ADVANTAGE MARKETING SYSTEMS INC/OK
Form 10-K
March 29, 2004

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

FORM 10-K

(Mark one)
(X) ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2003

( ) 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	73-1016728
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
711 N.E. 39th Street Oklahoma City, Oklahoma	73105
(Address of principal executive offices)	(Zip code)

REGISTRANT'S TELEPHONE NUMBER INCLUDING AREA CODE: (405) 842-0131

SECURITIES REGISTERED UNDER SECTION 12(b) OF THE EXCHANGE ACT:

Title of each class	Name of each exchange on which registered
Common Stock, $0.0001 Par Value	American Stock Exchange

SECURITIES REGISTERED UNDER SECTION 12(g) OF THE EXCHANGE ACT:

Common Stock, $0.0001 Par Value

Indicate by check mark whether the registrant (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 ( )

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes ( ) No (X)

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K ( ).

On June 30, 2003, the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked prices of such common equity was $5,612,436.

As of March 19, 2004 there were 6,690,469 shares of Common Stock, par value $0.0001 per share, outstanding.

Documents incorporated by reference: The information called for by Part III is incorporated by reference to the definitive proxy statement for the registrant's 2004 annual meeting of stockholders, which will be filed with the Securities and Exchange Commission not later than 120 days after December 31, 2003.

ADVANTAGE MARKETING SYSTEMS, INC.
FORM 10-K
For the Fiscal Year Ended December 31, 2003
TABLE OF CONTENTS

** Information required by Part III is incorporated by reference from the Company's definitive proxy statements for its 2004 annual meeting of shareholders.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Certain statements under the captions "Item 1. Business," "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation," and elsewhere in this report 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); our ability to obtain financing for future acquisitions and other factors.

2

PART I

ITEM 1. BUSINESS

Advantage Marketing Systems, Inc., or AMS, began operations in 1987, and through a corporate reorganization in 1995, became an Oklahoma corporation. We develop and distribute performance-based nutritional, weight loss and personal care products. We distribute our products through a network marketing system using independent distributors that we refer to as "associates."

We distribute our products direct to the public through network marketing. We believe that network marketing is the most effective form of distribution for products that require additional information. Person-to-person product education is expensive and not normally available through traditional distribution channels.

Network marketing appeals to a wide cross-section of people, particularly those seeking to supplement income, start a home-based business, or pursue entrepreneurial opportunities other than conventional full-time employment. We consider the attractive compensation plan, monthly cash bonus pools, along with trips, prizes and incentives to be attractive components of the AMS network marketing system.

Our marketing plan is designed to provide financial incentives to build and manage a team of recruited associates in their downline organization.

On an ongoing basis, we review our product line for duplication and sales movement and make adjustments accordingly. As of December 31, 2003, our primary product lines consisted of:

- 34 nutritional products;

- 8 weight management products; and

- 18 personal care products consisting primarily of skin care products.

Our products are manufactured by various manufacturers pursuant to formulations developed for us and are sold to our independent associates located in all 50 states, the District of Columbia and Canada.

We believe that our network marketing system is ideally suited to market nutritional, weight management and personal care products because sales of such products are strengthened by ongoing personal contact between associates and their customers. Associates are given the opportunity through sponsored events and training sessions to network with other associates, develop selling skills and establish personal goals. We supplement monetary incentives with other forms of recognition in order to further motivate and foster an atmosphere of excitement throughout our associate network.

ACQUISITION OF LIFESCIENCE TECHNOLOGIES, INC. ("LST")

Effective January 4, 2001, we purchased the LST group of companies for $1.2 million and a five-year payment of $41,667 per month or 5% of the gross sales of LST products, whichever is greater. The seller had the option to take up to 860,000 shares of common stock in lieu of cash at an option price of $3.00 per share, which was never exercised. As a result of the acquisition, we added 14 products and over 5,000 associates. We paid the remaining balance of the acquisition cost, plus accrued interest on January 29, 2004.

KEY OPERATING STRENGTHS

Our principal objective is to be a leading developer and distributor of weight loss products and performance-based wellness systems. Our strategy to achieve this objective and maintain our position in the industry is to capitalize on our operating strengths, which include the development and sale of

performance-based products, a strong product development capability, an attractive compensation plan for associates, and an experienced management team.

Performance-based Products. We have developed a line of high-quality health products based on industry demand. We believe that the development and delivery of essential vitamins, minerals, and other supplements will help individuals achieve top physical, mental and emotional performance.

Product Development. Our product development effort is based on the identification of next generation health discoveries, anticipation of consumer demand and the acquisition of completed and tested new product technology. Our management team continually:

- Investigates health, performance and industry trends for new natural extracts and formulated products;
- Searches for formulations and ingredients that may be candidates for new products;
- Identifies and compares existing and newly identified nutritional supplements;
- Updates and improves existing products as new discoveries in nutrition are made; and
- Prepares products to comply with regulatory requirements of international markets we enter.

Manufacturing. We outsource all manufacturing of our own products for the following reasons:

- Quality control is easier to monitor at established facilities;
- The market for quality services in the marketplace is competitive and attractive; and
- We believe our financial resources are better allocated to product development, marketing services and sales support.

Attractive Associate Compensation Plan and Benefits. We are committed to providing a highly competitive compensation plan to attract and retain associates, who constitute our sales force. We believe the AMS associate compensation plan is one of the most financially rewarding in the network marketing industry. We pay daily incentives for recruiting new associates and weekly commissions for product sales. The AMS compensation plan is a consistent plan, meaning associates can recruit and receive compensation daily and weekly for their business in any market in which we conduct business. To drive sales, plus provide product information and team management skills for associates, we sponsor events throughout the year which offer information about our products and the network marketing system. These meetings are designed to assist new associates with business development and provide a forum for product development, in addition to providing interaction with successful associates and our management.

Experienced Management Team. Our management team includes individuals with expertise in various managerial disciplines, including marketing, customer service, information technology, finance and operations. The current executive management team is responsible for developing an infrastructure to support rapid growth, strengthening our financial condition, and improving operational controls.

GROWTH STRATEGY

We seek to grow our business by pursuing the following strategies:

New Associate and Preferred Customer Recruiting, Training and Development. We recognize the need to aggressively grow our associate sales force, thereby building new sales. In 2003, we re-launched the Company to the industry after restructuring the marketing, sales and internet business strategies. We focused on the development and distribution of performance-based nutrition and weight loss products that will allow consumers to see and feel the difference, and others to noticeably recognize the difference in them within a

short period of time. We recognize the value that repositioning offers, backed by our exclusive core products: AM-300, Prime One, Prime One Concentrate and ToppFast.

With new product packaging, new leadership and an enhanced commission plan for recruiting, we are focused on building the associate customer base and assisting associates in building their businesses and have declared 2004 "The Year of Recruiting". This focus includes the introduction of a monthly cash bonus pool targeted at new associate recruiting, the establishment of two, 24 hour-a-day, seven day-a-week Internet sites and weekly hotel opportunity meetings intended to present the business opportunity to potential associates. During 2003, we focused on associate recruiting by introducing two Internet marketing systems, with training approved and supported by the Company. We launched a cutting edge recruiting and product selling website for associates as well as an advanced lead generation and recruiting marketing site that allows associates to market online for new customers and associates.

As a result of this focus, we are positioned to increase associate enrollments in fiscal year 2004. In an effort to aggressively attract and retain associates, we intend to continue to introduce new performance-based products that deliver noticeable results, to enhance the compensation plan, to introduce Internet marketing, to introduce duplicatable sales tools, to expand weekly meetings and to enhance infrastructure to promote customer service levels.

New Market Entry. We believe that, in addition to the U.S. and Canadian markets, significant growth opportunities continue to exist in international markets. We intend to select new markets following an assessment of several factors including market size, anticipated demand for AMS products, receptivity to network marketing, and ease of entry, which includes consideration of possible regulatory restrictions on our products or network marketing system. We will begin preparation for further international expansion as sales leadership develops. We envision a seamlessly integrated associate compensation plan in each market that allows associates to receive commissions for global sales. This seamless downline (associate's sales organization, including the associate's recruits and their recruits) structure would be designed to allow an associate to build a global network by creating downlines across national borders. Associates would not be required to establish new downlines or to re-qualify for higher levels of compensation in newly opened markets. We believe that going to a seamless compensation plan provides significant motivation and reward for associates to expand internationally by entering these new markets.

New Product Introduction. Using our marketing demand and development capabilities, we will continue to introduce new products and continuously enhance existing products. Products introduced in 2003 include AM-300 Fat Burning Solution, Spark of Life -daily liquid nutritional, Topp Fast meal replacement shakes, Prime Plus anti-catabolic lean muscle enhancer, Vital Chelates Plus, The Sorgente Trio Non-Surgical facelift and Coral Calcium. Our practice is to introduce new products, primarily at Company-sponsored events, based on demand.

Strategic Acquisitions. We believe that attractive acquisition opportunities may arise in the future. We intend to pursue strategic acquisition opportunities that would grow our customer base, expand product lines, enhance manufacturing and technical expertise, allow vertical integration, or otherwise complement our business or further our strategic goals.

INDUSTRY OVERVIEW

The nutrition industry includes many small- and medium-sized companies that manufacture and distribute products generally intended to maintain the body's health and general well being. The four major product categories within the nutrition industry are as follows:

- Nutritional Supplements - products such as vitamins and minerals, sports performance enhancers, meal replacements, dietary supplements, herbs and botanicals, and compounds derived from these substances;

- Natural and Organic Foods - products such as cereals, milk, non-dairy beverages, and frozen entrees;

- Functional Foods - products with added ingredients or fortification specifically for health or performance purposes; and
- Natural Personal Care - products combining nutrition with skin care.

We believe that the nutrition industry is being fueled by the following:

- The public's exposure to more widely accepted natural and homeopathic alternatives;
- The desire to slow down the aging process;
- The national and worldwide trend toward preventive health care combining Eastern and Western medicine; and
- The rapid product introductions taking place in response to scientific research fueled by new demand.

Nutritional products are distributed through six major sales channels. Each channel has changed in recent years, primarily due to advances in technology and communications, resulting in improved product distribution and faster dissemination of information. The major sales channels are as follows (AMS associates participate in four of the six channels listed below):

- Mass market retailers, including mass merchandisers, drug stores, supermarkets and discount stores;
- Natural health food retailers;
- Network marketing;
- Mail order;
- Healthcare professionals and practitioners; and
- The Internet.

PRODUCTS

Our primary product lines include nutritional, weight management and personal care. We currently market approximately sixty products, exclusive of variations in product size, colors or similar variations of our basic product line.

Nutritional. This product line includes antioxidants, minerals, vitamins, and other nutritional supplements. The nutritional supplement products are designed to provide optimal absorption, bioavailability, and efficacy. During the years ended December 31, 2003, 2002 and 2001, 44.9%, 40.2% and 38.9% of our net sales were derived from the 34 products in the nutritional category, which contain herbs, vitamins, minerals and other natural ingredients. The top-selling products in this category are Prime One, Prime One Concentrate and Spark of Life liquid nutritional which totaled approximately 16.0%, 3.8% and 4.3%, respectively, of net sales in fiscal year 2003.

Weight Management. This product line was developed to provide a comprehensive approach to weight management including the AM-300 family of weight loss supplements, along with weight loss systems. During the years ended December 31, 2003, 2002 and 2001, the weight management category represented 48.0%, 51.8% and 54.7% of our net sales. Sales were derived from the eight products in the weight management category that we market under the Advantage Marketing Systems label.

Personal Care. This product line includes scientifically developed natural products designed to support healthy skin and hair. Products in this line include those from the Chambre International line and products acquired from Dr. Robert Nakamura and Immudyne Inc. The three-product wrinkle and facial-line reducing system is called "Nino Sorgente Skin Care" and includes eye serum, facial serum and daily moisturizer. During the years ended December 31, 2003, 2002 and 2001, 2.8%, 2.9% and 1.5% of our net sales were derived from the 18 products in the personal care category.

Promotional Materials. In addition to these three principal product lines, we have developed and sell to associates materials and online tools designed to assist them in building their business and selling products. These sales aids are generally written and produced by AMS and include product audio tapes, CD ROM'S, video tapes, brochures and business forms designed by us and printed by outside publishers. We periodically contract with authors and publishers to produce or provide books, tapes, and other items dealing with health topics and personal motivation, which are made available to associates.

New associates are required to purchase an enrollment packet containing training materials that assist in beginning and growing a business. Associates do not earn commissions on the sale of sales aids or enrollment packets.

Other Products and Services. Prior to focusing on nutritional, weight management and personal care products in October 1993, we marketed various packages of consumer benefit services provided by third-party providers. The only remaining benefit service we offer is a pre-paid legal service. The pre-paid legal services are provided by Pre-Paid Legal Services, Inc. This program membership represented less than 1% of our net sales during 2003, 2002 and 2001.

New Product Identification. We are committed to continuous product innovation and improvement through market demand and products backed by science. The mission of our science and product development is to develop, for target groups, advanced wellness products that deliver performance-based results around our core peak performance and weight loss focus. That is, products that deliver noticeable results, slow the aging process, reduce the risk of chronic illness, and promote long-term health. New product ideas and research efforts are supported using a combination of our advisory talent and research, third-party studies and sponsored research. We intend to dedicate resources for the science and development of new products and reformulation of existing products. Prior to introducing new products, we investigate product formulation as it relates to regulatory compliance and other issues.

For products on which we acquire the distribution or ownership rights, we maintain and access any and all science and research related to those products. For example, the acquisition of Prime One brought over 45 years of research and thousands of trials and studies on the Prime One products and ingredients. The distribution rights for Immudyne's Sorgente skin care system brought the use of patents, studies and documentation for use in our marketing effort.

We maintain an advisory relationship with Dr. Robert Nakamura, and also rely upon the product development staff of Chemins Company, Inc. and other manufacturers, independent researchers, vendor research departments and others for such services. When a new product concept is identified or when an existing product must be reformulated, the new product concept or reformulation project is generally submitted to Chemins for technical development and implementation. We continually review our existing products for potential enhancements to improve their effectiveness and marketability. While we consider our product formulations to be proprietary trade secrets, such formulations are not patented. Accordingly, there is no assurance that another company will not replicate one or more of our products.

Product Procurement and Distribution; Insurance. Essentially all of our product line in the weight management category is manufactured by Chemins Company, Inc. utilizing our product formulations. Naturtech manufactures our nutritional product line, and essentially all of our product line in the personal care category is manufactured by GDMI, Inc. and Columbia Cosmetics, Inc.

All our vendors have assured us that they conduct quality control processes, and laboratory analysts test for biological contamination of raw materials and finished goods. In the analytical chemistry laboratory, analysts test for chemical contamination and accurate active ingredient levels of raw materials and finished products. Both laboratories conduct stability tests on finished products to determine product shelf life.

We have not generally entered into long-term supply agreements with the manufacturers of our product line or the third-party providers of our consumer benefit services. However, we customarily enter into contracts with our manufacturers and suppliers to establish the terms and conditions of purchases. Our arrangements with Chemins Company, Inc. may be terminated by either party upon the completion of any outstanding purchase orders. Therefore, there can be no assurance that Chemins will continue to manufacture our products or provide research, development and formulation services. In the event the relationship with any of our manufacturers becomes impaired, we will be required to obtain alternative manufacturing sources for our products. In such event, there is no assurance that the manufacturing processes of our current manufacturers can be replicated by another manufacturer. Although we have not previously experienced product unavailability or supply interruptions, we believe that we would be able to obtain alternative sources for our nutritional, weight management and personal care products. A significant delay or reduction in availability of products, however, could have a material adverse effect on our business, operating results and financial condition.

Most of the raw materials used in the manufacture of our products are available from a number of suppliers. We have not generally experienced difficulty in obtaining necessary quantities of raw materials. When supplies of certain raw materials have tightened, we have been able to find alternative sources as needed, and believe we will be able to do so in the future if the need arises.

We, like other marketers of products that are intended to be ingested, face an inherent risk of exposure to product liability claims in the event that the use of our products results in injury. We maintain a claims made policy, with limited product liability insurance with coverage limits of $1,000,000 per occurrence and $2,000,000 in the aggregate. Products containing ephedra, which represented 35.9% of our 2003 net sales, are not covered by our product liability insurance. Although we do not obtain contractual indemnification, our product manufacturers carry product liability insurance that covers our products. Product liability claims in excess of insurance coverage may result in significant losses, which would adversely affect product sales, results of our operations, financial condition and the value of our common stock.

All of the items in our product line include a customer satisfaction guarantee. Within 30 days of purchase, any retail customer or associate who is not satisfied with our product for any reason may return it or any unused portion to the associate from whom it was purchased or to us for a full refund or credit toward the purchase of another product. Associates may obtain replacements from us for products returned to them by retail customers if they return such products on a timely basis. Furthermore, in most jurisdictions, we maintain a buy-back program. Under this program, we will repurchase products sold to an associate, subject to a 10% restocking charge, provided the associate resigns and returns the product in marketable condition within 12 months of original purchase, or longer where required by applicable state law or regulations. We believe this buy-back program addresses a number of the regulatory compliance issues pertaining to network marketing systems. For the years ended December 31, 2003, 2002 and 2001, the cost of products returned to us was 0.9%, 0.6% and 1% of gross sales.

Our product line is distributed principally from our facilities in Oklahoma City or from our regional support centers. Products are warehoused in Oklahoma City and at selected regional support centers.

NETWORK MARKETING

We market and distribute our products through a network marketing system and sell directly to associates and preferred customers. At December 31, 2003, we had approximately 18,552 "active" associates. To be considered "active" an associate must have purchased $50 in products or $22 on autoship of our products within the preceding 90 days. Network marketing is a form of person-to-person direct selling through a network of vertically organized independent distributors who purchase products at wholesale prices from the manufacturer for resale to retail consumers. The emergence of readily available means of mass communication such as personal computers, facsimiles, low-cost long distance telephone services, and the Internet have

contributed to the rapid growth of network marketing. The concept of network marketing is based on the strength of personal recommendations that frequently come from friends, neighbors, relatives, and close acquaintances. We believe that network marketing is an effective way to distribute our products because it allows person-to-person product education, which is not as readily available through other distribution channels. We believe our network marketing system appeals to a broad cross-section of people, particularly those seeking to:

- Supplement family income;
- Start a home business; or
- Pursue employment opportunities other than conventional, full-time employment.

A majority of our associates therefore sell our products on a part-time basis.

We believe that our network marketing system is ideally suited to market our product line because sales of such products are strengthened by ongoing personal contact between retail consumers and associates, many of whom use our products themselves. Sales are made through direct personal sales presentations as well as presentations made to groups in a format known as "opportunity meetings." These sales methods are designed to encourage individuals to purchase our products by informing potential customers and associates of our product line and results of personal use, and the potential financial benefits of becoming an associate. The objective of the marketing program is to develop a broad based network marketing organization within a relatively short period. Our marketing efforts are typically focused on middle-income families and individuals.

Our network marketing program encourages individuals to develop their own downline network marketing organizations. Each new associate is either linked to:

- The existing associate that personally enrolled the new associate into our network marketing organization; or

- The existing associate in the enrolling associate's downline as specified at the time of enrollment.

Growth of an associate's downline organization is dependent on the recruiting and enrollment of additional associates within such associate's downline organization.

Associates are encouraged to assume responsibility for training and motivation of others within their downline organization and to conduct opportunity meetings as soon as they are appropriately trained. We strive to maintain a high level of motivation, morale, enthusiasm and integrity among the members of our network marketing organization. We believe this result is achieved through a combination of products, sales incentives, personal recognition of outstanding achievement and quality promotional materials. Under our network marketing program, associates purchase sales aids and brochures from us and assume the costs of advertising and marketing our product line to their customers as well as the direct cost of recruiting new associates. We believe that this form of sales organization is cost efficient because our direct sales expenses are primarily limited to the payment of bonuses, which are only incurred when products are sold.

We continually strive to improve our marketing strategies, including the compensation structure within our network marketing organization and the variety and mix of products in our line, to attract and motivate associates. These efforts are designed to increase monthly product sales and the recruiting of new associates.

To aid associates in easily meeting the monthly personal product purchase requirement to qualify for bonuses, we developed the "autoship" in 1994. Under the autoship purchasing arrangement, associates establish a standing product order for an amount in excess of $22 that is automatically charged to their credit card or deducted from their bank account for goods shipped that month. At December 31, 2003, 2002, and 2001, we had approximately 16,343, 23,051, and 27,912 associates participating in the autoship.

Our bonus structure provides for payment of bonuses on product purchases made by other associates in an associate's downline organization. Associates derive income from several sources:

- First, associates earn profits by purchasing from our product line at wholesale prices (which are discounted up to 40% from suggested retail prices) and selling to customers at retail;

- Second, associates earn profits from the products sold in the sign-up of new associates from our enroller bonuses and lucrative coding bonuses, which are tied to the downline organization;

- Third, associates who establish their own downline organization may earn bonuses of up to 36% of bonus value on product purchases by associates within the first four levels of their downline organization;

- Fourth, associates who have $600 per month of product purchases on their first and second levels combined, become directors and have the opportunity to build an additional director downline organization and receive additional bonuses of 4% of bonus value on product purchases by such downline organization;

- Fifth, associates who have $1,200 per month of product purchases on their first and second levels combined, two director legs and $2,500 wholesale volume monthly in their downline, become silver directors and have the opportunity to build an additional silver director downline organization and receive additional bonuses of 5% of bonus value on product purchases by such downline organization;

- Sixth, associates who have $1,800 per month of product purchases on their first level and second levels combined, two silver legs and have a total of $5,000 wholesale volume monthly in their downline, become gold directors and have the opportunity to receive an additional bonus of 3% of bonus value on product purchases by their silver director downline organization. In addition, gold directors have the opportunity to receive generation bonuses of up to 3% of bonus value on the product purchases by associates of silver director downline organizations that originate from their silver director downline organization through four generations; and

- Seventh, associates who maintain the gold director requirements and develop three gold directors, each one from a separate leg of their downline organization plus $40,000 wholesale volume in downline organization, become platinum directors and have the opportunity to build an additional platinum director downline organization and receive additional bonuses of 5% of bonus value on product purchases by such downline organization.

Combining these levels of bonuses, our total "pay-out" on products subject to bonuses is approximately 63% of the bonus value of product sales, and 42.1% of total sales.

Each associate in our network marketing organization has a director, a silver director, a gold director and a platinum director. Each director has a silver director, a gold director and a platinum director. Each silver director has a gold director and a platinum director. Each gold director has a platinum director. As of December 31, 2003, we had 295 silver directors, 393 gold directors and 50 platinum directors.

Under our regional support center program, we designate associates to serve as regional support center directors and provide them special training and support. Each regional support center director functions as a product distribution center for our products. As of December 31, 2003, we had 38 regional support center directors.

We maintain a computerized system for processing associate orders and calculating bonus payments which enable us to remit such payments promptly. We believe that prompt and accurate remittance of bonuses is vital to recruiting and maintaining associates, as well as increasing their motivation and loyalty to us. We make weekly bonus payments based upon the previous week's product purchases, while most network marketing companies only make monthly bonus payments. During 2003, 2002 and 2001, we paid bonuses to 6,824, 8,909 and 11,814 associates, in the aggregate amounts of $7,504,420, $9,414,421 and $11,403,519, respectively.

We are committed to providing the best possible support to our associates. Associates in our network marketing organization are provided training guides and are given the opportunity to participate in our training programs. We sponsor regularly scheduled conference calls for our platinum directors which include testimonials from successful associates and satisfied customers as well as current product and promotional information. We produce a monthly newsletter which provides information on our products and network marketing system. The newsletter is designed to help recruit new associates by answering commonly asked questions and includes product information and business building information. The newsletter also provides a forum for additional recognition of associates for outstanding performance. In addition, we regularly sponsor training sessions for our associates across the United States. At these training sessions, associates are provided the opportunity to learn more about our product line and selling techniques so they can build their businesses more rapidly. We produce comprehensive and attractive four color catalogues and brochures that display and describe our product line. We maintain a web page at www.amsonline.com, which provides general company information along with product line and network marketing system information.

From time to time, associates fail to adhere to the AMS policies and procedures, including those governing the marketing of our products or representations regarding the compensation plan. We systematically review reports of alleged associate misbehavior. Infractions of the policies and procedures are reported to a compliance committee that determines what disciplinary action may be warranted in each case. If we determine that an associate has violated any of the AMS policies and procedures, we may take a number of disciplinary actions. For example, we may terminate the associate's purchase and distribution rights completely, or impose sanctions such as warnings, fines, or probation. We may also withdraw or deny awards, suspend privileges, withhold commissions until specific conditions are satisfied, or take other appropriate actions at our discretion. An in-house compliance department also routinely reviews associate activities.

We believe that the ability to efficiently manage distribution, compensation, manufacturing, inventory control, and communications functions through the use of sophisticated and dependable information processing systems is critical to our success. To optimally support our customer base and core business processes, our information technology resources consist of a customized, Web-enabled order-entry system and an integrated system to manage inventory, production planning, fulfillment, and financial information. Our information systems are maintained by in-house staff and outside consultants. These systems are designed to provide, among other things, financial and operating data for management, timely and accurate product ordering, bonus payment processing, inventory management and detailed associate records. Since 1994, we have invested more than $2,700,000 to enhance our computer and telecommunications systems.

REGULATION

In the United States, as well as in any foreign markets in which we may sell our products, we are subject to laws, regulations, administrative determinations, court decisions and similar restrictions at the federal, state and local levels, collectively known as "regulations". These regulations include and pertain to, among other things:

- The formulation, manufacturing, packaging, labeling, advertising, distribution, importation, sale and storage of our products;

- Our product claims and advertising, including direct claims and advertising as well as claims and advertising by associates, for which we may be held responsible; and

- Our network marketing organization.

Products. The formulation, manufacturing, packaging, labeling, advertising, distribution and sale and storage of our products are subject to regulation by a number of governmental agencies. The federal agencies include the Food and Drug Administration, or FDA, the Federal Trade Commission, or FTC, the Consumer Product Safety Commission, the United States Department of Agriculture and the Environmental

Protection Agency. Our activities are also regulated by various codes and agencies of the states, localities and foreign countries in which our products are or may be manufactured, distributed or sold. The FDA, in particular, regulates the formulation, manufacturing and labeling of dietary supplements, cosmetics and skin care products, including some of our products.

The Dietary Supplement Health and Education Act of 1994, or DSHEA, revised the provisions of the Federal Food, Drug and Cosmetic Act, or FFDCA, concerning the composition and labeling of dietary supplements, which we believe is generally favorable to the dietary supplement industry. DSHEA created a new statutory category of products, or "dietary supplements." This new category includes vitamins, minerals, herbs, amino acids and other dietary substances for human use to supplement the diet. However, DSHEA grandfathered, with certain limitations, dietary ingredients that were on the market before October 15, 1994. A dietary supplement containing a new dietary ingredient and placed on the market on or after October 15, 1994 must have a history of use or other evidence establishing a basis for expected safety. Manufacturers of dietary supplements using a "structure-function" statement or claim must have substantiation that the statement is truthful and not misleading.

The majority of our sales come from products that are classified as dietary supplements under the FFDCA and DSHEA. The labeling requirements for dietary supplements have been set forth in final regulations, with respect to labels affixed to containers, effective March 23, 1999. These regulations include how to declare nutrient content information, and the proper detail and format required for the "Supplement Facts" box. During 1999, we revised our product labels to be in compliance with these regulations. Many states have also recently become active in the regulation of dietary supplement products. These states may require modification of labeling or formulation of certain of our products sold in these states, e.g. Texas and California.

In addition, on January 6, 2000, the FDA published a Final Rule on permissible structure/function statements to be placed on labels and in brochures. Structure/function statements are claims of the benefit or positive effect of a product or an ingredient on the body's structure or function. This regulation does not significantly change the way that the FDA interprets structure/function statements. Thus, we did not make any substantial label revisions based on this regulation regarding any of our structure/function product statements. We believe that AMS has adequate substantiation for all label claims used.

Ehpedra. As a marketer of products that are ingested by consumers, we are subject to the risk that one or more of the ingredients in our products may become the subject of adverse regulatory action. For example, one of the ingredients in our AM-300 product is Ephedra, an herb that contains naturally-occurring ephedrine alkaloids. Our manufacturer uses a powdered extract of that herb when manufacturing AM-300. We market AM-300 principally as an aid in weight management. The extract is an 8% extract, which means that every 100 milligrams of the powdered extract contains approximately eight milligrams of naturally occurring ephedrine alkaloids. Ephedrine-containing dietary supplements have been the subject of adverse publicity in the United States and other countries relating to alleged harmful effects, or adverse events.

On February 11, 2004, the 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 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 is April 12, 2004. The Company will comply with the new regulation and cease all sales and advertisement of AM-300 and any other ephedra-containing supplement on April 12, 2004. Anticipating the eventuality of a total ban, over a year ago AMS formulated an Ephedra-free AM-300 for weight loss. After April 12, 2004, this non-ephedra product will still be permitted, and we expect strong sales. For the future, the FDA has indicated that it will now consider whether alternatives to Ephedra, 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 our 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 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 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. Our AM-300 labels comply with this regulation. Again, after April 12, 2004, no sales of ephedrine-containing supplements are 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, our manufacturer will be required to adhere to them. The FDA will most likely institute an effective date for the GMPs which will allow our 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 AMS website must not contain disease claims or drug claims, but only permissible structure/function claims. The 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 claim, whether express (direct) or implied, must be substantiated by reliable and competent scientific evidence. Because our website must comply with both FDA and FTC regulations, we routinely ask our regulatory compliance counsel to review certain web pages, especially the content of new product promotions. When necessary, our 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. AMS also requires associate websites to be in compliance with FDA and FTC regulations. As such, and to ensure Internet compliance, associates may only copy or link to our corporate website. Any independent websites are absolutely unauthorized, and their creators are solely liable for defending any regulatory enforcement actions.

In markets outside the United States, prior to commencing operations or marketing products, we may be required to obtain approvals, licenses, or certifications from a country's ministry of health or comparable agency. Approvals or licensing may be conditioned on reformulation of AMS products for the market or may be unavailable with respect to certain products or product ingredients. We must also comply with local product labeling and packaging regulations that vary from country to country. Foreign regulatory requirements have not placed a significant burden on our ability to operate in current foreign countries.

Product Claims and Advertising. Advertising of products is subject to regulation by the FTC under the FTC Act. Section 5 of the FTC Act prohibits unfair methods of competition and unfair or deceptive acts or practices in or affecting commerce. Section 12 of the FTC Act provides that the dissemination of, or causing to be disseminated, any false advertisement pertaining to drugs or foods, which would include dietary supplements, is an unfair or deceptive act or practice. Under the FTC's Substantiation Doctrine, an advertiser is required to have a "reasonable basis" for all objective product claims before the claims are made. Failure to adequately substantiate claims may be considered either deceptive or unfair practices. Pursuant to this FTC requirement, we are required to have adequate substantiation for all material advertising claims made for our products.

In recent years the FTC has initiated numerous investigations of and actions against dietary supplement, weight management, and cosmetic products and companies. The FTC has issued a guidance

document to assist companies in understanding and complying with the substantiation requirement. We have organized the documentation to support our advertising and promotional practices in compliance with these guidelines.

The FTC may enforce compliance with the law in a variety of ways, both administratively and judicially, using compulsory process, cease and desist orders, and injunctions. FTC enforcement can result in orders requiring, among other things, limits on advertising, corrective advertising, consumer redress, divestiture of assets, rescission of contracts, and such other relief as the agency deems necessary to protect the public. Violation of these orders could result in substantial financial or other penalties. We have not been notified that we were the subject of any action by the FTC, but any action in the future by the FTC could materially adversely affect our ability to successfully market our products.

Compliance Efforts. We attempt to remain in full compliance with all applicable laws and regulations governing the manufacture, labeling, sale, distribution, and advertising of our dietary supplements. We retain special legal counsel for advice on both Food and Drug Administration and Federal Trade Commission legal issues. In particular, we work closely with special legal counsel who specializes in Dietary Supplement Health and Education Act regulations for label revisions, content of structure/function statements, advertising copy, and also the position of the Food and Drug Administration on ephedra-containing products.

Network Marketing System. Laws and regulations in each country in which we operate prevent the use of deceptive or fraudulent practices that have sometimes been inappropriately associated with legitimate direct selling and network marketing activities. These laws include anti-pyramiding, securities, lottery, referral selling, anti-fraud and business opportunity statutes, regulations, and court cases. Illegal schemes, typically referred to as "pyramid," "chain distribution," or "endless chain" schemes, compensate participants primarily or solely for the introduction or enrollment of additional participants into the scheme. Often these schemes are characterized by large up-front entry or sign-up fees, over-priced products of low value, little or no emphasis on the sale or use of products, high-pressure recruiting tactics, and claims of huge and quick financial rewards requiring little or no effort. Generally these laws are directed at ensuring that product sales ultimately are made to consumers and that advancement within sales organizations is based on sales of the enterprise's products, rather than investments in the organizations or other non-retail sales related criteria or activity. Where required by law, we obtain regulatory approval of our network marketing system, or, where approval is not required or available, the favorable opinion of local counsel as to regulatory compliance.

We currently have independent associates in all 50 states, the District of Columbia, and Canada. In addition to federal regulation in the United States, each state has enacted its own "Little FTC Act" to regulate sales and advertising. Occasionally we receive requests to supply information regarding our network marketing plan to regulatory agencies. Although we have from time to time modified our network marketing system to comply with interpretations of various regulatory authorities, we believe that our network marketing program is in compliance with laws and regulations relating to network marketing activities in our current markets. Nevertheless, we remain subject to the risk that, in one or more of our present or future markets, the marketing system or the conduct of certain associates could be found not to be in compliance with applicable laws and regulations. Failure by an associate or us to comply with these laws and regulations could have a material adverse effect on our business in a particular market or in general. Any or all of these factors could adversely affect the way we do business and could affect our ability to attract potential associates or enter new markets. In the United States, the FTC has been active in its enforcement efforts against both pyramid schemes and legitimate network marketing organizations with certain legally problematic components, having instituted several enforcement actions resulting in signed settlement agreements and payment of large fines. Although to our knowledge, we have not been the target of an FTC investigation, there can be no assurance that the FTC will not investigate us in the future. Noncompliance with applicable laws and regulations could:

- Result in enforcement action and imposition of penalties;

- Require modification of our network marketing system;

- Result in negative publicity; or

- Have a negative effect on associate morale and loyalty.

Any of these consequences could have a material adverse effect on our sales as well as our financial condition.

We cannot predict the nature of any future law, regulation, interpretation, or application, nor can we predict what effect additional governmental legislation or regulations, judicial decisions, or administrative orders, when and if promulgated, would have on our business in the future. It is possible that future developments may require that we revise our network marketing program. Any or all of these requirements could have a material adverse effect on our business, results of operations, and financial condition.

We are subject to the risk of challenges to the legality of our network marketing system by our associates, both individually and as a class. Generally such challenges would be based on claims that our network marketing system was operated as an illegal "pyramid scheme" in violation of federal securities laws, state unfair practice and fraud laws and the Racketeer Influenced and Corrupt Organizations Act.

Two important Federal Trade Commission cases have established legal precedent for determining whether a network marketing system constitutes an illegal pyramid scheme. The first, IN RE KOSCOT INTERPLANETARY, INC., 86 F.T.C. 1106 (1975), set forth a standard for determining whether a marketing system constituted a pyramid scheme. Under the KOSCOT standard, a pyramid scheme is characterized by the participants' payment of money to a company in return for:

- The right to sell a product; and

- The right to receive, in return for recruiting other participants into the program, rewards that are unrelated to sales of the product to ultimate users.

Applying the KOSCOT standard in IN RE AMWAY CORP., 93 F.T.C. 618 (1979), the Federal Trade Commission determined that a company will not be classified as operating a pyramid scheme if the company adopts and enforces policies that in fact encourage retail sales to consumers and prevent "inventory loading". Inventory loading occurs when associates purchase large quantities of non-returnable inventory to obtain the full amount of compensation available under the system. In AMWAY, the Federal Trade Commission found that the marketing system of Amway Corporation did not constitute a pyramid scheme, noting the following Amway policies:

- Participants were required to buy back, from any person they recruited, any saleable, unsold inventory upon the recruit leaving Amway;

- Every participant was required to sell at wholesale or retail at least 70% of the products bought in a given month in order to receive a bonus for that month; and

- In order to receive a bonus in a month, each participant was required to submit proof of retail sales made to 10 different consumers.

We believe that our network marketing system is not classified as a pyramid scheme under the standards set forth in KOSCOT, AMWAY, and other applicable law. In particular, in most jurisdictions, we maintain an inventory buy-back program to address the problem of inventory loading. Pursuant to this program, we repurchase products sold to an associate (subject to a 10% restocking charge) provided that the associate:

- Resigns; and

- Returns the product in marketable condition within 12 months of original purchase, or longer where required by applicable state law or regulations.

Our literature provided to associates describes our buy-back program. In addition, pursuant to agreements with our associates, each associate represents that at least 70% of the products he or she buys will be sold to non-associates. However, as is the case with other network marketing companies, the bonuses paid by us to our associates are based on product purchases including purchases of products that are personally consumed by the downline associates. Basing bonuses on sales of personally consumed products may be considered an inventory loading purchase. Furthermore, associates' bonuses are based on the wholesale prices received by us on product purchases or, in some cases based upon the particular product purchased, on prices less than the wholesale prices.

In the event of challenges to the legality of our network marketing system by associates, we would be required to:

- Demonstrate that our network marketing policies are enforced; and

- That the network marketing system and associates' compensation thereunder serve as safeguards to deter inventory loading and encourage retail sales to the ultimate consumers.

In WEBSTER V. OMNITRITION INTERNATIONAL, INC., 79 F.3d 776 (9th Cir. 1996), the United States Court of Appeals held that a class action brought against Omnitrition International, Inc., a multilevel marketing seller of nutritional supplements and skin care products, should be allowed to proceed to trial. The plaintiffs, former associates of Omnitrition's products, alleged that Omnitrition's selling program was an illegal pyramid scheme and claimed violations of Racketeer Influenced and Corrupt Organizations Act and several federal and state fraud and securities laws. Despite evidence that Omnitrition complied with the AMWAY standards, the court ruled that a jury would have to decide whether Omnitrition's policies, many of which apparently were similar to compliance policies adopted by us, were adequate to ensure that Omnitrition's marketing efforts resulted in a legitimate product marketing and distribution structure and not an illegal pyramid scheme. We believe that our marketing and sales programs differ in significant respects from those of Omnitrition, and that our marketing program complies with applicable law. The two most significant differences are:

- The Omnitrition marketing plan required associates to purchase $2,000 in merchandise in order to qualify for bonuses as compared to $22 on autoship under our marketing program; and

- The Omnitrition inventory repurchase policy was limited to products that were less than three months old as compared to one year under our inventory repurchase policy.

Lessons from the OMNITRITION case are that:

- A selling program which operates to generate only the minimum purchases necessary to qualify for bonuses is suspect; and

- A selling program must operate to generate purchases independently of the payment of bonuses in order to have a legitimate product marketing and distribution structure.

We believe that our selling program operates to generate significant purchases "for intrinsic value" as demonstrated by our sales figures. During the month of December 2003, 18,552 of our associates placed a total of 22,085 orders averaging $61 in size while only a single $22 on autoship per month is necessary to qualify for bonuses. In view of the holding of the court of appeals in the OMNITRITION case, however, there is no assurance that, if challenged, we would prevail against private plaintiffs alleging violations of anti-pyramid and securities laws. A final ruling against us in such a suit could result in the imposition of a material liability against us. Moreover, even if we were successful in defending against such suit, the costs of such defense, both in dollars spent and in management time, could be material and adversely affect our operating results. In addition, the negative publicity of such a suit could adversely affect our sales and ability to attract and retain associates.

Nutrition for Life International, Inc., one of our competitors and a multilevel seller of personal care and nutritional supplements, announced in January 1997, that it had settled class action litigation brought by associates alleging fraud in connection with the operation of a pyramid scheme. Nutrition for Life paid in excess of $3 million to settle claims brought on behalf of its associates, and related securities fraud claims brought on behalf of certain purchasers of its stock.

We believe that our marketing program is significantly different from the program allegedly promoted by Nutrition for Life and that our marketing program is not in violation of anti-pyramid laws or regulations. Two issues in the Nutrition for Life matter were a $1,000 buy-in urged on new recruits, and the paying of commissions on product vouchers prior to the actual delivery of product. By design, our marketing program offers no incentive to anyone to make a large personal purchase nor do we use product vouchers. Actual average order size in December 2003 was $61. However, there is no assurance that claims similar to the claims brought against Nutrition for Life and other multilevel marketing organizations will not be brought against us, or that we will prevail in the event any such claims were made. Furthermore, even if we were successful in defending against any such claims, the cost of conducting such a defense, both in dollars spent and in management time, could be material and adversely affect our operating results and financial condition. In addition, the negative publicity of such a suit could adversely affect our sales and ability to attract and retain associates.

INTELLECTUAL PROPERTY

Trademarks. We have developed and use registered trademarks in our business, particularly relating to the corporate and product names. We use several trademarks and trade names in connection with our products and operations. As of December 31, 2003, we had 30 federal trademark registrations with the United States Patent and Trademark Office. Federal registration of a trademark enables the registered owner of the mark to bar the unauthorized use of the registered mark in connection with a similar product in the same channels of trade by any third party anywhere in the United States, regardless of whether the registered owner has ever used the trademark in the area where the unauthorized use occurs. We have filed applications and own trademark registrations, and we intend to register additional trademarks in foreign countries where AMS products are or may be sold in the future. Protection afforded registered trademarks in some jurisdictions may not be as extensive as the protection available in the United States.

We also claim ownership and protection of certain product names, unregistered trademarks, and service marks under common law. Common law trademark rights do not provide the same level of protection afforded by registration of a trademark. In addition, common law trademark rights are limited to the geographic area in which the trademark is actually used. We believe these trademarks, whether registered or claimed under common law, constitute valuable assets, adding to recognition of AMS and the marketing of AMS products. We therefore believe that these proprietary rights have been and will continue to be important in enabling us to compete.

Trade Secrets. We own certain intellectual property, including trade secrets, which we seek to protect, in part, through confidentiality agreements with employees and other parties, although some employees involved in research and development activities have not entered into these agreements. Even where these agreements exist, there can be no assurance that these agreements will not be breached, that we would have adequate remedies for any breach, or that our trade secrets will not otherwise become known to or independently developed by competitors. Our proprietary product formulations are generally considered trade secrets, but are not otherwise protected under intellectual property laws.

COMPETITION

The business of developing and distributing nutritional, personal care, and weight management products such as those we sell and distribute is highly competitive. Numerous manufacturers, distributors, and retailers compete for consumers and, in the case of other network marketing companies, for associates. We compete directly with other entities that develop, manufacture, market, and distribute products in each of our product lines. We compete with these entities by emphasizing the underlying science, value, and high quality of our products as well as the convenience and financial benefits afforded by our network marketing

system and compensation plan. However, many of our competitors are substantially larger and have greater financial resources and broader name recognition. Our markets are highly sensitive to the introduction of new products that may rapidly capture a significant share of those markets.

The nutritional supplement market is characterized by:

- Large selections of essentially similar products that are difficult to differentiate;

- Retail consumer emphasis on value pricing;

- Constantly changing formulations based on evolving scientific research;

- Low entry barriers resulting from low brand loyalty, rapid change, widely available manufacturing, low regulatory requirements, and ready access to large distribution channels; and

- A lack of uniform standards regarding product ingredient sources, potency, purity, absorption rate, and form.

Similar factors are also characteristic of products comprising our other product lines. There can be no assurance that we will be able to effectively compete in this intensely competitive environment. In addition, nutritional, personal care, and weight management products can be purchased in a wide variety of channels of distribution, including retail stores. Our product offerings in each product category are relatively few compared to the wide variety of products offered by many of our competitors and are often premium priced. As a result, our ability to remain competitive depends in part upon the successful introduction of new products and enhancements of existing products.

We also compete with other network marketing organizations for the time, attention, and commitment of new and current associates. Our ability to remain competitive depends, in significant part, on our success in recruiting and retaining associates. We believe that we offer a rewarding associate compensation plan and attractive associate benefits and services. To the extent practicable, our associate compensation plan is designed to be seamless, permitting international expansion without re-qualification or re-entry requirements. We pay incentives weekly, reducing the time an associate must wait between purchase and sale of products and payment of commissions. There can be no assurance that our programs for recruiting and retaining associates will be successful. We also compete for the time, attention, and commitment of this independent associate force. The pool of individuals interested in the business opportunities presented by network marketing tends to be limited in each market and is reduced to the extent other network marketing companies successfully recruit these individuals into their businesses. Although we believe that we offer an attractive opportunity for our associates, there can be no assurance that other network marketing companies will not be able to recruit our existing associates or deplete the pool of potential associates in a given market.

We believe that the leading network marketing company in the world, based on total sales, is Amway Corporation and its affiliates, and that Avon Products, Inc. is the leading direct seller of beauty and related products worldwide. Leading competitors in the nutritional network marketing and nutritional product industry include Herbalife International, Inc., Market America, Inc., Nature's Sunshine Products, Inc., NBTY, Nu Skin Enterprises, Inc., Twinlab Corporation, and Weider Nutrition. We believe there are other manufacturers of competing product lines that may launch direct selling enterprises, which will compete with us in certain product lines and for associates. There can be no assurance that we will be able to successfully meet the challenges posed by this increased competition.

EMPLOYEES

As of December 31, 2003, we had 58 full-time and 11 part-time employees, consisting of four executive officers, 23 involved in administrative activities, eight involved in marketing activities, 22 involved in customer

service and business development activities and 12 involved in shipping activities. Our employees are not represented by a labor organization. We consider our employee relations to be good.

AVAILABILITY OF INFORMATION

We file periodic reports and proxy statements with the Securities and Exchange Commission, or SEC. The public may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. The public may obtain information about the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. We file our reports with the SEC electronically. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The address of this site is http://www.sec.gov.

Our internet address is www.amsonline.com. We make available on our website, free of charge, copies of our annual report of Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) of the Exchange Act as soon as reasonably possible after we electronically file such material with, or furnish to, the SEC.

ITEM 2. PROPERTIES

We maintain our executive offices in our state of the art distribution and call center located at 711 NE 39th Street, Oklahoma City, OK 73105. The 23,346 square foot, $1.3 million facility was completely paid for in January 2004. We are currently working to sub-lease the previous executive offices at the Northwest Expressway location, which is still under contract through May 31, 2008, and have lease rental costs of approximately $11,000 per month. All our properties are in good condition.

ITEM 3. LEGAL PROCEEDINGS

The case of Ronald Potter et al v. Advantage Marketing Systems, Inc. et al, a products liability claim, was filed in the Oklahoma County District Court in March 2003. The Plaintiffs allege that the ingestion of ephedra included in AM-300 resulted in the death of Pamela Sue Potter. We have filed an Answer to the Petition. Written discovery and responses have been exchanged. Otherwise, there has been little action in the case. We have denied any wrongdoing and intend to vigorously defend the claim. The amount of damages sought is unknown, but includes compensatory and punitive damages.

The case of In re Jose Garcia v. Advantage Marketing Systems, Inc., a products liability claim, was filed in the Superior Court of California, San Bernardino County, in February 2003. The Plaintiff claims personal injury and lost wages resulting from the ingestion of ephedra included in AM-300. We have filed an Answer to the Petition. Written discovery and responses have been exchanged. Otherwise, there has been little action in the case. We have denied any wrongdoing and intend to vigorously defend the claim. The amount of damages sought is unknown.

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.

19

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

No matters were submitted to a vote of security holders during the fourth quarter of our fiscal year ended December 31, 2003.

PART II

ITEM 5. MARKET FOR REGISTSRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

From November 6, 1997 to June 14, 1999, our common stock was traded on the Nasdaq SmallCap Market under the symbol "AMSO." On June 15, 1999, our common stock began trading on the American Stock Exchange under the symbol "AMM."

On March 19, 2004, the closing sale price of our common stock on the American Stock Exchange was $5.25. We believe there are approximately 1,606 holders of our common stock. The following table sets forth the high and low closing sale price of our common stock on the American Stock Exchange.

	COMMON STOCK CLOSING BID PRICES	
	HIGH	LOW
2003--CALENDAR QUARTER ENDED:		
March 31	$1.79	$1.20
June 30	$1.49	$1.15
September 30	$2.99	$1.21
December 31	$6.59	$2.80
2002--CALENDAR QUARTER ENDED:		
March 31	$2.60	$1.95
June 30	$3.05	$1.96
September 30	$2.35	$1.90
December 31	$2.00	$1.20

We have never declared or paid cash dividends on our common stock. We currently intend to retain future earnings, if any, to fund the development and growth of our business. Future cash dividends, if any, will be determined by the Board of Directors and will be based on earnings, available capital, financial condition, and other factors deemed relevant by the Board of Directors.

Equity Compensation Plan Information

Plan Category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of secu remaining ava for future is under equi compensation (excluding sec reflected column (a
Equity plans approved by security holders	2,261,808	$2.06	863,192
Equity compensation plan not approved by security holders(1)	430,000	$1.92	--
Total	2,691,808	$2.04	863,192

(1) Prior to approval of the 1995 Stock Option Plan, the Company issued 673,250 incentive stock options to employees and associates, 430,000 of which remain outstanding. These options have a term of 10 years, are exercisable, in whole or in part, at any time prior to the termination date, and have an exercise price of $1.75 to $2.00 per share. The options may be assigned or transferred, in whole or in part, so long as such assignment or transfer is in accordance with and subject to the provisions of the Securities Act of 1933, as amended, and the rules promulgated thereunder.

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth selected financial and statistical data, computed as a percentage of net sales, for the years ended December 31, 2003, 2002, 2001, 2000 and 1999. The selected financial data are derived from our audited consolidated financial statements and should be read in conjunction with them and the notes thereto. The results of operations for the periods presented are not necessarily indicative of our future operations.

			YEAR ENDED DECEMBER 31,
	2003	2002	2001
INCOME STATEMENT DATA:			
Net sales	$18,486,178	$22,303,581	$28,440,920
Cost of sales	12,750,336	15,126,983	19,231,150
Gross profit	5,735,842	7,176,598	9,209,770
Marketing, distribution and administrative expenses:			
Marketing	1,538,981	2,487,006	2,304,922
Distribution and administrative	7,242,167	5,768,245	6,875,871
Total marketing, distribution and administrative expenses	8,781,148	8,255,251	9,180,793
Goodwill impairment	--	3,788,374	--
Income (loss) from operations	(3,045,306)	(4,867,027)	28,977
Other income (expense):			
Interest and dividends,net	(74,704)	(53,895)	(31,800)
Other income (expense)	(39,690)	(39,170)	16,841
Total other income (expense)	(114,394)	(93,065)	(14,959)
Income (loss) before income taxes	(3,159,700)	(4,960,092)	14,018
Income tax (benefit)	(590,839)	(1,755,057)	5,467
Net income (loss)	$(2,568,861)	$(3,205,035)	$ 8,551
Net income (loss) per common share-basic	$ (0.57)	$ (0.73)	$ --
Net income (loss) per common share-assuming dilution	$ (0.57)	$ (0.73)	$ --
Weighted average common shares outstanding-basic	4,508,986	4,419,196	4,379,486
Weighted average common shares outstanding-assuming dilution	4,508,986	4,419,196	4,692,298
STATISTICAL DATA:			
Total cost of sales	69.0%	67.8%	67.6%
Gross profit	31.0%	32.2%	32.4%
Total marketing, distribution			

and administrative expense.......	47.5%	37.0%	32.3%
Net income (loss)...............	(13.9)%	(14.4)%	0.0%
CASH FLOW DATA:			
Net cash provided by (used in) operating activities	$(1,042,590)	$ 694,712	$ 1,508,177
Net cash provided by (used in) investing activities............	(237,197)	68,193	(1,383,960)
Net cash provided by (used in) financing activities............	2,381,769	(537,795)	781,284
BALANCE SHEET DATA:			
Total assets	$12,204,019	$10,686,269	$14,672,404
Total liabilities	3,910,156	3,355,840	4,127,226
Stockholders' equity............	8,293,863	7,330,429	10,545,178

21

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The following discussion should be read in conjunction with our consolidated financial statements and notes thereto under Item 8 below.

GENERAL

Since 1996, our business and operations have been significantly affected by the acquisitions of, or acquisitions of the assets of, Miracle Mountain International, Inc., Chambre International, Inc., Stay 'N Shape International, Inc., Solution Products International, Inc., Nation of Winners, Inc., Now International, Inc. , ToppMed Inc. and LifeScience Technologies Inc., or LST. Over the years, these acquisitions and asset purchases have added 11,790 associates to our ranks and 129 products to our product line.

LST was our most recent acquisition. On January 4, 2001, we purchased the LST group of companies for $1.2 million and a five year payment of $41,667 per month, or 5% of the gross sales of LST products, whichever is greater. The seller had the option to take up to 860,000 shares of our common stock in lieu of cash at an option price of $3.00 per share. As a result of this acquisition, we added 14 products and over 5,000 associates. We paid the balance of the acquisition price, plus accrued interest, in full on January 29, 2004.

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. 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 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.

The following table sets forth information used by management to assess our results of operations over the prior three (3) years, both in aggregate amounts and the percentage increase or decrease over the prior year:

	2003	%increase (decrease)	2002	(decrease)
Net sales	$18,486,178	(17.1)%	$22,303,581	(21.6
Gross profit	5,735,842	(20.1)	7,176,598	(22.1
Net Income (Loss)	(2,568,861)	19.8	(3,205,035)	(37,481.4
Free Cash Flow(1)	(1,449,481)	(6,256.5)	(22,802)	92.2
Average Monthly Purchases per Associate(2)	$ 61	5.2	$ 58	107.1
Total Associates	44,000	0.1	40,000	(44.4
Active Associates	19,000	(51.3)	39,000	(44.3

(1) Free cash flow is defined as cash flow from operations minus capital expenditures.

	2003	2002	2001
Cash flow from operations....	($ 1,042,590)	$ 694,713	$1,508,177
Capital expenditures.........	406,891	717,515	1,798,899
Free cash flow...............	($ 1,449,481)	($ 22,802)	($ 290,722)

(2) Average monthly purchases per associates is calculated by dividing total sales by total number of associate transactions.

22

Below we discuss the reasons for the reductions in the above matrices for 2003 versus 2002 and 2001. To reverse this trend, we have emphasized the recruiting of new sales associates as our best model for growth in 2004. We believe we can attract and retain experienced and new sales associates through our WellnessCEO system, our new compensation plan, our refocused product offerings, and our new customer acquisition program.

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 less associate discounts, sales returns, and, beginning June 1, 2001, a portion of freight costs. 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

- A portion of the 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 material to our independent associates. All of our customers pay for sales in advance of shipment. As such, we have no trade receivables. We used to make loans to associates, which were repayable in five years or less, and which were secured by commissions controlled by us. Associate loans are no longer allowed. Interest rates on loans were typically two percent or more above the Prime rate and were fixed. All loans and receivables were secured by guaranteed payment sources that were within our control. As such, there was no need for an allowance for doubtful accounts. We were still collecting on prior associate loans as of December 31, 2003 in the total amount of $241,878.

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets". This standard requires companies to stop amortizing existing goodwill and intangible assets with indefinite lives effective January 1, 2002. Under the new rules, companies would only adjust the carrying amount of goodwill or indefinite life intangible assets upon an impairment of the goodwill or indefinite life intangible assets. We implemented these standards effective January 1, 2002. Based on an evaluation of goodwill at October 31, 2002, we determined that goodwill of approximately $3,800,000 was 100% impaired and should be written off in its entirety.

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 than 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 reasonable 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.

Units Offering. On November 12, 1997, we completed the offering of 1,495,000 units, each consisting of one share of common stock and one redeemable common stock purchase warrant. Each redeemable common stock purchase warrant was exercisable for the purchase of one share of our common stock for $3.40 on or before November 6, 2002. In connection with this offering, we sold to the underwriters, Paulson Investment Company, Inc. and Joseph Charles & Assoc., Inc., warrants exercisable for the purchase of 130,000 units for $5.40 per unit on or before November 6, 2002. On September 16, 2002, we extended the exercise period for the redeemable stock purchase warrants and the underwriter warrants from November 6, 2002 to November 12, 2003. On October 14, 2003, we extended the exercise period for the redeemable stock purchase warrants and the underwriter warrants from November 12, 2003 to November 12, 2004. On December 10, 2003 we announced the redemption of all outstanding redeemable stock purchase warrants and the underwriter warrants not exercised by January 16, 2004. Rather than have their warrants redeemed, substantially all of the holders of the redeemable stock purchase warrants and the underwriter warrants exercised their warrants on or before the redemption date. Proceeds from the exercise of the redeemable stock purchase warrants and the underwriter warrants totaled $5,394,615. The redemption price for the unexercised warrants totaled $11,870.

Warrant Modification Offering and Rights Offering. In January 1997, we distributed non-transferable rights to our common stock shareholders. These rights entitled the holders to subscribe for and purchase up to 2,148,191 units, each unit consisting of one share of our common stock and one 1997-A warrant, for the price of $6.80 per unit. Concurrently, we called and redeemed our outstanding class A and class B common stock purchase warrants for $.0008 per warrant on March 17, 1997. However, in connection with the warrant redemption, we offered to the holders of the class A and class B warrants the right to purchase units, each comprised of one share of common stock and one 1997-A warrant, at an exercise price of $6.00 per unit.

Each 1997-A warrant was exercisable on or before November 6, 2002, to purchase one share of common stock for $3.40, subject to adjustment in certain events. On September 16, 2002, we extended the exercise period for the 1997-A warrants from November 6, 2002 to November 12, 2003. On October 14, 2003, we extended the exercise period for the 1997-A warrants from November 12, 2003 to November 12, 2004. On December 10, 2003, we announced the redemption of all outstanding 1997-A warrants not exercised by January 16, 2004. Rather than have their warrants redeemed, substantially all of the holders of the 1997-A warrants

exercised their warrants on or before the redemption date. Proceeds from the exercised of the 1997-A warrants totaled $714,877. The redemption price for the unexercised warrants totaled $25.

In January 2004, we issued 1,170,064 shares of common stock upon exercise of the redeemable stock purchase warrants, the underwriter warrants and the 1997-A warrants.

RESULTS OF OPERATIONS

Comparison of 2003 and 2002

Our net sales during the year ended December 31, 2003, decreased by $3,817,403, or 17.1%, to $18,486,178 from $22,303,581 during the year ended

December 31, 2002. During 2003, we made sales to approximately 44,000 associates, compared to sales during 2002 to approximately 40,000 associates. The aggregate number of associates at December 31, 2003 was down from 2002 due to decreased recruiting activity. At December 31, 2003, we had approximately 19,000 "active" associates compared to approximately 39,000 at December 31, 2002. An associate is considered to be "active" if he or she has made a product purchase of $50 or more from us or is enrolled in our autoship program within the previous 90 days. Sales per associate per month increased to $61 for 2003, compared to $58 for 2002.

Our cost of sales during 2003 decreased by $2,376,647, or 15.7%, to $12,750,336 from $15,126,983 during 2002. This decrease was attributable to reduced sales, resulting in:

- A decrease of $1,469,426 in associate commissions and bonuses;
- A decrease of $764,519 in the cost of products sold; and
- A decrease of $142,702 in shipping costs.

Total cost of sales as a percentage of net sales increased to 69.0% during the year ended December 31, 2003, from 67.8% during the same period in 2002. This was primarily due to an increase in cost of shipping to 8.3% of net sales from 7.5%, which was due to increased rates, and an increase in commissions and bonuses to 42.1% of net sales from 41.5%. This increase was partially offset by a decrease in cost of products sold to 18.5% of net sales from 18.8% due to efficiency in inventory purchasing and carrying cost.

Our gross profit decreased $1,440,756 or 20.1%, to $5,735,842 during 2003 from $7,176,598 during 2002. The gross profit decreased as a percentage of net sales to 31.0% in 2003 from 32.2% in 2002, as reflected in our cost of goods sold increase as a percentage of net sales.

Marketing, distribution and administrative expenses increased $525,897 or 6.4%, to $8,781,148 during the year ended December 31, 2003, from $8,255,251 during the same period in 2002. This increase was primarily attributable to:

- An increase in executive employee costs of approximately $670,000 related to the accrual of future payments on employment agreements;
- An increase in bonus expense of approximately $320,000 related to exercise of employee stock options;
- An increase in information systems consulting expense of approximately $95,000 due to changes in Internet programs;
- An increase in consulting expense of approximately $70,000 related to executive management consulting;
- An increase of approximately $68,000 in legal expenses related to the current litigation;
- An increase in vehicle expense of approximately $65,000 related to the write down of vehicles;
- An increase in bad debt expense of $24,500 due to the write off of uncollectible associate advances; and
- A loss on sale of assets of approximately $117,000.

The increase in marketing, distribution and administrative expenses were partially offset by:

- A decrease in convention expenses of approximately $330,000 related to lower costs for our annual convention and regional conferences;

- A decrease in promotion costs of approximately $200,000;

- A decrease in administrative expense of approximately $155,000, related primarily to decreases in bank charges and executive dues;

- A decrease in travel expense of approximately $144,000; and

- A decrease of approximately $99,000 in rent and insurance costs related to better rates for liability insurance and to the lease expiration on our old warehouse building.

The marketing, distribution and administrative expenses as a percentage of net sales increased to 47.5% in 2003, from 37.0% in 2002.

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 142, "Goodwill and Other Intangible Assets". This standard required companies to stop amortizing existing goodwill and other intangible assets with indefinite lives effective January 1, 2002. Under the new rules, companies would only adjust the carrying amount of goodwill or indefinite life intangible assets upon an impairment of the goodwill or indefinite life intangible assets. We implemented this standard effective January 1, 2002. Upon an evaluation at October 31, 2002, we determined that goodwill was impaired and should be written off in its entirety. This resulted in a one-time impairment charge of $3,788,374, or 17.0% of net sales for 2002.

Our net other expense increased by $21,329 to net other expense of $114,394 during 2003, from a net other expense of $93,065 during the same period in 2002. This increase was primarily due to:

- A decrease in investment income of $15,000 related to marketable securities; and

- A loss on sale of marketable securities of $14,000.

Our loss before taxes decreased $1,800,392 to a loss of $3,159,700 during 2003, from a loss of $4,960,092 during 2002. Income (loss) before taxes as a percentage of net sales was (17.1%) and (22.2%) during 2003 and 2002. Income tax expense (benefit) during 2003 and 2002 was ($590,839) and ($1,755,057). Our net loss decreased $636,174, to a net loss of $2,568,861 during 2003, from a net loss of $3,205,035 during 2002. This decrease in net loss was attributable to:

- The decrease in gross profit to $5,735,842 during 2003 from $7,176,598 during 2002;

- The impairment of goodwill of $3,788,374 in 2002;

- The increase in marketing, distribution and administrative expense to $8,781,148 during 2003 from $8,255,251 during 2002; and

- The creation of a deferred tax valuation allowance of $441,000.

Net loss as a percentage of net sales decreased to (13.9%) during 2003, from (14.4%) during 2002.

Comparison of 2002 and 2001

Our net sales during the year ended December 31, 2002, decreased by $6,137,339, or 21.6%, to $22,303,581 from $28,440,920 during the year ended December 31, 2001. During 2002, we made sales to approximately 40,000 associates, compared to sales during 2001 to approximately 71,597 associates. The aggregate number of associates at December 31, 2002 decreased 2001 due to decreased recruiting activity. At December 31, 2002, we had approximately 39,000 "active" associates compared to approximately 69,700 at December 31, 2001 due to decreased recruiting. Sales per associate per month increased to $58 for 2002, compared to $28 for 2001.

Our cost of sales during 2002 decreased by $4,104,167, or 21.3%, to $15,126,983 from $19,231,150 during 2001. This decrease was attributable to reduced sales, resulting in:

- A decrease of $2,432,420 in associate commissions and bonuses;

- A decrease of $1,279,169 in the cost of products sold; and

- A decrease of $391,582 in shipping costs.

Total cost of sales as a percentage of net sales increased to 67.8% during the year ended December 31, 2002, from 67.6% during the same period in 2001. This was primarily due to an increase in cost of shipping to 7.5% of net sales from 7.3%, which was due to increased rates, and an increase in commissions and bonuses to 41.5% of net sales from 41.1%. This increase was partially offset by a decrease in cost of products sold to 18.8% of net sales from 19.2% due to efficiency in inventory purchasing and carrying cost.

Our gross profit decreased $2,033,172, or 22.1%, to $7,176,598 during 2002 from $9,209,770 during 2001. The gross profit decreased as a percentage of net sales to 32.2% in 2002 from 32.4% in 2001, as reflected in our cost of goods sold increase as a percentage of net sales.

Marketing, distribution and administrative expenses decreased $925,542, or 10.1%, to $8,255,251 during the year ended December 31, 2002, from $9,180,793 during the same period in 2001. This decrease was primarily attributable to:

- Non-recurring expenses in 2001 of approximately $255,000 related to the operation of the LifeScience Technologies California warehouse in January and February of 2001, plus the transition costs related to the LifeScience Technologies acquisition in January 2001;

- A decrease in depreciation and amortization expense of approximately $167,000, due to the cessation of goodwill amortization in 2002 per FASB 142 (See Note 1 to our financial statements);

- A decrease in professional services expense of approximately $300,000 due to the buyout of options in 2001, and a change in auditing firm in 2002, saving us approximately $76,000; and

- A decrease in contract services from 2001 of $193,600 incurred to supplement our technical staff during the LifeScience Technologies acquisition transition.

The marketing, distribution and administrative expenses as a percentage of net sales increased to 37.0% in 2002, from 32.3% in 2001.

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 142, "Goodwill and Other Intangible Assets". This standard required companies to stop amortizing existing goodwill and other intangible assets with indefinite lives effective January 1, 2002. Under the new rules, companies would only adjust the carrying amount of goodwill or indefinite life intangible assets upon an impairment of the goodwill or indefinite life intangible assets. We implemented this standard effective January 1, 2002. Upon an evaluation at October 31, 2002, we determined that goodwill was impaired and should be written off in its entirety. This resulted in a one-time impairment charge of $3,788,374, or 17.0% of net sales for 2002.

Our net other expense increased by $78,106 to net other expense of $93,065 during 2002, from a net other expense of $14,959 during the same period in 2001. This increase was primarily due to:

- A decrease in investment income of $28,000 related to marketable securities offset by an increase in interest income of $22,000;

- A decrease in collection of written off accounts receivable of $11,000 related to collection of old, outstanding debt;

- A loss on sale of marketable securities of $30,000; and

- A loss on sale of assets of $17,500.

Our income (loss) before taxes decreased $4,974,110, to a loss of $4,960,092 during 2002, from income of $14,018 during 2001. Income (loss) before taxes as a percentage of net sales was (22.2%) and 0.0% during 2002 and 2001. Income tax expense (benefit) during 2002 and 2001 was $(1,755,057) and $5,467. Our net income (loss) decreased $3,213,586, to a net loss of $3,205,035 during 2002, from a net income of $8,551 during 2001. This decrease in net income (loss) was attributable to:

- The increase in net other expense to $93,065 during 2002 from net other expense of $14,959 during 2001;

- The decrease in gross profit to $7,176,598 during 2002 from $9,209,770 during 2001;

- The impairment of goodwill of $3,788,374; and

- The decrease in marketing, distribution and administrative expense to $8,255,251 during 2002 from $9,180,793 during 2001.

Net income as a percentage of net sales decreased to (14.4%) during 2002, from 0.0% during 2001.

Seasonality

No pattern of seasonal fluctuations exists. However, there is no assurance that we will not become subject to seasonal fluctuations in the future.

ACCOUNTING STANDARDS TO BE ADOPTED

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 December 31, 2003, 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), will not have a material effect on our financial condition or results of operations.

In November 2003, the Emerging Issues Task Force (EITF) of the FASB reached a consensus on one issue with respect to EITF Issue 03-1, "The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments," thereby requiring certain quantitative and qualitative disclosures for securities accounted for under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity

28

Securities," that are impaired at the balance sheet date but for which an other-than-temporary impairment has not been recognized. Adoption of EITF Issue 03-1, which was effective for us on December 31, 2003, did not have a material impact on our financial position, results of operations or cash flows. The required disclosures have been considered in Note 3 to our consolidated financial statements.

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.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity" (SFAS 150). SFAS No. 150 changes the accounting for certain financial instruments that, under previous guidance, could be classified as equity or "mezzanine" equity, by now requiring those instruments to be classified as liabilities (or assets in some circumstances) in the consolidated balance sheets. Further, SFAS No. 150 requires disclosure regarding the terms of those instruments and settlement alternatives. The guidance in SFAS No. 150 generally is effective for all financial instruments entered into or modified after May 31, 2003, and was otherwise effective at the beginning of the first interim period beginning after June 15, 2003. We have evaluated SFAS No. 150 and determined that it does not have an impact on our financial reporting and disclosures.

COMMITMENTS AND CONTINGENCIES

Recent Regulatory Developments - As a marketer of products that are ingested by consumers, we are subject to the risk that one or more of the ingredients in our products may become the subject of adverse regulatory action. For a discussion regarding the impact of regulatory developments on our business, please see "Business - Regulation".

Product Liability - We, like other marketers of products that are intended to be ingested, face the inherent risk of exposure to product liability claims in the event that the use of our products results in injury. We maintain limited product liability insurance coverage with limits of $1,000,000 per occurrence and $2,000,000 in the aggregate. Products containing ephedra, which represented approximately 35.9% of our 2003 net sales, are not covered by our product liability insurance. We generally do not obtain contractual indemnification from our product manufacturers. However, all of our product manufacturers carry product liability insurance, which covers our products. A product liability claim could result in material losses.

Legal Proceedings - We are currently involved in five products liability suits related to the ingestion of our 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. We have, and will continue to, deny any wrongdoing and intend to vigorously defend against the claims. The amounts of damages sought are unknown, but include compensatory and punitive damages.

LIQUIDITY AND CAPITAL RESOURCES

Our primary source of liquidity has been cash provided by sales of our common stock, marketable securities and operating activities. At December 31, 2003, we had working capital of $4,420,554 compared to $3,186,583 at December 31, 2002. We also added $1,170,064 in January 2004 from the exercise of warrants. During the year ended December 31, 2003, net cash used in operating activities was $1,042,590 net cash used in investing activities was $237,197, and net cash provided by financing activities was $2,381,769. We had a net increase in cash during this period of $1,101,982. 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. Capital expenditures and debt retirement will be paid from our net proceeds generated from our warrant redemption.

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 accrue 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.

The following summarizes our contractual obligations at December 31, 2003 and the effect such obligations are expected to have on our liquidity and cash flow in future periods.

	TOTAL	LESS THAN 1 YEAR	1 - 3 YEARS	3 - 5 YEARS
Bank loans and notes (1).........	$1,989,170	$ 485,161	$1,500,611	$ 3,398
Capital lease obligations........	244,248	91,831	100,703	51,714
Operating leases.................	649,850	132,278	265,886	251,686
Total............................	$2,883,268	$ 709,270	$1,867,200	$306,798

(1) See Note 4 to our financial statements. All of our bank loans and notes were paid in their entirety in January 2004.

At December 31, 2003, we had marketable debt and equity securities of $1,876,978 compared to $1,621,143 at December 31, 2002. All of our securities are unrestricted investments.

During the first quarter of 1998, we agreed to loan John W. Hail, our Chief Executive Officer and a major shareholder, up to $250,000. Subsequently we also agreed to loan up to an additional $75,000. In 2000, an additional $200,000 was approved. On January 1, 2001 the outstanding balance on all the notes plus interest were combined into one note payable in monthly installments. Our board of directors unanimously approved the loans and extension. These loans are collateralized by stock and property, and bear interest at 8% per annum. These loans were paid in full in 2003. No new loans will be made to our officers or directors.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our balance sheet includes marketable securities, which we believe are a conservative blend of income and growth investments resulting in moderate market risk. We invest in equity marketable securities to generate capital growth, and fixed-income marketable securities to provide current income. Because of the nature of these investments, both current interest rates and equity market movements will affect total return and risk. Our fixed income investments of approximately $800,000 are subject to interest risk and market value risk. We have approximately $1,000,000 of equity investments that are exposed to market risk.

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

The following table lists our cash equivalents and our short-term fixed-income marketable securities at December 31, 2003 and December 31, 2002:

	DECEMBER 31, 2003			DECEM
	AVERAGE INTEREST RATE (1)	COST	FAIR VALUE	AVERAGE INTEREST RATE (1)
Cash equivalents...	--%	$ 17,709	$ 17,709	--%
Short-term Investments......	--%	787,551	786,855	6.00%
		$805,260	$804,564	

(1) Average interest rate is calculated by taking the individual security

interest rates multiplied by each investment's weighted average share of the total fixed-income marketable securities.

At December 31, 2003 all of our fixed income securities were in mutual funds, creating no average interest rates for fixed income securities.

Fair value of the cash equivalents and fixed-income marketable securities decreased $14,983 during the year ended December 31, 2003 to $804,564 from $819,547 at December 31, 2002. This decrease was primarily due to net redemption of fixed income securities.

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 December 31, 2003, our equity investments had a value of $1,072,414 compared to $801,596 at December 31, 2002, primarily due to the purchase of mutual fund equity investments in the second, third and fourth quarters of 2003.

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 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our consolidated financial statements are set forth beginning on page F-1 hereof.

ITEM 9. CHANGES IN AND DISAGREEMENT WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. 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 has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART III

In accordance with the provisions of General Instruction G (3), information required by Items 10, 11, 12, 13 and 14 of Form 10-K are incorporated herein by reference to our Proxy Statement for the Annual Meeting of Shareholders to be filed prior to April 29, 2004.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a)(1) The following financial statements of Advantage Marketing Systems, Inc. are included in Item 8:

(a)(2) Financial Statement Schedules

All other schedules have been omitted since the required information is not present, or not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements or notes thereto.

(a)(3) Exhibits

EXHIBIT NO.	DESCRIPTION
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.
10.1	Warrant Agreement between Registrant and U.S. Stock Transfer Inc., dated as of January 16, 1997, as amended and restated January 8, 1998, incorporated by reference to Amendment No. 2 to Form 8-A Registration Statement, filed with the Commission on January 13, 1998.
10.2	Unit and Warrant Agreement between Registrant and U.S. Stock Transfer Inc., dated as of November 6, 1997, as amended and restated January 8, 1998, incorporated by reference to Amendment No. 1 to Form 8-A Registration Statement, filed with the Commission on January 15, 1998.
10.5	Purchase and Assignment Agreement by and among Advantage Marketing Systems, Inc., LifeScience Technologies Holdings, Inc., GHI Holdings, Inc., LifeScience Technologies, Inc. and RMS Limited Partnership, dated as of January 3, 2001, incorporated by reference to Form 8-K filed with the

	Commission on January 8, 2001.
10.6	Promissory Note dated January 3, 2001, to RMS Limited Partnership by Advantage Marketing Systems, Inc., LifeScience Technologies Holdings, Inc., LifeScience Technologies Holdings Limited Partnership, LifeScience Technologies Holdings, Inc., LifeScience Technologies of Japan and LST Fulfillment Limited Partnership, incorporated by reference to Form 8-K filed with the Commission on January 8, 2001.
10.7	Stock Option Agreement of Advantage Marketing Systems dated January 3, 2001, incorporated by reference to Form 8-K filed with the Commission on January 8, 2001.
10.8	Joint Marketing Agreement with PrimeBuy Network.com, Inc., dated August 30, 2002, incorporated by reference to Form 10-Q filed with the Commission on November 1, 2002.

10.9	Promissory Note executed by PrimeBuy Network.com, Inc., dated August 2, 2002, incorporated by reference to Form 10-Q filed with the Commission on November 1, 2002.
10.10*	The Advantage Marketing Systems, Inc. 1995 Stock Option Plan, incorporated by reference to Form SB-2 Registration Statement (No. 33-80629), filed with the Commission on November 20, 1996.
10.11*	Employment Agreement by and between David D'Arcangelo and Registrant dated effective as of November 25, 2002, incorporated by reference to Form 10-K/A filed with the Commission on March 31, 2003.
10.12*	Non-Qualified Stock Option Agreement by and between David D'Arcangelo and Registrant dated effective as of December 2, 2002, incorporated by reference to Form 10-K/A filed with the Commission on March 31, 2003.
10.13*	The Advantage Marketing Systems, Inc. 2003 Stock Incentive Plan, incorporated by reference to Form S-8 Registration Statement (No. 333-109093), filed with the Commission on September 24, 2003.
10.14	Fulfillment Services Agreement with Vita Sales & Distribution Multi-Country, dated January 19, 2004, filed herewith.
10.15*	Employment Agreement by and between John W. Hail and Registrant dated effective as of November 4, 2003, filed herewith.
21	Subsidiaries, incorporated by reference to Form 10-K filed with the Commission on April 17, 2001.
23.1	Consent of Grant Thornton LLP, filed herewith.
31.1	Chief Executive Officer Certification, filed herewith.

31.2	Chief Financial Officer Certification, 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.
*	Designates a compensatory plan.

(b) Reports on Form 8-K.

- On December 10, 2003, the registrant filed an 8-K reporting its intent to redeem all of its outstanding 1997-A Warrants, its Redeemable Common Stock Purchase Warrants and its Underwriter Warrants.
- On November 4, 2003, the registrant filed an 8-K reporting its financial results for the three months and nine months ended September 30, 2003.
- On October 16, 2003, the registrant filed an 8-K reporting the extension of the exercise period of its 1997-A Warrants, its Redeemable Common Stock Purchase Warrants and its Underwriter Warrants from November 12, 2003 to November 12, 2004.

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.

REGISTRANT:
ADVANTAGE MARKETING SYSTEMS, INC.

Date: March 29, 2004

By: /S/ JOHN W. HAIL

John W. Hail, Chief Executive Officer,
Chairman of the Board and Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Date: March 29, 2004

By: /S/ JOHN W. HAIL

John W. Hail, Chief Executive Officer,
Chairman of the Board and Director

Date: March 29, 2004

By: /S/ REGGIE B. COOK

Reggie B. Cook, Chief Financial
Officer and Secretary Treasurer

Date: March 29, 2004

By: /S/ DAVID J. D'ARCANGELO

David J. D'Arcangelo, President

	and Director
Date: March 29, 2004	By: /S/ DENNIS P. LONEY Dennis P. Loney, Chief Operational Officer
Date: March 29, 2004	By: /S/ M. THOMAS BUXTON III M. Thomas Buxton III, Director
Date: March 29, 2004	By: /S/ STEVEN M. DICKEY Steven M. Dickey, Director
Date: March 29, 2004	By: /S/ HARLAND C. STONECIPHER Harland C. Stonecipher, Director
Date: March 29, 2004	By: /S/ STEVEN R. HAGUE Steven R. Hague, Director

34

INDEX TO FINANCIAL STATEMENTS

ADVANTAGE MARKETING SYSTEMS, INC. AND SUBSIDIARIES
AUDITED CONSOLIDATED FINANCIAL STATEMENTS:

F-1

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors and Stockholders
Advantage Marketing Systems, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Advantage Marketing Systems, Inc. and Subsidiaries as of December 31, 2003 and 2002, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Advantage Marketing Systems, Inc. and Subsidiaries as of December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangibles, on January 1, 2002.

GRANT THORNTON LLP

Oklahoma City, Oklahoma
February 17, 2004

ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2003 AND 2002

	2003
ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents	$ 2,309,281
Marketable securities, available for sale, at fair value	1,876,978
Receivables	416,919
Receivable from affiliates	--
Prepaid taxes and income tax receivable	464,975
Inventory	901,529
Deferred income taxes	4,854
Other assets	41,212
Total current assets	6,015,748
RECEIVABLES	232,809
PROPERTY AND EQUIPMENT, net	3,461,733
COVENANTS NOT TO COMPETE and other intangibles, net	558,004
DEFERRED INCOME TAXES	1,883,172
OTHER ASSETS	52,553
TOTAL	$ 12,204,019

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:	
Accounts payable	$ 357,696
Accrued commissions and bonuses	215,062
Accrued other expenses	328,136
Accrued sales tax liability	130,185
Notes payable	485,161
Capital lease obligations	78,954
Total current liabilities	1,595,194
LONG-TERM LIABILITIES:	
Notes payable	1,504,009
Capital lease obligations	142,880
Deferred compensation	668,073
Total liabilities	3,910,156
COMMITMENTS AND CONTINGENCIES (Notes 5 and 12)	
STOCKHOLDERS' EQUITY:	
Common stock - $.0001 par value; authorized 495,000,000 shares; issued 5,905,307 and 4,896,674 shares; outstanding 5,432,512 and 4,424,314 shares, respectively	590
Paid-in capital	15,160,183
Notes receivable for exercise of options	(31,000)
Accumulated deficit	(4,687,718)
Accumulated other comprehensive income (loss), net of tax	96,284
Total capital and accumulated deficit	10,538,339
Less cost of treasury stock (472,795 shares)	(2,244,476)
Total stockholders' equity	8,293,863
TOTAL	$ 12,204,019

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

F-3

ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001

	2003	2002
Net sales	$ 18,486,178	$ 22,303,581
Cost of sales	12,750,336	15,126,983
Gross profit	5,735,842	7,176,598
Marketing, distribution and administrative expenses:		

Marketing	1,538,981	2,487,006
Distribution and administration	7,242,167	5,768,245
Total marketing, distribution and administrative expenses	8,781,148	8,255,251
Goodwill impairment	--	3,788,374
Income (loss) from operations	(3,045,306)	(4,867,027)
Other income (expense):		
Interest and dividends, net	(74,704)	(53,895)
Other income (expense), net	(39,690)	(39,170)
Total other income (expense)	(114,394)	(93,065)
INCOME (LOSS) BEFORE TAXES	(3,159,700)	(4,960,092)
INCOME TAX EXPENSE (BENEFIT)	(590,839)	(1,755,057)
NET INCOME (LOSS)	$ (2,568,861)	$ (3,205,035)
Net income (loss) per common share - basic	$ (.57)	$ (.73)
Net income (loss) per common share - assuming dilution	$ (.57)	$ (.73)
Weighted average common shares outstanding - basic	4,508,986	4,419,196
Weighted average common shares - assuming dilution	4,508,986	4,419,196

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001

	SHARES (SEE NOTE 6)	COMMON STOCK	PAID-IN CAPITAL	NOTES RECEIVABLE FOR EXERCISE OF OPTIONS	R E (D

BALANCE, JANUARY 1, 2001	4,348,814	$ 482	$11,642,188	$ (31,088)	$
Options exercised with cash	61,000	6	121,994	--	
Comprehensive Income:					
Net Income	--	--	--	--	
Unrealized loss on available for sale securities, net of tax.....	--	--	--	--	
Comprehensive income	--	--	--	--	
	-----------	-----------	-----------	-----------	--
BALANCE, DECEMBER 31, 2001	4,409,814	488	11,764,182	(31,088)	
Options exercised with cash	14,500	2	29,058	--	
Payments of notes receivable	--	--	--	88	
Comprehensive Income:					
Net Loss	--	--	--	--	(
Unrealized loss on available for sale securities, net of tax.....	--	--	--	--	
Comprehensive Loss	--	--	--	--	
	-----------	-----------	-----------	-----------	--
BALANCE, DECEMBER 31, 2002	4,424,314	490	11,793,240	(31,000)	(
Options exercised with cash	369,838	37	1,090,483	--	
Warrants exercised with cash	581,575	58	2,131,217	--	
Stock issued	56,785	5	145,243	--	
Comprehensive Income:					
Net Loss	--	--	--	--	(
Unrealized gain on available for sale securities, net of tax.....	--	--	--	--	
Comprehensive (Loss)	--	--	--	--	
	-----------	-----------	-----------	-----------	--
BALANCE, DECEMBER 31, 2003	5,432,512	$ 590	$15,160,183	$ (31,000)	$(
	===========	===========	===========	===========	==

	COMPRE-HENSIVE INCOME (LOSS)	ACCUMU-LATED OTHERCOM-PREHENSIVE INCOME (LOSS), NET OF TAX	TREASURY STOCK	TOTAL STOCK-HOLDERS' EQUITY
BALANCE, JANUARY 1, 2001		$ (20,828)	$(2,244,476)	$10,423,905
Options exercised with				

cash	--	--	--	122,000
Comprehensive Income:				
Net Income	8,551	--	--	8,551
Unrealized loss on available for sale securities, net of tax.....	(9,278)	(9,278)	--	(9,278)
Comprehensive income	$ (727)	--	--	--
BALANCE, DECEMBER 31, 2001		(30,106)	(2,244,476)	10,545,178
Options exercised with cash	--	--	--	29,060
Payments of notes receivable	--	--	--	88
Comprehensive Income:				
Net Loss	(3,205,035)	--	--	(3,205,035)
Unrealized loss on available for sale securities, net of tax.....	(38,862)	(38,862)	--	(38,862)
Comprehensive Loss	$(3,243,897)	--	--	--
BALANCE, DECEMBER 31, 2002		(68,968)	(2,244,476)	7,330,429
Options exercised with cash	--	--	--	1,090,520
Warrants exercised with cash	--	--	--	2,131,275
Stock issued	--	--	--	145,248
Comprehensive Income:				
Net Loss	(2,568,861)	--	--	(2,568,861)
Unrealized gain on available for sale securities, net of tax.....	165,252	165,252	--	165,252
Comprehensive (Loss)	$(2,403,609)	--	--	--
BALANCE, DECEMBER 31, 2003		$ 96,284	$(2,244,476)	$ 8,293,863

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001

	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)...	$(2,568,861)	$(3,205,035)
Adjustments to reconcile net income (loss) to net		

cash provided by (used in) operating activities:		
Depreciation and amortization	982,168	1,016,260
Goodwill impairment	--	3,788,374
Stock issued for services	73,600	--
Employee compensation recognized upon exercise of stock options	282,653	--
Deferred taxes	(590,839)	(1,331,778)
(Gain) loss on sale of assets	117,273	17,568
Realized (gain) loss on sale of marketable securities	52,557	33,841
Impairment of inventory and other assets	--	116,143
Changes in assets and liabilities which provided (used) cash:		
Receivables	(310,645)	200,988
Inventory	(103,377)	421,156
Prepaid taxes and income tax receivable	--	(365,855)
Other assets	2,478	183,854
Accounts payable and accrued expenses	352,330	(180,803)
Deferred compensation	668,073	--
Net cash provided by (used in) operating activities	(1,042,590)	694,713
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(406,891)	(717,515)
Sales of property and equipment	25,678	284,438
Advances to affiliates	--	36,438
Advances to notes receivable	--	--
Receipts on notes receivable	123,593	85,631
Repayment of related party receivables	63,562	433,036
Purchase of marketable securities, available for sale	(1,240,980)	(1,817,520)
Sale of marketable securities, available for sale	1,197,841	1,763,685
Purchase of other intangibles	--	--
Acquisition of new business, net of cash acquired	--	--
Net cash provided by (used in) in investing activities	(237,197)	68,193
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock	879,515	29,061
Proceeds from exercise of warrants	2,131,275	--
Proceeds from notes payable	--	--
Repayments of notes receivable for exercise of stock options	--	88
Payment of notes payable	(486,586)	(455,295)
Principal payment on capital lease obligations	(142,435)	(111,649)
Net cash provided by (used in) financing activities	2,381,769	(537,795)
NET INCREASE IN CASH AND CASH EQUIVALENTS	1,101,982	225,111
CASH AND CASH EQUIVALENTS, BEGINNING	1,207,299	982,188
CASH AND CASH EQUIVALENTS, ENDING	$ 2,309,281	$ 1,207,299

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

F-6

ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION - The consolidated financial statements include the accounts of Advantage Marketing Systems, Inc. and its wholly owned subsidiaries, Miracle Mountain International, Inc. and Chambre' International, Inc. (the "Company"). All significant intercompany accounts have been eliminated.

NATURE OF BUSINESS - The Company markets a product line of consumer oriented products in the weight management, dietary supplement and personal care categories that are produced by various manufacturers. The Company sells its product line through a network of full and part-time independent associates. The Company also sells supplies and materials to its independent associates.

USE OF ESTIMATES - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

REVENUE RECOGNITION - The Company recognizes revenue upon shipment of products, training aids and promotional material to the independent associates.

LOANS AND TRADE RECEIVABLES - All of the Company's customers pay for sales in advance of shipment. As such, the Company has no trade receivables. Loans to associates are repayable in five years or less; are secured by commissions controlled by the Company; and are no longer allowed. Interest rates on loans are typically two percent or more above the Prime rate and are fixed.

CREDIT LOSSES AND DOUBTFUL ACCOUNTS - All loans and receivables are collateralized by guaranteed payment sources that are within the Company's control. As such, management believes there is no need for an allowance for doubtful accounts.

SALES RETURNS - All of the Company's products include a customer satisfaction guarantee. Company products may be returned within 30 days of purchase for a full refund or credit toward the purchase of another Company product. The Company also has a buy-back program whereby it will repurchase products sold to an independent associate (subject to a restocking fee) provided that the associate terminates his/her associateship agreement with the Company and returns the product within 12 months of original purchase in marketable condition. The cost of products returned to the Company is included in net sales. For the years ended December 31, 2003, 2002 and 2001, the cost of products returned to the Company was less than one percent of gross sales.

CASH AND CASH EQUIVALENTS - Cash and cash equivalents consist of cash in banks and all short term investments with initial maturities of three months or less. The Company maintains its cash and cash equivalents in accounts that may not be federally insured. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk.

MARKETABLE SECURITIES - All of the Company's marketable securities are classified as available for sale and reported at fair value. The related unrealized gains and losses are 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.

INVENTORY - Inventory consists of consumer product inventory and training and promotional material such as video tapes, cassette tapes and paper supplies held for sale to customers and independent associates. Inventory is stated at the lower of cost or market. Cost is determined on a first-in, first-out method.

SHIPPING AND HANDLING COSTS - Shipping and handling costs are included as a component of cost of goods sold. Fees charged to customers for shipping and handling are included in sales.

INTANGIBLES - Intangible assets consist of covenants not to compete and other intangibles, which have a significant residual value. Covenants not to compete are being amortized over the life of the contracts.

The table below details the gross carrying amount and accumulated amortization:

	FOR THE YEAR ENDED DECEMBER 31,		
	2003	2002	2001
Non-compete covenants, gross	$ 644,000	$ 644,000	$ 644,000
Other intangibles, gross	428,338	428,338	428,338
Total intangibles, gross	$1,072,338	$1,072,338	$1,072,338
Accumulated amortization, non-compete covenants	$ 450,083	$ 393,683	$ 337,283
Accumulated amortization, other intangibles	64,251	42,834	21,417
Total accumulated amortization	$ 514,334	$ 436,517	$ 358,700

Intangible amortization for the years ended December 31, 2003, 2002 and 2001, was $77,817 per year. Estimated amortization expense for the years 2004, 2005 and 2006 is $77,817 and estimated amortization expense for the years 2007 and 2008 is $46,134.

PROPERTY AND EQUIPMENT - Property and equipment are stated at cost or, in the case of leased assets under capital leases, at the fair value of the leased property and equipment, less accumulated depreciation and amortization. Property and equipment are depreciated using the straight-line method over the estimated useful lives of the assets of three to 20 years. Assets under capital leases and leasehold improvements are amortized over the lesser of the term of the lease or the life of the asset.

LONG-LIVED ASSETS - Management of the Company assesses recoverability of its long-lived assets whenever events or changes in circumstances indicate that the carrying value of the asset may not be recoverable through future cash flows generated by that asset. Recoverability is assessed and measured on long-lived assets using an estimate of the undiscounted future cash flows attributable to the asset. Impairment is measured based on future cash flows discounted at an appropriate rate.

FAIR VALUE DISCLOSURE - The Company's financial instruments include cash and cash equivalents, marketable securities, receivables, short-term payables, notes payable and capital lease obligations. The carrying amounts of cash and cash equivalents, receivables and short-term payables approximate fair value due to their short-term nature. Marketable securities held for sale are carried at fair value. The carrying amounts of capital lease obligations approximate fair value based on borrowing rates currently

available to the Company. Notes payable with carrying amounts of $1,989,170 and $2,444,628 had fair values of approximately $2,050,000 and $2,520,000 at December 31, 2003 and 2002, respectively.

EARNINGS (LOSS) PER SHARE - Earnings (loss) per common share is computed based upon net income (loss) divided by the weighted average number of common shares outstanding during each period. Earnings (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 earnings (loss) per common share and earnings (loss) per common share - assuming dilution:

	INCOME (LOSS) (NUMERATOR)	SHARES (DENOMINATOR)	P
For the year ended December 31, 2003:			
Loss per common share:			
Loss available to common stockholders	$(2,568,861)		$
Weighted average common shares outstanding		4,508,986	
Loss per common share - assuming dilution:			

Options	--	--	
Loss available to common stockholders plus assumed conversions	$(2,568,861)	4,508,986	$
For the year ended December 31, 2002:			
Loss per common share:			
Loss available to common stockholders	$(3,205,035)		$
Weighted average common shares outstanding		4,419,196	
Loss per common share - assuming dilution:			
Options	--	--	
Loss available to common stockholders plus assumed conversions	$(3,205,035)	4,419,196	$
For the year ended December 31, 2001:			
Earnings per common share:			
Income available to common stockholders	$ 8,551		$
Weighted average common shares outstanding		4,379,486	
Earnings per common share - assuming dilution:			
Options	--	312,812	
Income available to common stockholders plus assumed conversions	$ 8,551	4,692,298	$

Options to purchase 2,691,808 shares of common stock at exercise prices ranging from $1.30 to $6.13 per share were outstanding at December 31, 2003 but were not included in the computation of loss per common share-assuming dilution because all options were antidilutive. At December 31, 2003, 359,996 common shares issuable pursuant to the terms of a convertible acquisition note payable were excluded from the determination of diluted loss per share under the if-converted method, because the effect of inclusion was antidilutive.

Options to purchase 1,756,653 shares of common stock at exercise prices ranging from $1.31 to $6.13 per share were outstanding at December 31, 2002 but were not included in the computation of loss per common share-assuming dilution because such inclusion would not be dilutive. At December 31, 2002, 526,664 common shares issuable pursuant to the terms of a convertible acquisition note payable were

excluded from the determination of diluted loss per share under the if-converted method, because the effect of inclusion was antidilutive.

Options to purchase 1,193,691 shares of common stock at exercise prices ranging from $2.95 to $6.13 per share were outstanding at December 31, 2001 but were not included in the computation of earnings per common share-assuming dilution because the options' exercise price was greater than the average market price of the common shares. At December 31, 2001, 693,332 common shares issuable pursuant to the terms of a convertible acquisition note payable were excluded from the determination of diluted earnings per share under the if converted method because the effect of inclusion was antidilutive.

Warrants to purchase 1,353,073 shares of common stock at exercise prices ranging from $3.40 to $5.40 per share at December 31, 2003 and warrants to purchase 1,874,768 shares of common stock at exercise prices ranging from $3.40 to $5.40 per share at December 31, 2002 and 2001 were outstanding but were not included in the computation of earnings per common share-assuming dilution because the warrants' exercise price was greater than the average market price of the common shares.

ACCOUNTING STANDARDS YET TO BE ADOPTED - 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 becomes applicable on December 31, 2003 for special purpose entities (SPEs) created prior to February 1, 2003. As of December 31, 2003, 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), will not have a material effect on its financial condition or results of operations.

In November 2003, the Emerging Issues Task Force or EITF of the FASB reached a consensus on one issue with respect to EITF Issue 03-1, "The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments," thereby requiring certain quantitative and qualitative disclosures for securities accounted for under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," that are impaired at the balance sheet date but for which an other-than-temporary impairment has not been recognized. Adoption of EITF Issue 03-1, which was effective for us on December 31, 2003, did not have a material impact on the Company's financial position, results of operations or cash flows. The required disclosures have been considered in Note 3 to the consolidated financial statements.

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. The Company does not expect the issuance of SAB No. 104 to significantly impact its current revenue recognition policies.

ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001 (CONT.)

In May 2003, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity" (SFAS 150"). SFAS No. 150 changes the accounting for certain financial instruments that, under previous guidance, could be classified as equity or "mezzanine" equity, by now requiring those instruments to be classified as liabilities (or assets in some circumstances) in the consolidated balance sheets. Further, SFAS No. 150 requires disclosure regarding the terms of those instruments and settlement alternatives. The guidance in SFAS No. 150 generally is effective for all financial instruments entered into or modified after May 31, 2003, and was otherwise effective at the beginning of the first interim period beginning after June 15, 2003. The Company has evaluated SFAS No. 150 and determined that it does not have an impact on its financial reporting and disclosures.

COMPREHENSIVE INCOME - The Company classifies other comprehensive income items by their nature in the financial statements and displays the accumulated balance of other comprehensive income separately in the stockholders' equity section of the balance sheet. The Company's only other comprehensive income item is related to unrealized gains (losses) on investment securities classified as available for sale.

	2003	2002	
Unrealized gain (loss) on investment arising during the period	$ 120,915	$ (69,299)	$
Less reclassification adjustment for gains (losses) included in net earnings	(44,337)	(30,437)	
Unrealized gain (loss) on investment, net of income taxes of $100,000, $23,517 and $5,615, respectively	$ 165,252	$ (38,862)	$

INCOME TAXES - The Company uses an asset and liability approach to account for income taxes. Deferred income taxes are recognized for the tax consequences of temporary differences and carryforwards by applying enacted tax rates applicable to future years to differences between the financial statement amounts and the tax bases of existing assets and liabilities. A valuation allowance is established if, in management's opinion, it is more likely than not that some portion of the deferred tax asset will not be realized.

GOODWILL - During 2001, goodwill was amortized using the straight-line method over 7 to 20 years and the Company assessed the recoverability of goodwill by determining whether the amortization of the asset balance over its remaining life could be recovered through the undiscounted future operating cash flows of the acquired operation. The amount of impairment, if any, was measured based on projected discounted future operating cash flows. Effective January 1, 2002, the Company adopted SFAS No. 142, "Goodwill and Other Intangible Assets" and ceased amortizing goodwill. Major provisions of this statement are as follows:

- Intangible assets acquired in a business combination must be recorded separately from goodwill if they arise from contractual or other legal rights or are separable from the acquired entity and can be sold, transferred, licensed, rented, or exchanged, either individually or as a part of a related contract, asset, or liability;

- Goodwill and intangible assets with indefinite lives are not amortized but are tested for impairment at least annually, except in certain circumstances, and whenever there is an impairment indicator; and

- All acquired goodwill must be assigned to reporting units for purposes of impairment testing and segment reporting.

The following table reconciles reported net income (loss) and related per share amounts to amounts that would have been presented exclusive of amortization expense recognized for goodwill that is no longer being amortized (tax-effected):

	YEARS ENDED DECEMBER 31,		
	2003	2002	2001
Reported net income (loss)	$ (2,568,861)	$ (3,205,035)	$ 8,551
Add back: Goodwill amortization .	--	--	141,733
Adjusted net income (loss)	$ (2,568,861)	$ (3,205,035)	$ 150,284
BASIC EARNINGS (LOSS) PER SHARE:			
Reported net income (loss)	$ (.57)	$ (.73)	$ .00
Goodwill amortization	--	--	.03
Adjusted net income (loss)	$ (.57)	$ (.73)	$ .03
DILUTED EARNINGS (LOSS) PER SHARE:			
Reported net income (loss)	$ (.57)	$ (.73)	$ .00
Goodwill amortization	--	--	.03
Adjusted net income (loss)	$ (.57)	$ (.73)	$ .03

The Company evaluated its goodwill as of the adoption of SFAS No. 142 on January 1, 2002 and determined that there were no indicators of impairment since the Company's market capitalization was in excess of the value of identifiable net assets as of January 1, 2002. The Company obtained a valuation from an independent third-party appraiser.

The Company updated its analysis of goodwill impairment as of October 31, 2002 and determined that there was an indicator of impairment of its recorded goodwill; accordingly, the Company completed the second phase of impairment testing. Based on the impairment test, the Company recognized an impairment of approximately $3.8 million as of December 31, 2002, which eliminated goodwill in its entirety.

The impairment was required because economic conditions at the time of testing reduced the market capitalization of the Company to a level below the value of identifiable net assets. Under SFAS No. 142, an impairment adjustment recognized after adoption is required to be recognized as an operating expense.

ADVERTISING COSTS - The Company expenses the cost of advertising the first time advertising takes place. Advertising expense for the years ended December 31, 2003, 2002 and 2001 was approximately $696, $2,254 and $38,704, respectively.

STOCK-BASED COMPENSATION - The Company applies Accounting Principles Board Opinion No. 25 and related interpretations in accounting for its stock-based compensation awards. 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 (see also Note 6) was determined based upon the fair value at the grant date consistent with the methodology prescribed under SFAS No. 123.

	Years Ended	
	2003	20
Net income (loss) as reported	$(2,568,861)	$(3,205
Adjustment, net of tax	(622,275)	(141
Proforma net loss	$(3,191,136)	$(3,346
Net income (loss) per common share as reported......................	$ (.57)	$
Adjustment, net of tax	(.14)	
Proforma net loss per common share, basic and diluted	$ (.71)	$
Weighted average common shares outstanding, basic and diluted	4,508,986	4,419

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 2003, 2002 and 2001, respectively: risk-free interest rates of 2.89, 2.92 and 4.86 percent; no dividend yield or assumed forfeitures; expected lives of 5.0 years; and volatility of 75, 55 and 63 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.

ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001 (CONT.)

2. MARKETABLE SECURITIES

Investments in securities are summarized as follows:

	DECEMBER 31, 2003			
Type of investment	COST/ AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIM FAI VAL
Short term investments - available for sale.....	$ 17,709	$ --	$ --	$ 1
Debt securities - available for sale				
Mutual Funds	$ 787,551	$ 6,875	$ (7,571)	$ 78
	$ 787,551	$ 6,875	$ (7,571)	$ 78
Equities - available for sale				
Mutual Funds	$ 921,605	$ 150,809	$ --	$1,07
	$ 921,605	$ 150,809	$ --	$1,07
	$1,726,865	$ 157,684	$ (7,571)	$1,87

ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001 (CONT.)

Type of investment	Cost/ Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses

Short term investments - available for sale..	$ 18,208	$ --	$ --	$
Debt securities - available for sale				
U.S. Treasury and other U.S. government corporations and agencies	$ 100,250	$ 344	$ --	$
Foreign bonds, notes and debentures	24,930	--	(148)	
Mutual Funds	662,000	14,057	(94)	
	$ 787,180	$ 14,401	$ (242)	$
Equities - available for sale				
Preferred Stock	$ 38,089	$ 4,457	$ (312)	$
Mutual Funds	892,804	--	(133,442)	
	$ 930,893	$ 4,457	$ (133,754)	$
	$ 1,736,281	$ 18,858	$ (133,996)	$

Proceeds from sales of available for sale securities were $1,197,281, $1,763,685 and $1,840,000 for 2003, 2002 and 2001, respectively. Gross gains of $30,466, $2,161 and $10,031 and gross losses of $74,803, $32,598 and $6,317 for 2003, 2002 and 2001, respectively, were realized on those sales. The Company had no significant amount of impaired investments at December 31, 2003, and believes its investments will be fully recovered.

For the years ended December 31, 2003, 2002 and 2001, interest income for available for sale securities was $1,291, $29,066 and $77,618, respectively. Dividend income for available for sales securities for the years ended December 31, 2003, 2002 and 2001 was $41,849, $29,437 and $8,443, respectively.

3. PROPERTY AND EQUIPMENT

Property and equipment consists of the following at December 31:

	December 31, 2002	
	2003	2002
Office furniture, fixtures and equipment ...	$ 4,501,628	$ 4,362,068
Vehicles	923,876	842,081
Leasehold improvements	62,793	62,793
Building	1,521,083	1,521,083
Land	148,308	148,308
	7,157,688	6,936,333
Accumulated depreciation and amortization ..	(3,695,955)	(3,030,901)
Total property and equipment, net	$ 3,461,733	$ 3,905,432

Depreciation expense for the years ended December 31, 2003, 2002 and 2001 was $870,574, $855,570, and $790,115, respectively.

During 2001, the Company completed construction of a state-of-the-art distribution and call center facility in Oklahoma City. The 23,346 square foot facility has the capability of handling warehouse volumes of up to $100 million in annual sales, and up to 100 employees in the call center. The Company funded this project, in part, with bank loans of $980,000 for the land and building and $166,216 for warehouse equipment. The interest rate on both loans is the Prime Rate minus .25%, which was 3.75% as of December 31, 2003, and requires 60 monthly principal and interest payments of

$9,570, with the remaining balance due on September 30, 2006. The balance of both loans, plus accrued interest, was paid in full on January 14, 2004.

4. DEBT

Notes payable and long-term debt consisted of the following at December 31:

	2003
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	$ 853,270
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	145,950
Note payable to RMS Limited Partnership, 7.5% effective rate, payable in 60 monthly installments net of discount of $80,069 and $169,070 at December 31, 2003 and 2002, respectively (See Note 10)	961,606
9.0% note payable to Ford Credit, payable in monthly installments of $720.13	--
5.0% note payable to Lexus Motor Credit, payable in monthly installments of $588.59	28,344
	1,989,170
Less current maturities	485,161
	$1,504,009

Interest expense for the year ended December 31, 2003, 2002 and 2001 was approximately $143,000, $167,000 and $199,000. Under the original terms of the bank notes, the Company was subject to various covenants, which include minimum tangible net worth, minimum debt service coverage ratio, and maximum debt to EBITDA ratio requirements.

Future maturities of long-term debt consists of the following at December 31, 2003:

2004	$ 485,161
2005	571,968
2006	921,933
2007	6,710
2008	3,398
	$ 1,989,170

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. LEASE AGREEMENTS

The Company has various capital leases for office equipment. The lease terms range from 24 to 60 months. Additionally, annual lease rental payments for each lease range from $700 to $40,000 per year. The schedule of future minimum lease payments below reflects all payments under the leases.

The property and equipment accounts include $846,414 and $718,554 for leases that have been capitalized at December 31, 2003 and 2002, respectively. Related accumulated amortization amounted to $570,718 and $473,109 at December 31, 2003 and 2002, respectively.

The Company leases office space under noncancellable operating leases. Future annual minimum lease payments under capital leases and noncancellable operating leases with initial or remaining terms of one year or more at December 31, 2003 are as follows:

	CAPITAL LEASES	OPERATING LEASES	TOTAL
Year ending:			
2004	$ 91,831	$132,278	$224,109
2005	75,131	131,887	207,018
2006	25,572	133,999	159,571
2007	25,572	135,041	160,613
2008	26,142	116,645	142,787

Total minimum lease payments	$244,248	$649,850	$894,098
Less amount representing interest	22,414		
Present value of net minimum lease payments ..	221,834		
Less current portion	78,954		
Long-term capital lease obligations	$142,880		

Rental expense under operating leases for the years ended December 31, 2003, 2002 and 2001 was $164,346, $202,122, and $202,951, respectively.

6. STOCKHOLDERS' EQUITY

Common Stock - On March 4, 1998, the Company announced its intent to repurchase up to one million shares of the Company's common stock in the open market for cash. In connection with such repurchase, the Company filed with the Securities and Exchange Commission pursuant to Section 13(e)(1) of the Securities Exchange Act of 1934, as amended, an Issuer Tender Offer Statement on

March 4, 1998. As of December 31, 2003, the Company had repurchased 472,795 shares of the common stock at a total cost of $2,244,476.

Common Stock Options and Other Warrants - During 2003, the Company granted 1,348,151 options to employees at exercise prices ranging from $1.30 per share to $3.95 per share. Options were granted primarily for services rendered and to ensure the future availability of those services to the Company. During 2003, 369,838 prior options were exercised for cash. In addition, during the period, 43,158 options were canceled and no options expired.

During 2002, the Company granted 325,982 options to employees at exercise prices ranging from $1.31 per share to $2.28 per share. Options were granted primarily for services rendered and to ensure the future availability of those services to the Company. During 2002, 14,500 prior options were exercised for cash. In addition, during the period, 97,714 options were canceled and 13,870 options expired.

During 2001, the Company granted 388,694 options to employees at exercise prices ranging from $2.60 per share to $3.00 per share. Options were granted primarily for services rendered and to ensure the future availability of those services to the Company. None of the options granted during 2001 were exercisable at December 31, 2001 due to a one year minimum vesting period. During 2001, 61,000 prior options were exercised for cash. In addition, during the period, 257,976 options were canceled and no options expired.

The following table summarizes the Company's employee stock option and other warrants activity for the years ended December 31, 2003, 2002 and

2001:

	2003	WEIGHTED AVERAGE EXERCISE PRICE	2002	WEIGHTED AVERAGE EXERCISE PRICE	200
Options and other warrants outstanding beginning of year...........	1,756,653	$ 2.36	1,556,755	$2.54	1,487
Options and other warrants issued during the year...............	1,348,151	1.64	325,982	1.60	388
Options and other warrants exercised during the year...............	(369,838)	2.18	(14,500)	2.00	(61
Option and other warrants cancelled during the year...............	(43,158)	3.04	(97,714)	2.74	(257
Options and other warrants expired during the year...............	--	--	(13,870)	2.24	
Options and other warrants outstanding, end of year...................	2,691,808	$ 2.04	1,756,653	$2.36	1,556

ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001 (CONT.)

The weighted average grant-date fair value of options and other warrants granted during 2003, 2002 and 2001 was $1.58, $0.73 and $1.80 per share, respectively.

	Options and Other Warrants Outstanding			Options and Other Warrants Exercisable	
RANGE OF EXERCISE PRICES	NUMBER OUTSTANDING AT 12/31/03	WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE	WEIGHTED-AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE AT 12/31/03	WEIGHTED-AVERAGE EXERCISE PRICE
$1.30 - $2.95	2,391,026	6.20 years	$1.79	1,134,879	$1.98

$3.00 - $4.75	251,910	2.20 years	$3.68	191,591	$3.70
$5.25 - $6.13	48,872	1.23 years	$5.79	42,198	$5.82
	2,691,808		$2.04	1,368,668	$2.34

Common Stock Warrants - The following table summarizes the Company's common stock warrants and their activity for the years ended December 31, 2003, 2002 and 2001:

	WARRANTS ISSUED AND OUTSTANDING	EXERCIS PRICE
December 31, 2003:		
1997-A Warrants, beginning of the year	308,768	$3.40
1997-A Warrants, exercised during the year	5,453	$3.40
1997-A Warrants, end of the year	303,315	$3.40
Redeemable Common Stock Purchase Warrants, beginning of the year	1,436,000	$3.40
Redeemable Common Stock Purchase Warrants, exercised during the year	422,202	$3.40
Redeemable Common Stock Purchase Warrants, end of the year	1,013,798	$3.40
Underwriters' Warrants, beginning of the year	130,000	$5.40
Underwriters' Warrants, exercised during the year	94,040	$5.40
Underwriters' Warrants, end of the year	35,960	$5.40
December 31, 2002		
1997-A Warrants	308,768	$3.40
Redeemable Common Stock Purchase Warrants	1,436,000	$3.40
Underwriters' Warrants	130,000	$5.40
December 31, 2001:		
1997-A Warrants.	308,768	$3.40
Redeemable Common Stock Purchase Warrants	1,436,000	$3.40
Underwriters' Warrants	130,000	$5.40

Each warrant entitles the holder to purchase one share of common stock. As of January 8, 1998, the Company reduced the exercise price of the 1997-A Warrants from $12.00 to $3.40 and extended the exercise period from January 31, 1999 to November 6, 2002, to correspond more closely to the terms of the Redeemable Common Stock Purchase Warrants. In addition, on September 16, 2002 the Company

ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001 (CONT.)

extended the exercise period from November 6, 2002 November 12, 2003. On October 14, 2003, the Company extended the exercise period for the 1997-A warrants from November 12, 2003 to November 12, 2004. On December 10, 2003, the Company announced the redemption of all outstanding 1997-A warrants not exercised by January 16, 2004. Proceeds from the 1997-A warrant redemption totaled $714,877 and payment for unexercised warrants was $25.

As of January 6, 1998, the exercise price of the Redeemable Common Stock Purchase Warrants was adjusted from $5.40 to $3.40. In addition, on September 16, 2002 the Company extended the exercise period from November 6, 2002 to November 12, 2003. On October 14, 2003, the Company extended the exercise period for the redeemable stock purchase warrants and the underwriter warrants from November 12, 2003 to November 12, 2004. On December 10, 2003, the Company announced the redemption of all outstanding redeemable stock purchase warrants and the underwriter warrants not exercised by January 16, 2004. Proceeds from the redeemable stock purchase warrants and the underwriter warrant redemption totaled $5,394,615 and payment for unexercised warrants was $11,870.

There was no expense recognized in the Company's financial statements relating to either of the warrant exercise price reductions as the changes only affected allocations of additional paid-in capital because the Redeemable Common Stock Purchase Warrants and the 1997-A Warrants were issued in conjunction with an equity offering of the Company. The reduced exercise prices exceeded the market value of the Company's common stock on the date of the reduction. In addition, there was no expense recognized in the Company's financial statements relating to the extension of the exercise period for either the 1997-A Warrants or the Redeemable Common Stock Purchase Warrants.

The Redeemable Common Stock Purchase Warrants are subject to redemption by the Company at $0.25 per warrant. All of the outstanding Redeemable Common Stock Purchase Warrants must be redeemed if any are redeemed. The Company may redeem the 1997-A Warrants for $0.0001 per warrant. Any redemption of unexercised 1997-A Warrants would be for all such outstanding warrants. The Underwriters' Warrants were issued in connection with the sale of common stock and Redeemable Warrants in November 1997 and were in addition to other fees paid to the underwriters. The Underwriters' Warrants entitle the holder to purchase one unit consisting of one share of the Company's common stock and one Redeemable Common Stock Purchase Warrant.

7. STOCK OPTION PLANS

During 1995, the Company approved the 1995 Stock Option Plan (the "Plan"). Under this Plan, options available for grant can consist of (i) nonqualified stock options, (ii) nonqualified stock options with stock appreciation rights attached, (iii) incentive stock options, and (iv) incentive stock options with stock appreciation rights attached. The Company has reserved 1,125,000 shares of the Company's common stock

$.0001 par value, for the Plan. The Plan limits participation to employees, independent contractors, and consultants. Non-employee directors are excluded from Plan participation. The option price for shares of stock subject to this Plan is set by the Stock Option Committee of the Board of Directors at a price not less than 85% of the market value of the stock on the date of grant. No stock options may be exercised within six months from the date of grant, unless under a Plan exception, nor more than ten years after the date of grant. The Plan provides for the grant of stock appreciation rights, which allow the holder to receive in cash, stock or combination thereof, the difference between the exercise price and the fair value of the stock at date of exercise. The fair value of stock appreciation rights is charged to compensation expense. The stock appreciation right is not separable from the underlying stock option or incentive stock option originally granted and can only be exercised in tandem with the stock option. No stock appreciation rights are attached to any options outstanding.

During 2003, the Company approved the 2003 Stock Incentive Plan, or 2003 Plan. Under the 2003 Plan, options available for grant can consist of (i) nonqualified stock options, (ii) incentive stock options, and (iii) restricted stock. The Company has reserved 2,000,000 shares of the Company's common stock $.0001 par value for the 2003 Plan. The Plan limits participation to employees, independent contractors, and consultants. The option price for shares of stock subject to this Plan is set by the Compensation Committee of the Board of Directors at a price not less than market value of the common stock on the date of grant. No stock options may be exercised within six months from the date of grant, unless under a Plan exception, nor more than ten years after the date of grant.

During the year ended December 31, 2003, the Company issued no options under the 1995 Plan and 1,334,000 options under the 2003 Plan. During the year ended December 31, 2002 the Company issued 325,982 options under the 1995 Plan. At December 31, 2003, the Company had 2,691,807 stock options outstanding of which 932,807 were issued pursuant to the 1995 Plan and 1,329,000 were issued pursuant to the 2003 Plan. During the year ended December 31, 2002, the Company had 1,756,653 stock options outstanding of which 1,083,403 were issued pursuant to the 1995 Plan.

8. RELATED PARTIES

During 2003, 2002 and 2001, the Company received approximately $8,520, $7,069 and $15,231, respectively, from Pre-Paid Legal Services, Inc. ("Pre-Paid Legal"), a shareholder, for commissions on sales of memberships for the services provided by Pre-Paid Legal. As of July 1, 2000, the Company began offering the Company's employees access to the services provided by Pre-Paid Legal through an employee benefit option. The Company pays half of the cost for each employee electing to participate in the plan. During 2003, 2002 and 2001, the Company paid $5,532, $6,934 and $7,593, respectively, to Pre-Paid Legal for these services. The Company's Chairman of the Board and Chief Executive Officer, John W. Hail, is a director of Pre-Paid Legal.

During the first quarter of 1998, the Company agreed to loan John W. Hail up to $250,000. Subsequently the Company also agreed to loan up to an additional $75,000. In 2000, an additional $200,000 was approved. On January 1, 2001 the outstanding balance on all the notes were combined into one note payable in monthly installments. The loans and extension were unanimously approved by the board of directors. These loans were collateralized by stock and property, and bear interest at 8% per annum. These loans were fully paid in 2003.

Also during 2003, 2002 and 2001, the Company paid Mr. Loney and his wife sales bonuses of $25,460, $30,887 and $38,028, respectively. These bonuses were based upon purchases by them and their downline associates in accordance with the Company's network marketing program applicable to all independent associates in effect at the time of the sales. Mr. Loney's wife is the daughter of John W. Hail.

ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001 (CONT.)

9. INCOME TAXES

Income taxes for 2003, 2002 and 2001 are comprised of current tax (benefit) expense of $0, $(423,279) and $(37,722) and deferred taxes of $(1,031,839), $(1,331,778) and $43,189, respectively. A reconciliation of the statutory Federal income tax rate to the effective income tax rate for the years ended December 31, 2003, 2002, and 2001 is as follows:

	2003	2002	2001
Statutory federal income tax rate ..	(34.0)%	(34.0)%	34.0%
State tax effective rate	(4.0)	(4.0)	4.0
Permanent differences	7.5	2.1	2.1
Benefit of graduated tax rates	0.2	0.2	-
Prior year assessments finalized ...	(2.4)	-	(1.5)
Increase in valuation allowance.....	14.0	-	-
Other	-	0.3	0.4
	(18.7)%	(35.4)%	39.0%

The change in the total deferred tax net assets from December 31, 2002 to December 31, 2003 was $482,355. This difference is allocated as $590,839 included in tax expense reduced by $108,484 classified in stockholders' equity, respectively.

Deferred tax liabilities and assets at December 31, 2003 and 2002 are comprised of the following:

	December 31, 2003	December 31, 2002
Deferred tax liabilities:		
Depreciation	$ (212,959)	$ (178,789)
Unrealized gains	(56,646)	
Total deferred tax liabilities	(269,605)	(178,789)
Deferred tax assets:		
Goodwill impairment and other intangibles	1,170,825	1,273,415
Net operating loss carryforwards	1,069,391	151,371
Deferred compensation	252,074	-
Inventory	41,471	60,518
Unrealized losses	-	43,448
Other	64,870	47,239
Valuation allowance	(441,000)	-
Total deferred tax assets	2,157,631	1,575,991
Net deferred taxes	1,888,026	1,397,202
Less current portion of net deferred tax assets	4,854	120,343
Noncurrent portion of deferred tax asset	$ 1,883,172	$ 1,276,859

The valuation allowance increased $441,000 for the year ended December 31, 2003.

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 $2,834,000 available to reduce future taxable income, which will begin to expire in 2009. Net operating loss carryforwards of $196,000 are limited in usage.

10. ACQUISITIONS

On January 4, 2001, the Company and one of its wholly owned subsidiaries, LifeScience Technologies Holdings, acquired LifeScience Technologies Holding Limited Partnership, LifeScience Technologies

YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001 (CONT.)

Limited, LifeScience Technologies of Japan, LST Fulfillment limited Partnership and LifeScience Technologies of Canada, Inc. (the "LifeScience Technologies Acquisition"). The purchase price to the Company was approximately $1.2 million cash plus $41,667 per month or 5% of LifeScience Technology product sales, whichever is greater, payable for 60 months commencing in January 2001. The seller, at its option, has the right to take shares of the Company's common stock at an option price of $3.00 per share in lieu of cash for the monthly payment. However, such option is limited to a total of 860,000 shares and shares not taken in a month are not cumulative. No shares have been issued under the agreement at December 31, 2003. In addition, the balance of the acquisition price, plus accrued interest, was paid in full on January 29, 2004.

The estimated fair value of assets acquired and liabilities assumed at acquisition are as follows:

Estimated Fair value of assets	
Cash	$ 76,760
Inventory	793,629
Property and equipment	283,924
Goodwill and other intangibles	2,508,805
Total fair value of assets	3,663,118
Liabilities assumed	
Accounts payable	176,060
Accounts expenses	181,223
Estimated fair value of acquisition	$3,305,835

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

11. SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

	Year Ended December 3	
	2003	2002
Cash paid during the year for:		
Interest	$ 140,232	$ 194,386
Income taxes - net of refund.	--	(56,912)
Noncash financing and investing activities:		
Property and equipment acquired by capital lease	131,807	--
Note payable for purchase of vehicle	31,128	
LifeScience Technologies Acquisition:		
Fair value of tangible net assets acquired	$ --	$ --

Purchase price in excess of tangible net assets acquired	--	--
Present value of future payments required	--	--
Cash included in tangible net assets acquired	--	--
Cash paid for acquisition, net of cash acquired	$ --	$ --

ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001 (CONT.)

12. COMMITMENTS, CONTINGENCIES AND GUARANTEES

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 is April 12, 2004. The Company will comply and cease 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. Again, 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 are 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, the Company's 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.

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 35.9% of the Company's 2003 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.

13. 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 bonus payment of 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 bonus payment 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 December 31, 2003, the discounted value of those fixed supplemental payments was approximately $668,000. The Company accrued this expense as distribution and administrative expenses.

14. QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The following is a summary of the quarterly results of operations for the years ended December 31, 2003 and 2002.

	2003			
	December 31	September 30	June 30	March 31
Revenues	$ 4,302,185	$ 4,883,055	$ 4,686,784	$ 4,614,153
Costs and expenses	6,421,667	5,193,596	4,972,625	5,057,989

Income (loss) before income taxes	(2,119,482)	(310,541)	(285,841)	(443,836)
Income tax expense (benefit)	(185,033)	(121,232)	(111,478)	(173,096)
Net income (loss)	$(1,934,449)	$ (189,309)	$ (174,363)	$ (270,740)
Net income (loss) per common share - basic	$ (0.41)	$ (0.04)	$ (0.04)	$ (0.06)
Net income (loss) per common share - assuming dilution	$ (0.41)	$ (0.04)	$ (0.04)	$ (0.06)

Net Loss per share is computed independently for each of the quarters presented; therefore, the sum of the quarterly loss per share does not necessarily equal the total for the year.

	2002			
	December 31	September 30	June 30	March 31
Revenues	$ 4,630,657	$ 5,525,701	$ 5,865,850	$ 6,281,373
Costs and expenses	9,547,803	5,845,558	5,738,921	6,131,391
Income (loss) before income taxes	(4,917,146)	(319,857)	126,929	149,982
Income tax expense (benefit)	(1,738,308)	(124,744)	49,502	58,493
Net income (loss)	$(3,178,838)	$ (195,113)	$ 77,427	$ 91,489
Net income (loss) per common share - basic	$ (0.73)	$ (0.04)	$ 0.02	$ 0.02
Net income (loss) per common share - assuming dilution	$ (0.73)	$ (0.04)	$ 0.02	$ 0.02

Net Income (loss) per share is computed independently for each of the quarters presented; therefore, the sum of the quarterly income (loss) per share does not necessarily equal the total for the year.

ADVANTAGE MARKETING SYSTEMS, INC.
AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001 (CONT.)

15. YEAR-END ADJUSTMENTS

The Company made certain year-end adjustments in 2003 resulting from the write off of bad debts, the write down of fixed assets, and accrual of deferred compensation that were material to the results of the fourth quarter. These adjustments, after applicable income tax effects, reduced net income (loss) as follows:

Write off of bad debts................................	$ 24,500
Write down of fixed assets............................	66,500
	$ 91,000

These adjustments increased 2003 fourth quarter basic loss per share by $0.02.

16. VALUATION AND QUALIFYING ACCOUNTS

The table below shows the beginning balance, activity and ending balance for the Company's reserves and allowances deducted from asset accounts:

		Additions			
Description	Balance at Beginning of Period	Charged to Costs and Expenses	Charged to Other Accounts	Deductions	B End
YEAR ENDED DECEMBER 31, 2003:					
Reserves and allowances deducted from asset accounts:					
Allowance for doubtful accounts	$ --	$--			$
Allowance for obsolete inventory	116,143			116,143	
Allowance for deferred tax assets	--	441,000			
YEAR ENDED DECEMBER 31, 2002:					
Reserves and allowances deducted from asset accounts:					
Allowance for doubtful accounts	$ 92,931			$ 92,931	$
Allowance for obsolete inventory	--	116,143			
YEAR ENDED DECEMBER 31, 2001:					
Reserves and allowances deducted from asset accounts:					
Allowance for doubtful accounts	$ 157,804			$ 64,873	$
Allowance for obsolete inventory	--	--			

* * * * * *

Exhibit Index

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.
10.1	Warrant Agreement between Registrant and U.S. Stock Transfer Inc., dated as of January 16, 1997, as amended and restated January 8, 1998, incorporated by reference to Amendment No. 2 to Form 8-A Registration Statement, filed with the Commission on January 13, 1998.
10.2	Unit and Warrant Agreement between Registrant and U.S. Stock Transfer Inc., dated as of November 6, 1997, as amended and restated January 8, 1998, incorporated by reference to Amendment No. 1 to Form 8-A Registration Statement, filed with the Commission on January 15, 1998.
10.5	Purchase and Assignment Agreement by and among Advantage Marketing Systems, Inc., LifeScience Technologies Holdings, Inc., GHI Holdings, Inc., LifeScience Technologies, Inc. and RMS Limited Partnership, dated as of January 3, 2001, incorporated by reference to Form 8-K filed with the Commission on January 8, 2001.
10.6	Promissory Note dated January 3, 2001, to RMS Limited Partnership by Advantage Marketing Systems, Inc., LifeScience Technologies Holdings, Inc., LifeScience Technologies Holdings Limited Partnership, LifeScience Technologies Holdings, Inc., LifeScience Technologies of Japan and LST Fulfillment Limited Partnership, incorporated by reference to Form 8-K filed with the Commission on January 8, 2001.
10.7	Stock Option Agreement of Advantage Marketing Systems dated January 3, 2001, incorporated by reference to Form 8-K filed with the Commission on January 8, 2001.
10.8	Joint Marketing Agreement with PrimeBuy Network.com, Inc., dated August 30, 2002, incorporated by reference to Form 10-Q filed with the Commission on November 1, 2002.
10.9	Promissory Note executed by PrimeBuy Network.com, Inc., dated August 2, 2002, incorporated by reference to Form 10-Q filed with the Commission on November 1, 2002.
10.10*	The Advantage Marketing Systems, Inc. 1995 Stock Option Plan, incorporated by reference to Form SB-2 Registration Statement (No. 33-80629), filed with the Commission on November 20, 1996.

10.11*	Employment Agreement by and between David D'Arcangelo and Registrant dated effective as of November 25, 2002, incorporated by reference to Form 10-K/A filed with the

	Commission on March 31, 2003.
10.12*	Non-Qualified Stock Option Agreement by and between David D'Arcangelo and Registrant dated effective as of December 2, 2002, incorporated by reference to Form 10-K/A filed with the Commission on March 31, 2003.
10.13*	The Advantage Marketing Systems, Inc. 2003 Stock Incentive Plan, incorporated by reference to Form S-8 Registration Statement (No. 333-109093), filed with the Commission on September 24, 2003.
10.14	Fulfillment Services Agreement with Vita Sales & Distribution Multi-Country, dated January 19, 2004, filed herewith.
10.15*	Employment Agreement by and between John W. Hail and Registrant dated effective as of November 4, 2003, filed herewith.
21	Subsidiaries, incorporated by reference to Form 10-K filed with the Commission on April 17, 2001.
23.1	Consent of Grant Thornton LLP, 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.

* Designates a compensatory plan.