PACIFICHEALTH LABORATORIES INC
Form 10QSB
May 17, 2004

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO 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 No. 333-36379

PACIFICHEALTH LABORATORIES, INC.
(Exact name of issuer as specified in its charter)

DELAWARE	22-3367588
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
100 Matawan Road, Suite 420 Matawan, NJ	07747
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (732) 739-2900

Check 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 registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes [X] No [_]

At May 12, 2004, there were 10,240,545 shares of common stock, par value $.0025 per share, of the registrant outstanding.

Transitional small business disclosure format: Yes [ ] No [X]

PACIFICHEALTH LABORATORIES, INC.

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PACIFICHEALTH LABORATORIES, INC.
BALANCE SHEETS

ASSETS

	March 31, 2004 (Unaudited)	December 31, 2003 (Audited)

Current assets:		
Cash and cash equivalents	$ 1,182,901	$ 1,798,703
Accounts receivable, net	1,740,011	669,300
Inventories	1,024,941	738,062
Prepaid expenses	222,171	191,859
Total current assets	4,170,024	3,397,924
Property and equipment, net	99,302	60,307
Patents	155,251	155,251
Deposits	19,320	10,895
Total assets	$ 4,443,897	$ 3,624,377
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Notes payable	$ 625,479	$ 470,145
Accounts payable and accrued expenses	1,044,618	376,693
Total current liabilities	1,670,097	846,838
Stockholders' equity:		
Common stock, $.0025 par value; authorized 50,000,000 shares; issued and outstanding: 10,240,545 shares at March 31, 2004 and 10,188,545 shares at December 31, 2003	25,601	25,471
Additional paid in capital	15,776,424	15,788,068
Accumulated deficit	(13,028,225)	(13,036,000)
	2,773,800	2,777,539
Total liabilities and stockholders' equity	$ 4,443,897	$ 3,624,377

PACIFICHEALTH LABORATORIES, INC.
STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED MARCH 31, 2004 AND MARCH 31, 2003
(UNAUDITED)

	2004	2003
Revenues:		
Net product sales	$ 2,303,597	$1,397,77
Cost of goods sold:	1,129,815	719,72
Gross profit	1,173,782	678,05

Selling, general and administrative expenses	1,093,694	997,70
Research & development expenses	38,372	87,29
Depreciation expense	9,509	14,11
	1,141,575	1,099,11
Net operating income (loss)	32,207	(421,05
Other income (expense)		
Interest income	2,601	94
Interest expense	(27,031)	(99
	(24,430)	(5
Income (loss) before income taxes	7,777	(421,10
Provision (benefit) for income taxes	-	
Net income (loss)	$ 7,777	$ (421,10
Basic and diluted income (loss) per share	$ 0.00	$ (0.0
Weighted average common shares - Basic	10,218,688	6,115,17
Weighted average common shares - Diluted	10,993,993	6,115,17

PACIFICHEALTH LABORATORIES, INC.
STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31, 2004 AND MARCH 31, 2003
(UNAUDITED)

	2004	2
Cash flows from operating activities:		
Net income (loss)	7,777	(4
Adjustments to reconcile net loss to		
net cash used in operating activities:		
Depreciation	9,509	
Intrinsic value of stock options granted	14,369	
Changes in assets and liabilities:		
Decrease (Increase) in accounts receivable	(1,070,711)	(3
Decrease (Increase) in inventories	(286,879)	4
Decrease (Increase) in prepaid expenses	(30,312)	
Decrease (Increase) in deposits	(8,425)	(
Increase (Decrease) in accounts payable/accrued expenses	667,925	1
Increase (Decrease) in other current liabilities	-	(
Net cash used in operating activities	(696,747)	(1

Cash flows from investing activity:		
Purchase of fixed assets	(48,505)	
Net cash used in investing activity	(48,505)	
Cash flows from financing activities:		
Issuance of notes payable	1,210,103	
Repayments of notes payable	(1,054,768)	(
Common stock issued	42,750	
Fees in connection with private placement	(68,635)	
Common stock options/warrants exercised	-	
Net cash used in financing activities	129,450	(
Net decrease in cash	(615,802)	(2
Cash, beginning balance	1,798,703	6
Cash, ending balance	$ 1,182,901	$ 4
Supplemental disclosures of cash flow information:		
Cash paid for interest	$ 27,031	$

PACIFICHEALTH LABORATORIES, INC.
NOTES TO FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED MARCH 31, 2004 AND 2003
(UNAUDITED)

1. BASIS OF PRESENTATION:

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions for Form 10-QSB and Item 310 of 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 adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004. The unaudited financial statements should be read in conjunction with the financial statements and footnotes thereto included in the Company's annual report on Form 10-KSB for the year ended December 31, 2003.

2. REVENUE RECOGNITION

Approximately $750,000 in sales of new products in the first quarter of

2004 is subject to a right of return provision if certain minimum levels of retail sales are not achieved by the customer in a 12-month period of time from the date of initial sale. Management believes these minimums will be met based upon initial retail sales of the product reported by the customer as well as the Company's past history with similar products such as ENDUROX R4 in similar channels of distribution.

3. INVENTORIES

As of March 31, 2004 and December 31, 2003, inventories consisted of the following:

	2004	2003
Raw Materials	$ 75,715	$ 14,841
Packaging supplies	58,262	33,127
Finished goods	890,964	690,094
	$1,024,941	$738,062

4. STOCK BASED COMPENSATION

The Company granted 12,000 Incentive Stock Options (ISOs) to employees during the first three months of 2004 with exercise prices ranging from $0.83 to $0.95 per share. 1,000 of these options vested upon grant, 5,500 of these options vest during the first quarter of 2005, and 5,500 of these options vest during the first quarter of 2006. The exercise price for all 12,000 options was equal to the fair market value of the common stock on the date of grant. Since the Company accounts for its options under APB No. 25, no compensation expense was recognized.

The Company also granted 11,000 stock options to consultants during the first three months of 2004. All 11,000 options vested upon grant with exercise prices ranging from $0.83 per share to $0.90 per share. These options were determined to have a value of $7,289 for the three months ended March 31, 2004 and this amount was charged to operations and added to paid-in capital in accordance with SFAS 123. In addition, 10,000 options issued to consultants expired during the first three months of 2004.

The following table illustrates the effect on net (loss) income and earnings per share if the fair value based method had been applied to all awards:

	Quarter End 2004
Reported net (loss) income	$ 7,777
Stock-based employee compensation expense included in reported net loss, net of related tax effects	- 0 -
Stock-based employee compensation determined under the	

fair value based method, net of related tax effects	(42,802)
Pro forma net (loss) income	$(35,025)
Basic and diluted (loss) per share:	
As reported	$0.00
Pro forma	($0.00)

5. INCOME TAXES

The Company has approximately $12,013,000 in Federal net operating loss carryovers that were generated through March 31, 2004 and are available to offset future taxable income in calendar years 2004 through 2024.

The components of the Company's deferred tax assets as of March 31, 2004 and December 31, 2003 are as follows:

	2004	2003
Net operating loss carry forwards	$ 4,830,000	$ 4,830,000
Deferred charges	-	-
Valuation allowance	(4,830,000)	(4,830,000)
Deferred tax asset	$ -	$ -

6. NOTES PAYABLE

Included in notes payable at March 31,2004 is $587,410 payable to USA Funding. During the second quarter of 2003, the Company secured a $750,000 revolving asset-based credit facility from USA Funding of Dallas, TX. This facility is for one year commencing on June 1, 2003. The amount of available credit is based on the value of the Company's eligible receivables from time to time. Eligible receivables include those receivables that have payment terms equal to or less than net 45 days or have been outstanding for less than 90 days. The receivables are financed with recourse. This credit facility bears interest at a rate of prime plus 2% as well as a 0.75% discount rate on all advances.

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

This Report contains forward-looking statements concerning our financial condition, results of operations and business, including, without limitation, statements pertaining to:

- The development of new products and the expansion of the market for our current products;
- Implementing aspects of our business plans;
- Financing goals and plans;
- Our existing cash and whether and how long these funds will be sufficient to fund our operations; and
- Our raising of additional capital through future equity financings.

These and other forward-looking statements are primarily in the section entitled "Management's Discussion and Analysis of Financial Conditions and Results of Operations". Generally, you can identify these statements because they use phrases like "anticipates," "believes," "expects," "future," "intends," "plans," and similar terms. These statements are only predictions. Although we do not make forward-looking statements unless we believe we have a reasonable basis for doing so, we cannot guarantee their accuracy, and actual results may differ materially from those we anticipated due to a number of uncertainties, many of which are unforeseen. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this prospectus. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including those stated in this Report.

We believe it is important to communicate our expectations to our investors. There may be events in the future, however, that we are unable to predict accurately or over which we have no control. Cautionary language in this Report provides examples of risks, uncertainties and events that may cause our actual results to differ materially from the expectations we describe in our forward-looking statements.

(A) INTRODUCTION

The Company was incorporated in April 1995 as a nutrition technology company that researches, develops, and commercializes functionally unique proprietary products for sports performance, weight loss and Type 2 diabetes.

SPORTS PERFORMANCE

Our first sports performance product, ENDUROX(R), was introduced in March 1996 with commercial sales beginning in May 1996. In March 1997, we extended the ENDUROX line of products with ENDUROX EXCEL(R). In February 1999, we introduced ENDUROX(R) R(4)(R) Performance/Recovery Drink to be taken following exercise. In clinical studies performed or funded by the Company, ENDUROX R(4) has demonstrated a number of exercise-related benefits including enhanced performance, extended endurance, and decreased post-exercise muscle damage. In June 2001, we introduced ACCELERADE(R) Sports Drink, to be taken during exercise using the same patented technology as ENDUROX R(4). Research studies funded by the Company have shown that ACCELERADE is significantly better than conventional sports drinks in improving endurance during exercise. In 2003, the Company introduced a ready-to-drink form of ACCELERADE into test market in the state of Colorado. This test market is expected to continue in 2004. In March 2004, the Company introduced COUNTDOWN(R), the first product specifically engineered for immediate post-workout intake by strength-training athletes.

WEIGHT LOSS

In weight loss, the Company has focused its research and development efforts on development of novel nutritional compositions that stimulate the body's major satiety peptide, or cholecystokinin (CCK). In April 2000, we introduced our first weight loss product, SATIETROL(R), a natural appetite control product based on this research. Clinical studies performed or funded by the Company have shown that Satietrol, a pre meal beverage, can reduce hunger up to 43% 3 1/2 hours after eating. In January 2001, we extended our weight loss product line with the introduction of SATIETROL COMPLETE(R), a 220-calorie meal replacement product that incorporates the patented SATIETROL technology. In June 2001, the Company signed an exclusive worldwide Licensing Agreement with GlaxoSmithKline ("GSK") for its SATIETROL technology. Under the Agreement, the Company received an initial payment of $1,000,000 and received a subsequent milestone payment of $250,000. GSK subsequently canceled the Licensing Agreement in September 2002 with all rights reverting to the Company. In the third quarter of 2003, the Company funded clinical studies performed at a private research firm that showed a statistically significant reduction in caloric intake in overweight individuals using a new improved form of SATIETROL in both beverage and tablet form. The Company will conduct additional studies on SATIETROL in 2004.

TYPE 2 DIABETES

Type 2 diabetes has become the fastest growing chronic condition in the United States. Obesity and poor glucose regulation appear to be primary characteristics of this condition. Research has suggested that cholecystokinin (CCK) may play a role in insulin release and glucose regulation. The Company's research in this area is to develop a nutritional product that can help Type 2 diabetics lose weight by controlling appetite while improving glucose regulation. The Company expects to initiate clinical trials on a product for use by Type 2 diabetics in the future.

(B) RESULTS OF OPERATIONS - THREE MONTHS ENDED MARCH 31, 2004 VS. MARCH 31, 2003

We recorded a net income of $7,777 or $0.00 per share for the three months ended March 31, 2004 compared to a net loss of ($421,103) or ($0.07) per share for the three months ended March 31, 2003. The net income for the three-month period ended March 31, 2004 vs. the net loss in the same period in 2003 is due primarily to increased revenues as detailed below.

Revenues in the three-month period ended March 31, 2004 increased 64% to $2,303,597 from $1,397,779 for the same period in 2003. Revenues of ENDUROX R(4) increased 8% and revenues of ACCELERADE increased 23% in the three months ended March 31, 2004 compared to the same period in 2003. The first quarter of 2004 also included significant opening orders for the Company's new COUNTDOWN post-workout drink for the strength-training athlete.

Approximately $750,000 in sales of new products in the first quarter of 2004 is subject to a right of return provision if certain minimum levels of retail sales are not achieved by the customer in a 12-month period of time from the date of initial sale. Management believes these minimums will be met based upon initial retail sales reported by the customer of the product as well as the Company's past history with similar products such as ENDUROX R4 in similar channels of distribution.

Gross profit was $1,173,782 for the three months ended March 31, 2004

compared to $678,058 for the three months ended March 31, 2003 due to the aforementioned increased revenues. For the three months ended March 31, 2004, gross profit margin was 51.0% compared to 48.5% for the three months ended

March 31, 2003. The primary reason for the increase in gross profit margin was due to slotting fees paid in the form of product for getting our ACCELERADE product sold in 900 Rite Aid drug stores that feature a special nutrition section in the first quarter of 2003.

Selling, general, and administrative ("S, G, & A") expenses increased to $1,093,694 for the three-month period ended March 31, 2004 from $997,703 for the three-month period ended March 31, 2003. S, G, & A expenses increased due primarily to increases in advertising and marketing expenses associated with the launch of our new COUNTDOWN product for the strength-training athlete.

Research and development expenses were $38,372 for the three months ended March 31, 2004 compared to $87,291 for the three months ended March 31, 2003. The decrease was due to research and development expenses in the first quarter of 2003 associated with the test market of the ready-to-drink form of our ACCELERADE product. We anticipate research and development expenses will increase as we conduct additional clinical trials on all of our products as we continue to seek out additional patents and claims for our products.

Interest expense was $27,031 for the three months ended March 31, 2004 compared to $1,000 for the three months ended March 31, 2003. The increase is due to our accounts receivable funding described in the Liquidity section below.

(C) LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2004, the Company's current assets exceeded its current liabilities by approximately $2.5 million with a ratio of current assets to current liabilities of approximately 2.5 to 1. At March 31, 2004, cash on hand was $1,182,901, a decrease of $615,802 from December 31, 2003, primarily because of an increase of $1,070,711 in accounts receivable and an increase in inventory of $286,879 from December 31, 2003. These were offset by an increase in accounts payable/accrued expenses of $667,925 from December 31, 2003. Accounts receivable, inventory, and accounts payable increased in support of the increased revenues.

During the second quarter of 2003, the Company secured a $750,000 asset-based credit facility from USA Funding of Dallas, TX. The amount of available credit is based on the value of the Company's eligible receivables from time to time. This credit facility bears interest at a rate of prime plus 2% as well as a 0.75% discount rate on all advances. At March 31, 2004, we had approximately $13,000 of availability under this credit facility and, as of May 12, 2004, we had approximately $100,000 of availability under this credit facility.

Because of our ability to borrow against our credit facility as described above and the equity raised in the 2003 private placements, we believe we have sufficient cash availability to fund all of our planned activities for at least the next twelve months. We may seek to raise additional equity capital in order to take advantage of any potential opportunities that may present themselves.

(D) OFF-BALANCE SHEET ARRANGEMENTS

There are no off-balance sheet arrangements between the Company and any other entity that have, or are reasonably likely to have, a current or future effect on the Company's financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources.

ITEM 3. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES. Based on their evaluation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of March 31, 2004, the end of the period covered by this report, the Company's chief executive officer and chief financial officer have concluded that the Company's disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and are operating in an effective manner.

CHANGES IN INTERNAL CONTROLS. There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their most recent evaluation.

II. OTHER INFORMATION

ITEM 1 LEGAL PROCEEDINGS

None.

ITEM 2. CHANGES IN SECURITIES

(A), (B) CHANGES IN SECURITIES:

None.

(C) RECENT SALES OF UNREGISTERED SECURITIES:

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:

31.1	Section 302 Certification of Robert Portman, Chief Executive Officer.
31.2	Section 302 Certification of Stephen P. Kuchen, Chief Financial Officer.
32	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(B) REPORTS ON FORM 8-K:

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

PACIFICHEALTH LABORATORIES, INC.

By: /S/ STEPHEN P. KUCHEN

STEPHEN P. KUCHEN

Vice President (Principal Financial Officer and Principal Accounting Officer)

Date: MAY 14, 2004
