PACIFICHEALTH LABORATORIES INC
Form 10-Q
August 13, 2002

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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 June 30, 2002

-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)
1480 Route 9 North, Suite 204 Woodbridge, NJ	07095
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (732) 636-6141

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 August 12, 2002, there were 6,114,703 shares of common stock, par value $.0025 per share, of the registrant outstanding.

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

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PACIFICHEALTH LABORATORIES, INC.

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PACIFICHEALTH LABORATORIES, INC.
BALANCE SHEETS

ASSETS

	June 30, 2002 (Unaudited)	December 31, 2001 (Audited)
Current assets:		
Cash and cash equivalents	$ 1,121,509	$ 1,848,847
Accounts receivable, net	798,117	192,628
Inventories	2,858,009	2,634,272
Prepaid expenses	270,780	165,079

Total current assets	5,048,415	4,840,826
Property and equipment, net	59,081	62,709
Other assets:		
Deposits	108,322	108,322
Total assets	$ 5,215,818	$ 5,011,857

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Notes payable	$ 56,635	$ 45,048
Accounts payable and accrued expenses	637,030	291,506
Total current liabilities	693,665	336,554
Stockholders' equity:		
Common stock, $.0025 par value; authorized 50,000,000 shares; issued and outstanding: 6,104,703 shares at June 30, 2002 and 6,039,203 shares at December 31, 2001	15,262	15,098
Additional paid-in capital	13,817,015	13,674,479
Accumulated deficit	(9,310,124)	(9,014,274)
	4,522,153	4,675,303
Total liabilities and stockholders' equity	$ 5,215,818	$ 5,011,857

PACIFICHEALTH LABORATORIES, INC.
STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2002 AND 2001
(UNAUDITED)

	Three Months Ended June 30,		
	2002	2001	2002
Revenues:			
Product sales	$ 1,818,096	$ 2,861,613	$ 2,975,
Licensing revenues	-	1,000,000	

Total Revenues	1,818,096	3,861,613	2,975,
Cost of goods sold	807,185	1,416,723	1,370,
Gross Profit	1,010,911	2,444,890	1,604,
Selling, general and administrative expenses	1,024,723	844,706	1,842,
Research & development	24,523	29,080	47,
Depreciation expense	9,359	10,863	18,
	1,058,605	884,649	1,908,
Net operating income (loss)	(47,694)	1,560,241	(304,
Other income (expense):			
Interest income	4,086	7,110	9,
Interest expense	(918)	(91,423)	(1,
	3,168	(84,313)	8,
Income (loss) before income taxes	(44,526)	1,475,928	(295,
Provision for income taxes	-	-	
Net income (loss)	$ (44,526)	$ 1,475,928	$ (295,
Basic income (loss) per share	$ (0.01)	$ 0.28	$ (0
Diluted income (loss) per share	$ (0.01)	$ 0.24	$ (0
Weighted average common shares:			
Basic	6,061,302	5,280,754	6,050,
Diluted	7,313,680	6,065,316	7,221,

PACIFICHEALTH LABORATORIES, INC.
STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2002 AND 2001
(UNAUDITED)

	2002	20

Cash flows from operating activities:		
Net income (loss)	$ (295,850)	$ 9
Adjustments to reconcile net income (loss)		
to net cash used in operating activities:		
Depreciation	18,574	
Intrinsic value of stock options granted	15,950	3
Changes in assets and liabilities:		
(Increase) / Decrease in accounts receivable	(605,489)	(1,4
(Increase) / Decrease in inventories	(223,737)	4
(Increase) / Decrease in prepaid expenses	(105,701)	
Increase in other assets	-	(2
Increase / (Decrease) in accounts payable/accrued expenses	345,524	(1
Net cash used in operating activities	(850,729)	(
Cash flows from investing activities:		
Purchase of fixed assets	(14,946)	
Net cash used in investing activities	(14,946)	
Cash flows from financing activities:		
Issuance of notes payable	52,700	
Repayments of notes payable	(41,113)	
Common stock issued	-	1,5
Common stock options/warrants exercised	126,750	2
Net cash provided by financing activities	138,337	1,7
Net increase (decrease) in cash	(727,338)	1,7
Cash, beginning balance	1,848,847	1
Cash, ending balance	$ 1,121,509	$ 1,9

PACIFICHEALTH LABORATORIES, INC.
NOTES TO FINANCIAL STATEMENTS
FOR THE THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2002 AND JUNE 30, 2001
(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 and six months ended June 30, 2002 are not necessarily indicative of the results that may be expected for the year ending December 31, 2002. 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, 2001. Certain amounts included in selling, general, and administrative expenses have been reclassified to interest expense for the three- and six- months ended June 30, 2001.

2. Inventories

As of June 30, 2002 and December 31, 2001, inventories consist of the following:

	2002	2001
Raw Materials	$ 336,996	$ 283,140
Work-in-process	-	-
Finished goods	2,524,226	2,354,437
Reserve for obsolescence	(3,213)	(3,305)
	$ 2,858,009	$ 2,634,272

3. Stock Based Compensation

The Company granted 56,500 Incentive Stock Options (ISOs) to employees during the first six months of 2002. 20,000 options vested upon grant with exercise prices ranging from $4.50 per share to $4.88 per share, 35,000 vest during the first six months of 2003 with exercise prices ranging from $3.77 per share to $3.80 per share, and 1,500 vest during the first six months of 2004 with an exercise price of $3.77 per share. The exercise price for all 56,500 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. See NOTE 6.

The Company also granted 500 stock options to consultants during the first six months of 2002. All 500 options vested upon grant with an exercise price of $3.80 per share. These options were determined to have a value of $815 for the six months ended June 30, 2002. This amount was charged to operations in the six months ended June 30, 2002 and added to paid-in capital in accordance with SFAS 123. Also, 15,700 options and 56,875 warrants issued to consultants expired during the first six months of 2002.

4. Income Taxes

The Company has approximately $8,750,000 in Federal net operating loss carryovers that were generated through June 30, 2002 and are available to offset future taxable income in calendar years 2002 through 2030.

The components of the Company's deferred tax assets as of June 30, 2002 and December 31, 2001 are as follows:

	2002	2001
Net operating loss carry forwards	$ 3,160,000	$ 3,035,000
Valuation allowance	(3,160,000)	(3,035,000)
Deferred tax asset	$ -	$ -

5. Licensing Agreement

On June 1, 2001, the Company entered into an exclusive license agreement with GlaxoSmithKline ("GSK"), one of the world's largest pharmaceutical companies, for SATIETROL, the Company's appetite control product. The agreement provides GSK with worldwide rights to the trademarks, technology, patents, and know how for SATIETROL for the duration of the patents which expires in 2017. Under the agreement, PHLI received an initial payment of $1,000,000, has received a subsequent milestone payment of $250,000, will receive additional milestone payments provided GSK meets certain development goals, and will receive ongoing product royalties upon launch of the product by GSK. The agreement does not set a specific time by which GSK must launch the product, but does set a specific time for launch after GSK has met some of the intermediate milestones. GSK is permitted to terminate the license agreement at any time for any reason, provided that it pays all milestone payments earned prior to termination. In this event, all rights to the product will revert to the Company. The license agreement grants GSK a right of first refusal to obtain an exclusive license on any new product developments in appetite suppression, weight loss, weight management, or meal replacement for weight loss. The right of first refusal only applies if the Company intends to use a third party to further develop or commercialize the new product, and does not apply if the Company will commercialize the product itself. The right of first refusal will lapse if the Company undergoes a change in control. The Company can continue to sell the SATIETROL line of products until GSK launches their SATIETROL product. At that time, the Company can continue to market the powdered meal replacement product, currently sold under the name SATIETROL COMPLETE(R), without using the SATIETROL name, in the current health food store channels of distribution. GSK will be responsible for future manufacturing, marketing, and sales of any products it launches. GSK also purchased approximately 9% of PHLI's common stock for $1.5 million under a contemporaneous stock purchase agreement. As of June 30, 2002, the Company has received an aggregate $2,750,000 from GSK from the combined licensing and stock purchase agreements. The Company expects to hear from GSK in the 3rd quarter of 2002 as to whether GSK will continue with the license agreement.

6. Restatement of Prior Period Financial Statements

The Company granted options to our Chief Executive Officer under his 1998 Employment Agreement to purchase up to 475,000 shares of our common stock at $6.00 per share. In connection with our CEO's 2001 Employment Agreement (the "Agreement"), the Company re-priced the exercise price of those options to $0.313 per share, which was the then market price of our common stock on the date of the Agreement. At the time of the execution of the Agreement such options were fully vested and had a fair value of $217,075. The options were fully exercised early in the second quarter of 2001.

The Company did not record a charge to operations until the fourth quarter of 2001. The Company determined that the transaction should have been recorded in the first quarter of 2001 and as such, restated the financial

statements for the first quarter of 2001. In addition, the financial statements for the six months ended June 30, 2001 are hereby being restated to incorporate the impact of the first quarter restatement with the filing of this Form 10-QSB. The effect of this restatement was to increase selling, general, and administrative expenses and net loss by $217,075 for the three months ended March 31, 2001. Net income per share for the six months ended June 30, 2001 decreased from $0.23 to $0.19 on a fully diluted basis.

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

This discussion may contain "forward-looking statements". Forward-looking statements reflect the Company's current views with respect to such future events. Actual results may vary materially and adversely from those anticipated, believed, estimated or otherwise indicated. These statements can be identified by introductory words such as "expects", "plans", "will", "estimates", "forecasts", "projects" or words of similar meaning and by the fact they do not relate strictly to historical or current facts. Forward-looking statements frequently are used in discussing new products and their potential. Many factors may cause actual results to differ from forward-looking statements, including inaccurate assumptions and a broad variety of risks and uncertainties, some of which are known, such as general economic conditions, consumer product acceptance, and competitive products, and others which are not known. No forward-looking statements are a guarantee of future results or events, and one should avoid placing undue reliance on such 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 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. We are currently formulating and developing a ready-to-drink version of ACCELERADE Sports Drink expected to be test marketed in the 4th quarter of 2002.

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.

On June 1, 2001, the Company entered into an exclusive license agreement with GlaxoSmithKline ("GSK"), one of the world's largest pharmaceutical companies, for SATIETROL, the Company's appetite control product. The agreement provides GSK with worldwide rights to the trademarks, technology, patents, and know how for SATIETROL for the duration of the patents which expires in 2017. Under the agreement, PHLI received an initial payment of $1,000,000, has received a subsequent milestone payment of $250,000, will

receive additional milestone payments provided GSK meets certain development goals, and will receive ongoing product royalties upon launch of the product by GSK. The agreement does not set a specific time by which GSK must launch the product, but does set a specific time for launch after GSK has met some of the intermediate milestones. GSK is permitted to terminate the license agreement at any time for any reason, provided that it pays all milestone payments earned prior to termination. In this event, all rights to the product will revert to the Company. The license agreement grants GSK a right of first refusal to obtain an exclusive license on any new product developments in appetite suppression, weight loss, weight management, or meal replacement for weight loss. The right of first refusal only applies if the Company intends to use a third party to further develop or commercialize the new product, and does not apply if the Company will commercialize the product itself. The right of first refusal will lapse if the Company undergoes a change in control. The Company can continue to sell the SATIETROL line of products until GSK launches their SATIETROL product. At that time, the Company can continue to market the powdered meal replacement product, currently sold under the name SATIETROL COMPLETE(R), without using the SATIETROL name, in the current health food store channels of distribution. GSK will be responsible for future manufacturing, marketing, and sales of any products it launches. GSK also purchased approximately 9% of PHLI's common stock for $1.5 million under a contemporaneous stock purchase agreement. As of June 30, 2002, the Company has received an aggregate $2,750,000 from GSK from the combined licensing and stock purchase agreements. The Company expects to hear from GSK in the 3rd quarter of 2002 as to whether they will continue with the license agreement.

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 in 2003 on a product for use by Type 2 diabetics.

(b) Results of Operations-Three and Six Months Ended June 30, 2002 vs. June 30, 2001

We recorded a net loss of ($44,526), or ($0.01) per share, for the second quarter ended June 30, 2002, compared to net income of $1,475,928, or $0.24 per share, for the second quarter ended June 30, 2001. We recorded a net

loss of ($295,850), or ($0.05) per share, for the six-month period ended June 30, 2002, compared to net income of $981,519, or $0.19 per share, for the six-month period ended June 30, 2001. The net loss in 2002 vs. the net income in 2001 for both the three- and six- month periods ended June 30 is due primarily to decreased revenues. Without taking into account the effect of our initial $1,000,000 license fee from GSK (and any offsetting expenses booked in connection with GSK), discussed below, our net income for the second quarter of 2001 would have been $500,928, or $0.08 per share, and our net income for the six month period ended June 30, 2001 would have been $6,519, or $0.00 per share.

Revenues in the quarter ended June 30, 2002 were $1,818,096 compared to $3,861,613 for the same period in 2001. Revenues in the six-month period ended June 30, 2002 were $2,975,026 compared to $4,471,692 for the same period in 2001. Although total revenues decreased due to decreases in sales of our SATIETROL product line, revenues from our sports performance products were up 29% for the three months ended June 30, 2002 versus the same period in 2001 and up 55% for the six months ended June 30, 2002 versus the same period in 2001. This is due to continued product acceptance and usage as well as our aggressive 2002 marketing and advertising campaign. SATIETROL revenues declined significantly in the three- and six- month periods ending June 30, 2002 versus the same periods in 2001 as in these periods in 2001 we received strong editorial exposure in several national women's magazines. Typically, our products in the SATIETROL category do not receive this type of independent exposure. In the three- and six- month periods ending June 30, 2001, we also recorded $1,000,000 in licensing revenues from GSK for our SATIETROL technology (see above). We had no such licensing revenues in 2002.

Our gross profit margin on product sales increased to 56% for the three months ended June 30, 2002 from 51% for the three months ended June 30, 2001. Our gross profit margin on product sales increased to 54 % for the six-month period ended June 30, 2002 from 50% for the six-month period ended June 30, 2001. The primary reasons for these increases were that, in 2001, sales discounts were given to new customers to increase distribution of our products and payment discounts were offered to customers to accelerate cash flow. Payment discounts stopped during the second quarter of 2001 as the Company improved its cash position.

Our selling, general, and administrative ("S, G, & A") expenses increased to $1,024,723 for the three-month period ended June 30, 2002 from $844,706 for the three-month period ended June 30, 2001. Our S, G, & A expenses increased to $1,842,317 for the six-month period ended June 30, 2002 from $1,601,686 for the six-month period ended June 30, 2001. The primary reason for the increase in S, G, & A expenses in the three-month and six-month periods ended June 30, 2002 compared to the same periods in 2001 was an increase in advertising and promotions expense as we carry out our 2002 marketing plan.

Research and development expenses were $24,523 for the three months ended June 30, 2002 versus $29,080 for the three months ended June 30, 2001. Research and development expenses were $47,360 for the six months ended June 30, 2002 versus $50,843 for the six months ended June 30, 2001. We anticipate research and development expenses will increase as additional clinical trials and studies are conducted on all of our products as we continue to seek out additional patents and claims for our products.

(c) Liquidity and Capital Resources

At June 30, 2002, the Company's current assets exceeded its current liabilities by approximately $4.3 million with a ratio of current assets to current liabilities of approximately 7.3 to 1. Cash decreased $727,338 from December 31, 2001 primarily because of our net loss for the first half of 2002 as well as an increase of $605,489 in accounts receivable from December 31, 2001 which was offset by an increase in accounts payable/accrued expenses of $345,524. Inventory levels increased by $223,737 at June 30, 2002 as compared to December 31, 2001 as we have slightly built up inventory on our sports performance products, as the second and third quarters are our peak seasons for these products.

At June 30, 2002, total inventory included approximately $1,150,000 of SATIETROL. On that date, the SATIETROL inventory had an average remaining shelf life of approximately 2 years. The Company is marketing this inventory to shopping clubs, multi-level marketers, and overseas customers, and believes that it will be able to sell this inventory by the end of 2002.

Based on our current level of operations, we do not see a need for additional cash in the next twelve months. However, we may seek to raise additional cash to fund the launch of the ACCELERADE ready-to-drink product.

II. OTHER INFORMATION

ITEM 2. CHANGES IN SECURITIES

(a), (b) Changes in Securities:

None.

(c) Recent Sales of Unregistered Securities:

None.

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

(a) On June 18, 2002, the Company held its Annual Meeting of Stockholders, pursuant to information contained in the Company's Notice of Annual Meeting of Stockholders and Proxy Statement that were mailed to stockholders on May 24, 2002.

(b) One of the matters listed in the Company's Proxy for the meeting was the annual Election of Directors. There were seven nominees for election who were elected by the shareholders to serve for a one-year term. The results of the balloting were as follows (Shares voting: 5,138,532 of 6,064,203):

Nominee	For	Against	Abstain
Robert Portman	4,878,042	-0-	260,490
Stephen P. Kuchen	4,878,742	-0-	259,790
David Portman	5,128,942	-0-	9,590
T. Colin Campbell	5,128,842	-0-	9,690
Irving Tabachnick	5,129,342	-0-	9,190
Michael Cahr	5,129,342	-0-	9,190
Joseph Harris	5,129,342	-0-	9,190

Although votes for Mr.Tabachnick were tabulated, Mr. Tabachnick passed away before the meeting.

(c) In addition to the election of directors, the other matter voted upon by the stockholders was the ratification of the appointment of Eisner, LLP (formerly Richard A. Eisner & Co., LLP) as independent auditors for the Company for the fiscal year ending December 31, 2002. This matter was approved. The results of the balloting for this matter was as follows:

Matter	For	Against	Abstain
Appointment of auditors	5,121,232	9,300	8,000

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

None.

(b) Reports on Form 8-K:

On April 8, 2002, the Company filed a Current Report on Form 8-K dated April 1, 2002, reporting, under Item 4, a change in our independent auditors from Larson, Allen, Weishair & Co., LLP to Richard A. Eisner & Co. to serve as the independent public accountants to audit the financial statements for the fiscal year ended December 31, 2002.

On April 11, 2002, the Company filed a Current Report on Form 8-K dated April 1, 2002, reporting, under Item 5, the increase in size of the Board of Directors to six and the appointment of Michael Cahr to the Board of Directors. In addition, on this report was the announcement of the Annual Meeting to take place on Tuesday, June 18, 2002 at 10:00 AM local time at the Woodbridge Hilton, Iselin, NJ 08830.

On May 3, 2002, the Company filed a Current Report on Form 8-K dated April 30, 2002, reporting, under Item 5, the increase in size of the Board of Directors to seven and the appointment of Joseph Harris to the Board of Directors.

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 - Finance & CFO
(Principal Financial Officer and
Principal Accounting Officer)

Date: AUGUST 12, 2002

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