportedly earned as a result of allegedly illegal conduct. We intend to vigorously defend the case.

On March 8, 2004, we were sued in Purcell v. Advantage Marketing Systems, Inc. and The Chemins Company, Inc., District Court in and for Pontotoc County, State of Oklahoma, Case No. C-04-127. No answer or other responsive pleading has yet been filed. The plaintiff alleges that he took AM-300, which contains ephedra, and was injured as a result. He seeks actual and punitive damages in an amount in excess of $10,000. We intend to vigorously defend the case.

ITEM 2. CHANGES IN SECURITIES, USE OF PROCEEDS AND ISSUER PURCHASES OF EQUITY SECURITIES

On December 10, 2003, our Board of Directors authorized the redemption of all of our outstanding 1997-A warrants, Redeemable Common Stock Purchase Warrants and Underwriter's Warrants. We completed the redemption of our outstanding 1997-A warrants, Redeemable Common Stock Purchase Warrants and Underwriter's Warrants on January 16, 2004.

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate dollar Value) Shares (or Units) that May Y Purchased Under the Plans Programs

Month #1 01/01/2004 through 01/31/2004	147,049	$	0.081	147,049	---
Month #2 02/01/2004 through 02/29/2004	---	$	---	---	---
Month #3 03/01/2004 through 03/31/2004	---	$	---	---	---

On January 14, 2004, we sold 5,000 shares of common stock to a consultant in exchange for approximately $14,000 of services. The sale was exempt from registration pursuant to Section 4(2) of the Securities Exchange Act of 1933.

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

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

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

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

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

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

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

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

(b) Form 8-K

We filed the following Form 8-Ks during the first quarter of 2004:

- March 25, 2004 - Item 7, Item 9 and Item 12 filing disclosing the press release and earnings call script announcing financial results of the year ended December 31, 2003

- January 27, 2004 - Item 5 and Item 7 filing disclosing the press release announcing completion of the outstanding warrant redemption.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

REGISTRANT:
ADVANTAGE MARKETING SYSTEMS, INC.

Dated: May 7, 2004

By: /S/ REGGIE B. COOK

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

Index of Exhibits

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