

Edgar Filing: NUTRASTAR INC - Form 10QSB

NUTRASTAR INC
Form 10QSB
May 15, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2002

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE
EXCHANGE ACT FOR THE TRANSITION PERIOD FROM
_____ to _____

Commission File Number 0-32565

NUTRASTAR INCORPORATED

(Exact name of small business issuer as specified in its charter)

CALIFORNIA

87-0673375

(State of other jurisdiction of incorporation
or organization)

(I.R.S. Employer Identification
Number)

1261 Hawk's Flight Court
El Dorado Hills, California

95762

(Address of Principal Executive Offices)

(Zip Code)

Issuer's telephone number: (916) 933-7000

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

YES X

NO

Common stock, no par value, 21,802,853 issued and outstanding as of April 30, 2002.

Edgar Filing: NUTRASTAR INC - Form 10QSB

INDEX

	Page
PART 1 - FINANCIAL INFORMATION.....	1
ITEM 1. FINANCIAL STATEMENTS.....	1
Principles of Consolidation.....	8
ITEM 2.MANAGEMENT'S DISCUSSIONS AND ANALYSIS OR PLAN OF OPERATIONS...	12
Critical Accounting Policies.....	15
Revenue Recognition.....	15
PART II - OTHER INFORMATION.....	17
ITEM 1. LEGAL PROCEEDINGS.....	17
ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.....	17
SIGNATURES.....	17

i

PART 1 - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PART 1 - FINANCIAL INFORMATION

1

FINANCIAL STATEMENT

NUTRASTAR INCORPORATED AND SUBSIDIARIES
CONTENTS
March 31, 2002 (unaudited)

	Page
CONDENSED, CONSOLIDATED FINANCIAL STATEMENTS	
Condensed, Consolidated Balance Sheet	3 - 4

Edgar Filing: NUTRASTAR INC - Form 10QSB

Condensed, Consolidated Statements of Operations	5
Condensed, Consolidated Statements of Cash Flows	6 - 7
Notes to Condensed, Consolidated Financial Statements	8 - 11

2

NUTRASTAR INCORPORATED AND SUBSIDIARIES
CONDENSED, CONSOLIDATED BALANCE SHEET
March 31, 2002 (unaudited)

ASSETS

Current assets	
Cash	\$ 43,620
Accounts receivable	34,485
Inventory	193,966
Prepaid expenses	22,661

Total current assets	294,732
Property and equipment, net	225,133
Patents and trademarks, net	114,027
Goodwill	250,001
Deposits	136,495

Total assets	\$1,020,388 =====

The accompanying notes are an integral part of these financial statements.

3

NUTRASTAR INCORPORATED AND SUBSIDIARIES
CONDENSED, CONSOLIDATED BALANCE SHEET
March 31, 2002 (unaudited)

LIABILITIES AND SHAREHOLDERS' EQUITY

Edgar Filing: NUTRASTAR INC - Form 10QSB

Current liabilities		
Accounts payable		\$ 524,398
Accrued salaries and benefits		88,577
Accrued expenses		85,654
Due to officer		12,759
Note payable to officer		100,000

Total current liabilities		811,388

Contingencies		
Shareholders' equity		
Convertible series A preferred stock, no par value, \$1 stated value		
3,000,000 shares authorized		
2,084,707 shares issued and outstanding		1,980,802
Common stock, no par value		
50,000,000 shares authorized		
21,649,520 shares issued and outstanding		4,925,845
Common stock committed		636,424
Deferred compensation		(936,174)
Accumulated deficit		(6,397,897)

Total shareholders' equity		209,000

Total liabilities and shareholders' equity		\$ 1,020,388
		=====

The accompanying notes are an integral part of these financial statements.

4

NUTRASTAR INCORPORATED AND SUBSIDIARIES
CONDENSED, CONSOLIDATED STATEMENTS OF OPERATIONS
For the Three Months Ended March 31,

	2002	2001
	-----	-----
	(unaudited)	(unaudited)
Net sales	\$ 294,357	\$ 468,320
Cost of goods sold	182,472	404,425
	-----	-----
Gross profit	111,885	63,895

Edgar Filing: NUTRASTAR INC - Form 10QSB

Operating expenses	1,181,468	419,993
	-----	-----
Loss from operations	(1,069,583)	(356,098)
	-----	-----
Other income (expense)		
Interest income	600	769
Interest expense	(740)	(4,898)
	-----	-----
Total other income (expense)	(140)	(4,129)
	-----	-----
Net loss	\$ (1,069,723)	\$ (360,227)
	=====	=====
Basic and diluted loss per share	\$ (0.05)	\$ (0.02)
	=====	=====
Basic and diluted weighted-average shares outstanding	21,649,520	15,346,340
	=====	=====

The accompanying notes are an integral part of these financial statements.

5

NUTRASTAR INCORPORATED AND SUBSIDIARIES
CONDENSED, CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Three Months Ended March 31,

	2002	2001
	-----	-----
	(unaudited)	(unaudited)
Cash flows from operating activities		
Net loss	\$ (1,069,723)	\$ (360,227)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	29,982	16,910
Non-cash issuances of stock options	342,702	--
Non-cash issuances of committed stock	137,250	--
(Increase) decrease in		
Accounts receivable	(32,892)	21,071
Inventory	(100,080)	261,311
Prepaid expenses	(13,873)	3,977
Deposits	44,576	100,000
Increase (decrease) in		
Accounts payable	142,280	(234,011)

Edgar Filing: NUTRASTAR INC - Form 10QSB

Accrued salaries and benefits	27,563	5,247
Accrued expenses	(1,715)	3,986
Due to officer	(19,270)	--
	-----	-----
Net cash used in operating activities	(513,200)	(181,736)
	-----	-----
Cash flows from investing activities		
Purchase of property and equipment	(41,124)	(179,975)
Purchase of patents and trademarks	(7,558)	(2,940)
	-----	-----
Net cash used in investing activities	(48,682)	(182,915)
	-----	-----
Cash flows from financing activities		
Proceeds from the issuance of common stock committed	100,000	--
Proceeds from notes payable	--	406,356
Proceeds from the issuance of common stock	--	31,000
Proceeds from note payable to officer	100,000	--
	-----	-----
Net cash provided by financing activities	200,000	437,356
	-----	-----
Net increase (decrease) in cash	(361,882)	72,705
Cash, beginning of year	405,502	5,865
	-----	-----
Cash, end of year	\$ 43,620	\$ 78,570
	=====	=====

The accompanying notes are an integral part of these financial statements.

6

NUTRASTAR INCORPORATED AND SUBSIDIARIES
CONDENSED, CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Three Months Ended March 31,

	2002	2001
	-----	-----
	(unaudited)	(unaudited)
Supplemental disclosures of cash flow information		
Interest paid	\$ --	\$ 4,898
	=====	=====
Income taxes paid	\$ 1,600	\$ --

NOTE 1 - ORGANIZATION AND LINE OF BUSINESS

General

NutraStar Incorporated ("NutraStar"), a California corporation, markets proprietary whole food dietary supplements derived from nutrient-dense stabilized rice bran (a nutraceutical) produced by an affiliated company, The RiceX Company ("RiceX"), a current shareholder and a publicly traded company. The Company has a license to distribute certain derivatives of RiceX's stabilized rice bran, as well as valued-added rice bran products in the United States of America.

On December 14, 2001, Alliance Consumer International, Inc. ("Alliance") acquired all of the outstanding common stock of NutraStar. For accounting purposes, the acquisition has been treated as a recapitalization of NutraStar with NutraStar as the acquirer (reverse acquisition).

Effective April 27, 2000, NutraStar became an 80% owner of NutraGlo Incorporated ("NutraGlo"), a Nevada corporation. NutraGlo was non-operative during 2000. During the year ended December 31, 2001, NutraGlo started marketing, manufacturing, and distributing NutraStar's stabilized rice bran and other nutraceuticals to the equine market. In connection with NutraStar's acquisition of Alliance, NutraStar issued 250,001 shares of common stock in exchange for the remaining 20% of the common stock of NutraGlo. The value of the shares was \$250,001, which has been recorded as goodwill in the accompanying consolidated balance sheet.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of NutraStar and its wholly owned subsidiaries, NutraStar Technologies, Inc. and NutraGlo (collectively, the "Company"). All significant inter-company accounts and transactions are eliminated in consolidation.

Basis of Presentation

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles for interim financial information and with the instructions to Form 10-QSB and Regulation S-B. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all normal, recurring adjustments considered necessary for a fair presentation have been included. The financial statements should be

Edgar Filing: NUTRASTAR INC - Form 10QSB

read in conjunction with the audited financial statements and notes thereto included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2001. The results of operations for the three months ended March 31, 2002 are not necessarily indicative of the results that may be expected for the year ended December 31, 2002.

8

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Going Concern

The Company has received a report from its independent auditors that includes an explanatory paragraph describing the uncertainty as to the Company's ability to continue as a going concern. These consolidated financial statements contemplate the ability to continue as such and do not include any adjustments that might result from this uncertainty.

Advertising Expense

The Company expenses all advertising costs, including direct response advertising, as they are incurred. Advertising expense for the three months ended March 31, 2002 and 2001 was \$20,346 (unaudited) and \$7,326 (unaudited), respectively.

Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Recently Issued Accounting Pronouncement

In April 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." SFAS No. 145 updates, clarifies, and simplifies existing accounting pronouncements. This statement rescinds SFAS No. 4, which required all gains and losses from extinguishment of debt to be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. As a result, the criteria in Accounting Principles Board No. 30 will now be used to classify those gains and losses. SFAS No. 64 amended SFAS No. 4 and is no longer necessary as SFAS No. 4 has been rescinded. SFAS No. 44 has been rescinded as it is no longer necessary. SFAS No. 145 amends SFAS No. 13 to require that certain lease modifications that have economic effects similar to sale-leaseback transactions be accounted for in the same manner as sale-lease transactions. This statement also makes technical corrections to existing pronouncements. While those corrections are not substantive in nature, in some instances, they may change accounting practice. The Company does not expect adoption of SFAS No. 145 to have a material impact, if any, on its financial position or

Edgar Filing: NUTRASTAR INC - Form 10QSB

results of operations.

9

NOTE 3 - PROPERTY AND EQUIPMENT

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

Furniture and equipment	\$ 18,417
Software	327,747

	346,164
Less accumulated depreciation	121,031

Total	\$225,133
	=====

Depreciation expense was \$26,946 (unaudited) and \$15,604 (unaudited) for the three months ended March 31, 2002 and 2001, respectively.

NOTE 4 - PATENTS AND TRADEMARKS

Patents and trademarks at March 31, 2002 consisted of the following:

Patents	\$ 72,738
Trademarks	51,809

	124,547
Less accumulated amortization	10,520

Total	\$114,027
	=====

Amortization expense was \$3,036 (unaudited) and \$1,306 (unaudited) for the three months ended March 31, 2002 and 2001, respectively.

NOTE 5 - NOTE PAYABLE TO OFFICER

On March 4, 2002, the Company entered into a note payable agreement with an officer of the Company, which bears interest at 10% per annum and is due on March 3, 2003.

NOTE 6 - CONTINGENCIES

Litigation

The Company is involved in certain legal proceedings and claims, which arise in the normal course of business. Management does not believe that the outcome of these matters will have a material effect on the

Edgar Filing: NUTRASTAR INC - Form 10QSB

Company's financial position or results of operations.

10

NOTE 7 - SHAREHOLDERS' EQUITY

Common Stock Committed

On March 15, 2002, the Company committed to issue 153,333 shares of common stock with a detachable purchase warrant to purchase 153,333 shares of common stock at an exercise price of \$1.20 per share in exchange for \$100,000. As of March 31, 2002, the Company had not issued the stock and has recorded the transaction as committed stock.

Common Stock and Stock Options

On January 7, 2002, the Company entered into a five-year employment agreement with an employee. In relation to this agreement, the Company issued options to purchase 155,000 shares of common stock. The options vest over four years in increments of 80,000, 25,000, 25,000, and 25,000, have an exercise price of \$1 per share, and expire on January 7, 2012. As of March 31, 2002, the Company recorded compensation expense and deferred compensation totaling \$48,438 and \$145,312, respectively, in relation to this transaction.

On January 10, 2002, the Company entered into a six-month consulting services agreement for marketing services. In relation to this agreement, the Company issued options to purchase 25,000 shares of common stock at an exercise price of \$1 per share. The options expire in 10 years. The Company recorded consulting expense of \$47,250 in relation to this transaction.

On February 4, 2002, the Company entered into a three-month marketing services agreement for public relations and advertising services. In relation to this agreement, the Company paid a retainer of \$35,000 upon execution of the agreement, issued 35,000 shares of restricted common stock, and issued options to purchase 50,000 shares of the Company's common stock at an exercise price of \$3 per share. The options expire in two years. The Company recorded consulting expense totaling \$90,250 in relation to this transaction.

On February 21, 2002, the Company entered into a one-year financial advisory services agreement. In relation to this agreement, the Company paid a non-refundable retainer of \$20,000, issued 200,000 restricted shares of common stock, and issued options to purchase 100,000 restricted shares of common stock at \$1 per share, 100,000 at \$2.50 per share, and 100,000 at \$4 per share. The Company recorded consulting expense totaling \$159,000 in relation to this transaction.

11

Edgar Filing: NUTRASTAR INC - Form 10QSB

ITEM 2. MANAGEMENT'S DISCUSSIONS AND ANALYSIS OR PLAN OF OPERATIONS

Caution About Forward-Looking Statements

This Form 10-QSB includes "forward-looking" statements about future financial results, future business changes and other events that haven't yet occurred. For example, statements like we "expect," we "anticipate" or we "believe" are forward-looking statements. Investors should be aware that actual results may differ materially from our expressed expectations because of risks and uncertainties about the future. The Company does not undertake to update the information in this Form 10-QSB if any forward-looking statement later turns out to be inaccurate. Details about risks affecting various aspects of the Company's business are discussed throughout this Form 10-QSB and should be considered carefully.

Plan of Operation for the Next Twelve Months

NTI was formed on February 4, 2000 and became the wholly-owned subsidiary of the Company on December 14, 2001. To date, the Company has focused on its relationship with the producer of its raw materials, RiceX, and to a lesser extent on its strategic alliances. The Company has commenced the limited distribution of its stabilized rice bran and rice bran products on the Internet and through direct-to-consumer response advertising campaigns. In the near future, the Company intends to commence the full distribution of its products as private label brands through strategic distributors on the occurrence of certain events, including the raising of additional capital required to implement the Company business plan.

The Company anticipates that in the next 12 to 24 months, it will need an additional \$10 to \$20 million in financing. The Company anticipates that it will need \$5 to \$15 million to make certain acquisitions, \$2.5 million to further increase production capacity, and \$2.5 million for additional working capital, including the purchase of inventory for anticipated sales growth. The Company expects to obtain this additional funding from private placements of debt and/or equity securities, or possibly through the public offering of its common stock.

Results of Operation

First Quarter 2002 versus First Quarter 2001

During the first quarter 2002, NutraStar generated net sales of \$294,357 compared to \$468,320 for the first quarter 2001, a decrease of 37% in comparison to 2001. Reasons for the decrease include a delay in obtaining final approval of the new Exclusive Distribution Agreement with The RiceX Company, which temporarily limited the amount of stabilized rice bran being shipped to the Company. In addition, new terms of the Exclusive Distribution Agreement transferred prior industrial customers of NutraStar to RiceX.

The cost of goods sold for the quarter ended March 31, 2002 decreased 45% to \$182,472 compared to \$404,425 for the quarter ended March 31, 2001. This decrease reflects the increase in production of higher margin products for resale as well as 2001 having more start-up production costs. The Company's

gross profit percentage increased to 38% from 14% for the quarter ended March 31, 2002 compared to the quarter ended March 31, 2001. Operating expenses of \$1,181,468 in the first quarter of 2002 more than doubled over the comparable period in fiscal year 2001 with operating expenses of \$419,993. This increase

Edgar Filing: NUTRASTAR INC - Form 10QSB

represents the Company's continued expansion of operations during fiscal year 2002 in a number of areas. During the quarter ended March 31, 2002 employee related expenses rose \$235,000 to \$451,000 as result of additional hired employees both after the first quarter of 2001 and during the first quarter of 2002. Professional fees increased approximately \$449,000 to \$558,000 in the first quarter of 2002 as the Company is using outside consultants in such areas as legal, financial and marketing in an attempt to limit direct hires until additional funding is obtained.

The Company incurred an operating loss of \$1,069,583 during the quarter ended March 31, 2002 compared to an operating loss of \$356,098 during the quarter ended March 31, 2001. This 300% increase in operating loss reflects the significant increase in the operating expenses relating to the Company's expanded business operations during fiscal year 2002 as discussed above.

During the quarter ended March 31, 2002, the Company recognized interest expense of \$740, which reflects interest paid on short-term promissory notes outstanding during all or part of the quarter and represents a decrease from interest expense of \$4,898 for the quarter ended March 31, 2001 which reflects the significant reduction in the amount of promissory notes outstanding. This expense increased the Company's overall net loss to \$1,069,723 compared to a total loss of \$360,227 recorded in the quarter ended March 31, 2001.

Due to the December 14, 2001 share exchange with Alliance, for accounting purposes, the acquisition has been treated as a recapitalization of NutraStar (formerly Alliance) with NTI as the acquirer (reverse acquisition). Consequently, the financial statements of NTI are presented as those of the Company. As a result, a comparison of the current financial statements as compared to those of Alliance as previously reported in its Form 10-SB may not be deemed relevant.

Liquidity and Sources of Capital

NutraStar has incurred significant operating losses since its inception, and, as of March 31, 2002 NutraStar has an accumulated deficit of \$6,397,897. At March 31, 2002, NutraStar had cash and cash equivalents of \$43,620 and a net working capital deficit of \$516,656.

To date, NutraStar has funded its operations, in addition to sales revenues, through a combination of short-term debt and the issuance of common and preferred stock. As of December 31, 2000 NutraStar had raised approximately \$383,000 from the sale of its common stock through private placement channels. During December 2001 NutraStar completed two private placements; the first raised \$1,000,000 from the sale of common stock at \$1.00 per share; and the second raised approximately \$1,841,707 through the conversion of debt and accrued interest into preferred stock that was priced at \$1.00 per share. During the quarter ended March 31, 2002, NutraStar raised an additional \$100,000 through the sale of its common stock as well as received proceeds of \$100,000 from a note payable to the Chairperson of NutraStar.

The Company is dependent on the proceeds from future debt or equity investments to expand its operations and fully implement the Company's business plan. If the Company is unable to raise sufficient capital, the Company will be required to delay or forego some portion of its business plan, which may have a material adverse effect on the Company's anticipated results from operations and financial condition. Alternatively, the Company may seek interim financing in the form of bank loans, private placement of debt or equity securities, or some combination thereof. Such interim financing may not be available in the amounts

Edgar Filing: NUTRASTAR INC - Form 10QSB

or at the times when the Company requires, and will likely not be on terms favorable to the Company.

Dependence on Key Supplier

NutraStar has entered into an agreement with The RiceX Company, whereby RiceX will sell NutraStar its rice bran solubles and rice bran fiber concentrates at prices equal to the lower of RiceX's standard price or the price negotiated by other customers for like quantities and products. The agreement also provides that RiceX will not sell any rice bran solubles or rice bran fiber concentrates products in the United States except to NutraStar. To maintain this exclusive right, NutraStar must purchase products equal to \$250,000 by April 15, 2002 (which quota has been met), \$500,000 during the three-month period ending July 15, 2002, \$750,000 during the three-month period ending October 15, 2002, \$1,250,000 during the three-month period ending January 15, 2003, \$1,500,000 for the six month period ending July 15, 2003, \$2,250,000 for the six-month period ending January 15, 2004, \$6,000,000 for the one-year period ending January 15, 2005, and increasing amounts each one-year period thereafter at a 10% increase per year. In consideration for this exclusive right, NutraStar will pay RiceX a royalty of 2% of NutraStar's gross receipts of all NutraStar's products that incorporated RiceX products, exclusive of shipping charges and returned product. To purchase products from RiceX, the NTI is required to provide a 50% deposit for all purchase orders in addition to the \$135,000 security deposit already paid to RiceX. The agreement has a 5-year term, and automatically renews for 2 additional 5-year terms unless NutraStar elects not to renew.

In addition to the risks associated with the potential termination of the RiceX Agreement, the inability of RiceX to deliver the amount of product that NutraStar requires, any interruption in product delivery for any reason, or the inability of RiceX to fulfill its contractual obligations would have a material adverse effect on NutraStar's business, results from operations, and financial condition, as NutraStar could not readily find and implement alternative suppliers and likely not on advantageous terms. NutraStar has the exclusive right to distribute certain of RiceX's products in the United States, but NutraStar may lose this exclusive right if it does not purchase increasing amounts of product from RiceX each year. RiceX's ability to manufacture certain of NutraStar's core products is currently limited to the production capability of RiceX's Dillon, Montana plant (the "Dillon Plant"). Currently, the Dillon Plant is capable of producing only a limited quantity of NutraStar's products, which will not be sufficient to meet NutraStar's short-term and long-term sales goals. The Company and/or RiceX plan to add production capacity during the current year.

Recent Accounting Pronouncements

In June 2001, the FASB issued SFAS No. 143, Accounting for Asset Retirement

14

Obligations. This statement applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development, and/or the normal operation of long-lived assets, except for certain obligations of lessees. This statement is not applicable to the Company.

In August 2001, the FASB issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. This statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This statement replaces SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of, the accounting and reporting provisions of APB No. 30, Reporting the Results of Operations - Reporting the Effects of

Edgar Filing: NUTRASTAR INC - Form 10QSB

Disposal of a Segment of a Business, and Extraordinary, Unusual, and Infrequently Occurring Events and Transactions, for the disposal of a segment of a business, and amends Accounting Research Bulletin No. 51, Consolidated Financial Statements, to eliminate the exception to consolidation for a subsidiary for which control is likely to be temporary. The adoption of SFAS No. 144 has not had a material impact, if any, on its financial position or results of operations.

In April 2002, the FASB issued SFAS No. 145, Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections. SFAS No. 145 updates, clarifies, and simplifies existing accounting pronouncements. This statement rescinds SFAS No. 4, which required all gains and losses from extinguishments of debt to be aggregated and if material, classified as an extraordinary item, net of related income tax effect. As a result, the criteria in APB No. 30 will now be used to classify those gains and losses. SFAS No. 64 amended SFAS No. 4 and is no longer necessary as SFAS No. 4 has been rescinded. SFAS No. 44 has been rescinded as it is no longer necessary. SFAS No. 145 amends SFAS No. 13 to require that certain lease modifications that have economic effects similar to sale-leaseback transactions be accounted for in the same manner as sale-lease transactions. This statement also makes technical corrections to existing pronouncements. While those corrections are not substantive in nature, in some instances, they may change accounting practice. This statement is not applicable to the Company.

Critical Accounting Policies

Our discussion and analysis of our financial conditions and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States. The preparation of financial statements require managers to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses and disclosures on the date of the financial statements. On an on-going basis, we evaluate our estimates, including, but not limited to, those related to revenue recognition. We use authoritative pronouncements, historical experience and other assumptions as the basis for making judgements. Actual results could differ from those estimates. We believe that the following critical accounting policies affect our more significant judgments and estimates in the preparation of our consolidated financial statements.

Revenue Recognition

Revenue is recorded at the time of merchandise shipment, net of provisions for

returns in accordance with interpretative guidance provided by Staff Accounting Bulletin (SAB) No. 101. The majority of the Company's sales are to distributors and these distributors generally have no right to return products.

Edgar Filing: NUTRASTAR INC - Form 10QSB

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Subsequent to the quarter ended March 31, 2002, a Complaint was filed against NTI by Millennium Integrated Services, Inc. ("MISI") in Superior Court, Sacramento County, on April 4, 2002 (Case No. 02A502006). MISI provided website development services to NTI, at a cost of \$204,405. MISI is seeking contract payment of \$204,405 plus interest of \$32,031 as well as damages for alleged conversion and misappropriation of trade secrets. On April 9, 2002, MISI filed a Motion for a Writ of Attachment which would allow MISI to seize and hold NTI assets worth \$236,436 pending the resolution of the lawsuit. On April 10, 2002, a Writ of Attachment was granted by the Court. NTI believes it has valid defenses and offsets to the payment for these services and either will appeal the Court's action or attempt to settle this matter. Settlement of this case could have a material affect on NutraStar's cash flow depending on how quickly any settlement would need to be paid. Conversely, litigating this matter could also have a material adverse affect on NutraStar's operations and financial results.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

- (a) Exhibits: None
- (b) Reports on Form 8-K:

On February 27, 2002, the Company filed an Amended Form 8-K/A for December 14, 2002, reporting an Item 7 submission regarding the filing of financial statements resulting from the Company's Plan and Agreement of Exchange with NTI.

On March 14, 2002, the Company filed a Form 8-K for March 7, 2002, reporting an Item 4 event regarding the change of independent accountants for the Company and its subsidiaries.

On March 25, 2002, the Company filed an Amended Form 8-K/A for March 7, 2002, revising the Item 4 information previously filed and including additional exhibits under Item 7.

SIGNATURES

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

NUTRASTAR INCORPORATED

Dated: May 15, 2002

/s/ James Kluber

James Kluber
Chief Financial Officer
(Principal Accounting Officer)