NUTRASTAR INC
Form 10QSB
August 19, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-QSB

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2002

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

Commission File Number 0-32565

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

CALIFORNIA	87-0673375
(State of other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
1261 Hawk's Flight Court El Dorado Hills, California	95762
(Address of Principal Executive Offices)	(Zip Code)

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

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

YES X NO ____

Common stock, no par value, 21,649,520 issued and outstanding as of July 31, 2002.

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PART 1 - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

NUTRASTAR INCORPORATED AND SUBSIDIARIES
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June 30, 2002 (unaudited)

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NUTRASTAR INCORPORATED AND SUBSIDIARIES
CONDENSED, CONSOLIDATED BALANCE SHEET
June 30, 2002 (unaudited)

ASSETS

Current assets	
Cash	$ 10,816
Accounts receivable	79,876
Inventory, net	131,614
Prepaid expenses	17,564
Total current assets	239,870
Property and equipment, net	220,009
Patents and trademarks, net	48,849
Goodwill	250,001
Total assets	$758,729

NUTRASTAR INCORPORATED AND SUBSIDIARIES
CONDENSED, CONSOLIDATED BALANCE SHEET
June 30, 2002 (unaudited)

LIABILITIES AND SHAREHOLDERS' DEFICIT

Current liabilities	
Accounts payable	$ 664,241
Accrued salaries and benefits	80,029
Deferred compensation	93,462
Accrued expenses	128,722
Due to officer	10,251
Note payable to officer	100,000
Total current liabilities	1,076,705
Put option	130,000
Total liabilities	1,206,705
Commitments and contingencies	
Convertible, redeemable series A preferred stock, no par value, $1 stated value 3,000,000 shares authorized 2,084,707 shares issued and outstanding	1,923,767
Shareholders' deficit	
Common stock, no par value 50,000,000 shares authorized 21,649,520 shares issued and outstanding	4,940,696
Common stock committed	686,674
Deferred compensation	(915,207)
Accumulated deficit	(7,083,906)
Total shareholders' deficit	(2,371,743)
Total liabilities and shareholders' deficit	$ 758,729

NUTRASTAR INCORPORATED AND SUBSIDIARIES
CONDENSED, CONSOLIDATED STATEMENTS OF OPERATIONS
For the Three and Six Months Ended June 30,

	For the Three Months Ended June 30,	For the Six Months Ended June 30,

	2002	2001	2002	2001
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Revenues				
Net sales	$ 536,370	$ 195,148	$ 830,727	$ 663,468
Commissions revenue	--	112,286	--	112,286
Total revenues	536,370	307,434	830,727	775,754
Cost of goods sold	371,526	165,772	553,998	570,197
Gross profit	164,844	141,662	276,729	205,557
Operating expenses	772,864	410,012	1,954,332	830,005
Loss from operations	(608,020)	(268,350)	(1,677,603)	(624,448)
Other income (expense)				
Interest income	--	--	204	--
Interest expense	(5,024)	(83,139)	(5,368)	(87,268)
Total other income (expense)	(5,024)	(83,139)	(5,164)	(87,268)
Net loss	(613,044)	(351,489)	(1,682,767)	(711,716)
Cumulative preferred dividend	(36,483)	--	(72,965)	--
Net loss available to common shareholders	$ (649,527)	$ (351,489)	$ (1,755,732)	$ (711,716)
Basic and diluted loss available to common shareholders per share	$ (0.03)	$ (0.02)	$ (0.08)	$ (0.04)
Basic and diluted weighted-average shares outstanding	21,649,520	15,943,905	21,649,520	15,943,905

NUTRASTAR INCORPORATED AND SUBSIDIARIES
CONDENSED, CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Six Months Ended June 30,

	2002 (unaudited)	2001 (unaudited)
Cash flows from operating activities		
Net loss	$(1,682,767)	$ (711,716)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	62,380	45,525
Inventory obsolescence	8,702	--
Loss reserve for patents and trademarks	66,678	--
Amortization of deferred compensation	155,980	--
Non-cash issuances of stock options	221,688	--
Non-cash issuances of warrants	850	--
Non-cash issuances of committed stock	162,500	--
(Increase) decrease in		
Accounts receivable	(78,283)	(1,765)
Inventory	(46,430)	443,204
Prepaid expenses	(8,776)	(78)
Deposits	316,071	100,525
Increase (decrease) in		
Accounts payable	147,122	(193,588)
Accrued salaries and benefits	19,015	13,013
Deferred Compensation	93,462	--
Accrued expenses	41,353	(54)
Due to officer	(21,778)	24,106
Net cash used in operating activities	(542,233)	(280,828)
Cash flows from investing activities		
Purchase of property and equipment	(66,149)	(233,111)
Purchase of patents and trademarks	(11,304)	(5,862)
Net cash used in investing activities	(77,453)	(238,973)
Cash flows from financing activities		
Proceeds from committed stock	125,000	--
Refunds of deposits payable	--	(173,000)
Proceeds from note payable to officer	100,000	--
Proceeds from convertible note payable	--	776,195
Net cash provided by financing activities	225,000	603,195
Net increase (decrease) in cash	$ (394,686)	$ 83,394
Cash, beginning of period	405,502	5,865
Cash, end of period	$ 10,816	$ 89,259
Supplemental disclosures of cash flow information		
Interest paid	$ 2,875	$ --

Income taxes paid	$ --	$ --

NOTE 1 - ORGANIZATION AND LINE OF BUSINESS

General

NutraStar Incorporated ('NutraStar"), a California corporation, markets proprietary whole food dietary supplements derived from nutrient-dense stabilized rice bran (a nutraceutical) produced by an affiliated company, The RiceX Company ("RiceX"), a current shareholder and a publicly traded company. The Company had a license to distribute certain derivatives of RiceX's stabilized rice bran, as well as valued-added rice bran products in the United States of America. This license was terminated subsequent to June 30, 2002 (see Note 10).

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

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

The transaction has been accounted for in accordance with Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations," which is required for all transactions occurring after June 30, 2001. In accordance with SFAS No. 141, the purchase price is to be allocated to assets acquired and liabilities assumed based on the estimated fair market value at the closing date of the acquisition, with the excess of the purchase price being allocated to goodwill. Since assets were not acquired and liabilities were not assumed in connection with this transaction, the value of the shares issued of $250,001 has been recorded as goodwill in the accompanying consolidated balance sheet. As NutraStar was the 80% owner of NutraGlo, the operations of NutraGlo have been consolidated with NutraStar. Therefore, pro forma information is not required.

The Company has four primary divisions through which it sells its products: (1) TheraFoods(TM), which distributes consumer products including RiSolubles(TM), RiceMucil(R), NutraFlex(TM), and StaBran(R), (2) NutraCea(R), which was created to compliment medical food products, (3) NeutraBeauticals(R), which provides natural products to improve skin health, and (4) NutraGlo, which developed a derivative of the NutraFlex(TM) product for horses.

NOTE 1 - ORGANIZATION AND LINE OF BUSINESS (Continued)

General (Continued)

For internal reporting purposes, management segregates the Company into two segments: (1) NutraStar, including the transactions of TheraFoods(TM) , NutraCea(R), and NeutraBeauticals(R), and (2) NutraGlo.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

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

Basis of Presentation

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles for interim financial information and with the instructions to Form 10-QSB and Regulation S-B. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all normal, recurring adjustments considered necessary for a fair presentation have been included. The financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2001. The results of operations for the six months ended June 30, 2002 are not necessarily indicative of the results that may be expected for the year ended December 31, 2002.

Going Concern

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

Revenue Recognition

Revenue is generally recognized upon shipment of product with a provision for estimated returns and allowances record at that time, if applicable. Commissions revenue is generally recognized when earned and collection is reasonably assured.

Deferred Compensation

Deferred compensation consists of salaries payable to employees of the Company that have been earned but not yet paid.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Advertising Expense

The Company expenses all advertising costs, including direct response advertising, as they are incurred. Advertising expense for the six months ended June 30, 2002 and 2001 was $40,044 (unaudited) and $8,368 (unaudited), respectively.

Estimates

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

Concentration of Credit Risk

For the six months ended June 30, 2002, four customers accounted for 80% and 26% of the Company's accounts receivable and total revenues, respectively.

Reclassifications

Certain amounts included in the prior period financial statements have been reclassified to conform with the current period presentation. Such reclassification did not have any effect on reported net loss.

Recently Issued Accounting Pronouncement

In April 2002, the Financial Accounting Standards Board ("FASB") issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." SFAS No. 145 updates, clarifies, and simplifies existing accounting pronouncements. This statement rescinds SFAS No. 4, which required all gains and losses from extinguishment of debt to be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. As a result, the criteria in Accounting Principles Board No. 30 will now be used to classify those gains and losses.

SFAS No. 64 amended SFAS No. 4 and is no longer necessary as SFAS No. 4 has been rescinded. SFAS No. 44 has been rescinded as it is no longer necessary. SFAS No. 145 amends SFAS No. 13 to require that certain lease modifications that have economic effects similar to sale-leaseback transactions be accounted for in the same manner as sale-lease transactions. This statement also makes technical corrections to existing pronouncements. While those corrections are not substantive in nature, in some instances, they may change accounting practice. The Company does not expect adoption of SFAS No. 145 to have a material impact, if any, on its financial position or results of operations.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recently Issued Accounting Pronouncement (Continued)

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs

Associated with Exit or Disposal Activities." This statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force ("EITF") Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." This statement requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF Issue 94-3, a liability for an exit cost, as defined, was recognized at the date of an entity's commitment to an exit plan. The provisions of this statement are effective for exit or disposal activities that are initiated after December 31, 2002 with earlier application encouraged. This statement is not applicable to the Company.

NOTE 3 - PROPERTY AND EQUIPMENT

Property and equipment at June 30, 2002 consisted of the following:

Furniture and equipment	$ 18,417
Software	352,773
	371,190
Less accumulated depreciation	151,181
Total	$220,009

Depreciation expense was $57,097 (unaudited) and $42,857 (unaudited) for the six months ended June 30, 2002 and 2001, respectively.

NOTE 4 - PATENTS AND TRADEMARKS

Patents and trademarks at June 30, 2002 consisted of the following:

Patents	$ 76,484
Trademarks	51,809
	128,293
Less accumulated amortization	12,766
Less loss reserve	66,678
Total	$ 48,849

NOTE 4 - PATENTS AND TRADEMARKS (Continued)

Amortization expense was $5,283 (unaudited) and $2,668 (unaudited) for the six months ended June 30, 2002 and 2001, respectively.

NOTE 5 - GOODWILL

Goodwill represents the purchase price of the remaining 20% of NutraGlo. As

of January 1, 2002, the Company adopted SFAS No. 142. SFAS No. 142 prohibits the amortization of goodwill, but requires that it be reviewed for impairment at least annually or on an interim basis if an event occurs or circumstances change that could indicate that its value has diminished or been impaired. Recoverability of goodwill is measured by a comparison of its carrying value to the future net cash flows expected to be generated by it. Cash flow projections are based on historical experience, management's view of growth within the industry, and the anticipated future economic environment. Since the Company purchased the remaining 20% of NutraGlo on December 12, 2001, amortization expense was not recorded as of December 31, 2001. As such, the transitional disclosure provisions of SFAS No. 142 do not apply.

NOTE 6 - PROMISSORY NOTES PAYABLE

During the years ended December 31, 2001 and 2000, the Company raised an aggregate of $2,080,000 through the issuance of short-term promissory notes and convertible promissory notes.

Activities related to the promissory notes are as follows:

- The promissory notes, with an aggregate principal balance of $1,180,000, bore interest ranging from 8% to 12% per annum. As of December 31, 2001, all of the promissory notes had been retired.

- The convertible notes, with an aggregate principal balance of $900,000, were immediately converted into shares of the Company's preferred stock at $1 per share and bore interest ranging from 8% to 15% per annum. As the convertible notes were convertible at rates that approximated market value, no discount was recorded relative to a beneficial conversion feature.

NOTE 6 - PROMISSORY NOTES PAYABLE (Continued)

- As of December 31, 2001, the Company had paid notes in the amount of $490,000 in cash. Notes with a principal balance of $1,340,000 and accrued interest of $90,196 had been converted into 1,430,196 shares of the Company's Series A preferred stock. Related to these conversions, the Company issued an additional 345,511 shares of Series A preferred stock to certain of the note holders and recorded related interest charges of $345,511. The remaining notes with a principal balance of $250,000 and accrued interest of $18,687 had been converted into committed common stock. Related to the conversion, the Company recorded interest charges of $130,487 for additional shares that will be issued.

- In connection with certain of the notes, the Company issued warrants to purchase 350,000 shares of the Company's common stock at an exercise price of $1 per share. The warrants expire on June 25, 2006 and are immediately exercisable. The Company recorded a discount related to the detachable warrants of $114,083, which represented the portion of the proceeds allocated to the warrants based on the relative fair values of the debt and warrants. At the date of conversion, $103,905 of the discount remained unamortized and has been debited to convertible Series A preferred stock as part of the conversion. In relation to these issuances, interest expense of

$10,178 was recorded.

NOTE 7 - NOTE PAYABLE TO OFFICER

On March 4, 2002, the Company entered into a note payable agreement with an officer of the Company, which bears interest at 10% per annum and is due on March 3, 2003. As of June 30, 2002, the note payable balance was $100,000.

NOTE 8 - PUT OPTION

During the year ended December 31, 2001, the Company issued 130,000 shares of Series A preferred stock to a related party as payment of accounts payable totaling $130,000. On January 15, 2002, these holders of the Series A preferred stock executed a put/call agreement. The put allows for the holder to sell to the Company all, but not less than all, of the 130,000 shares of the Company's Series A preferred stock, or common stock if any of the Series A preferred stock were converted, for $130,000, plus all accumulated, but unpaid dividends, at any time after six months from January 15, 2002. Related to the put option and the related conversion of debt, the Company has recorded a liability of $130,000.

In addition, the Company maintains the right to call the option and purchase back the shares of the Series A preferred stock for $130,000, plus any unpaid and accrued dividends at any time, subject to certain provisions.

NOTE 9 - COMMITMENTS AND CONTINGENCIES

Agreements

On April 12, 2002, the Company entered into a two-year marketing agreement, whereby the Company is to pay a commission of 10% of gross receipts on sales from customers introduced to the Company by the consultant, subject to certain requirements. In relation to this agreement, the Company granted to the consultants five-year options to purchase up to 150,000 shares of the Company's common stock at an exercise price of $0.75 per share, vesting according to the achievement of certain levels of gross receipts. The agreement automatically renews after the initial two-year term.

On May 6, 2002, the Company entered into a one-year finder's and advisory agreement, whereby the finder is to seek businesses that are consistent with the Company's business and strategic plans or to introduce the Company to investors. The fees paid to the finder for finding investors to fund the Company are based upon certain percentages, ranging from 2% to 10%, plus unaccountable expenses, depending on the amount funded by the investors. In addition, 10% of the transaction value will be paid in cashless warrants. If the finder arranges a credit line or other types of debt placement, the fees paid to the finder will be 2% of the total debt placement.

If the finder introduces a business or entity and the Company engages in a merge-type transaction or other similar transactions, the fees paid to the finder are based upon certain percentages, ranging from 3% to 7%, depending on the transaction value. In addition, 10% of the transaction value will be paid in cashless warrants. This agreement is automatically renewed after the initial one-year term.

On June 10, 2002, the Company entered into a one-year finder's fee

agreement, whereby the Company is to pay the finder 5% of the gross revenues generated from a commercial transaction other than financing, a merger, or some other form of business combination. For every $100,000 in gross revenues that are generated by the finder, the Company will issue warrants to the finder to purchase 5,000 shares of common stock, which will be exercisable immediately, at the then current market price on a cashless basis, subject to certain limitations.

Litigation

On April 4, 2002, a complaint was filed against the Company by Millennium Integrated Services, Inc. ("MISI"). MISI provided Web site development services to the Company at a cost of $204,405. MISI is seeking contract payment of $204,405, plus interest of $32,031 and damages for alleged conversion and misappropriation of trade secrets. On April 9, 2002, MISI filed a Motion for a Writ of Attachment that would allow MISI to seize and hold the Company's assets worth $236,436, pending the resolution of the lawsuit. This Writ of Attachment was granted on April 10, 2002.

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NOTE 9 - COMMITMENTS AND CONTINGENCIES (Continued)

Litigation (Continued)

Certain of the Company's accounts receivable totaling $20,245 as of June 30, 2002 have been attached to secure an accounts payable balance to MISI of $210,235 as of June 30, 2002. The Company believes that the settlement of this case may have a material effect on the Company's cash flows.

In addition, the Company is involved in certain legal proceedings and claims which arise in the normal course of business. Management does not believe that the outcome of these matters will have a material effect on the Company's financial position or results of operations.

NOTE 10 - SHAREHOLDERS' DEFICIT

Common Stock Committed

On March 15, 2002, the Company committed to issue 153,333 shares of common stock with a detachable purchase warrant to purchase 153,333 shares of common stock at an exercise price of $1.20 per share in exchange for $100,000. As of June 30, 2002, the Company had not issued the stock and has recorded the transaction as committed stock.

On April 1, 2002, the Company committed to issue 25,000 shares of common stock to a consultant for consulting expenses totaling $25,250.

On June 10, 2002, the Company committed to issue 60,606 shares of common stock with detachable purchase warrants to purchase 60,606 shares of common stock at an exercise price of $0.50 per share in exchange for cash totaling $25,000.

The following table reconciles total shares and amount recorded as common stock committed:

	Shares	Amount

Committed upon conversion of debt and accrued interest	399,174	$399,174
Committed upon receipt of cash	213,939	125,000
Committed for consulting services	260,000	162,500
Total	873,113	$686,674

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NOTE 10 - SHAREHOLDERS' DEFICIT (Continued)

Common Stock and Stock Options

On January 7, 2002, the Company entered into a five-year employment agreement with an employee. In relation to this agreement, the Company issued options to purchase 155,000 shares of common stock. The options vest over four years in increments of 80,000, 25,000, 25,000, and 25,000, have an exercise price of $1 per share, and expire on January 7, 2012. As of June 30, 2002, the Company recorded compensation expense and deferred compensation totaling $48,438 and $145,312, respectively, in relation to this transaction.

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

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

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

On June 10, 2002, the Company issued warrants to purchase shares of common stock at $0.50 per share to a consultant for consulting expenses valued at $850.

On June 19, 2002, the Company issued options to purchase 50,000 shares of common stock at an exercise price of $1 per share to a consultant for consulting expenses valued at $14,000.

NOTE 11 - RELATED PARTY TRANSACTIONS

During the six months ended June 30, 2002, certain expenses of the Company totaling $21,027 were paid by RiceX. Certain of these expenses were reimbursed by the Company, and at June 30, 2002, $3,566 was owed to RiceX.

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NOTE 12 - LINES OF BUSINESS

For internal reporting purposes, management segregates the Company into two segments as follows for the six months ended June 30, 2002:

	NutraStar	NutraGlo	Eliminations	Total
Total revenues	$ 475,139	$ 355,588	$ -	$ 830,727
Income (loss) from operations	$ (1,788,030)	$ 110,427	$ -	$ (1,677,603)
Identifiable assets	$ 433,283	$ 701,682	$ (376,236)	$ 758,729
Capital expenditures	$ 66,149	$ -	$ -	$ 66,149
Depreciation and amortization	$ 62,380	$ -	$ -	$ 62,380

Operations of NutraGlo were insignificant during the six months ended June 30, 2001 and therefore are not presented.

NOTE 13 - SUBSEQUENT EVENTS

Litigation

On July 16, 2002, the Company was summoned to answer a complaint filed by Faraday Financial, Inc. ("Faraday"). Between December 2000 and March 2001, the Company issued convertible promissory notes totaling $450,000 and a promissory note totaling $50,000. On December 13, 2001, Faraday entered into a settlement agreement with the Company, whereby Faraday agreed to cancel the promissory notes in exchange for 735,730 shares of preferred stock. Faraday claims that the settlement agreement required that the Company effect a registration statement covering the preferred stock by June 30, 2002. In the event the Company failed to effect a registration statement by June 30, 2002, the Company was to immediately forfeit to Faraday 735,730 shares of common stock in the name of the Chief Executive Officer of the Company.

In addition, the Chief Executive Officer entered into an escrow agreement to ensure the automatic forfeiture of the common stock and entered into a guarantee to be personally responsible to Faraday for the original $500,000 loan amount, plus 12% interest per annum. Faraday has filed its fourth claim for relief for a judgment against the Company for $500,000, plus accrued, but unpaid interest, attorneys' fees and costs, and other such costs. Management does not believe that the outcome of this matter will result in a material impact on the financial condition of the Company.

Note Payable

On July 9, 2002, the Company entered into a promissory note agreement with the Chief Executive Officer of the Company for $12,000. Interest accrues at 10% per annum, and the note payable is due on August 9, 2002. The due date was subsequently extended to September 9, 2002.

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NOTE 13 - SUBSEQUENT EVENTS (Continued)

Termination of Agreement

During the six months ended June 30, 2002, the Company received notice from RiceX, stating that the Company was in default under the terms of its distribution agreement with RiceX dated December 12, 2001. On July 9, 2002, RiceX exercised its right to terminate the exclusive distribution agreement and the related license agreements with the Company due to the Company's default. Purchase of inventory from RiceX as of June 30, 2002 totaled $206,786. The Company has recorded a loss reserve for the license agreement totaling $66,678 as of June 30, 2002.

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

Caution About Forward-Looking Statements

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

Plan of Operation for the Next Twelve Months

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

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

Results of Operation

Second Quarter 2002 versus Second Quarter 2001

During the second quarter 2002, NutraStar generated net sales of $536,370 compared to $195,148 for the second quarter 2001, an increase of 175% in comparison to 2001. Reasons for the increase include the ramp-up of the Company's e-commerce sales program as well as increased sales through strategic alliances. The increase in net sales also reflects the Company's focus on the marketing of its own products, as opposed to cross-selling RiceX products which explains the lack of commission revenues from the sale of RiceX products during the most recent quarter.

During the second quarter of 2001, the Company also recognized commission revenues from RiceX of $112,286. This commission revenue resulted in total revenues of $307,434 for the second quarter of 2001 compared to total revenues of $536,370 for the second quarter of 2002, representing a 74% increase in total revenue.

The cost of goods sold for the quarter ended June 30, 2002 increased 124% to $371,526 compared to $165,772 for the quarter ended June 30, 2001. This increase reflects the increase in production of products for resale during the second quarter of 2002. The Company's gross profit increased to $164,844 from $141,662 for the quarter ended June 30, 2002 compared to the quarter ended June 30, 2001; however, the gross profit margin decreased from 46% in the second quarter of 2001 to 31% in the same period of 2002. Operating expenses of $772,864 in the second quarter of 2002 reflects an increase of 88% over the comparable period in fiscal year 2001 which had operating expenses of $410,012. This increase reflects the Company's accrual of non-cash compensation and consulting fees as well as establishment of a reserve for inventory. Professional fees increased approximately $118,531 to $185,651 in the second quarter of 2002 as the Company is using outside consultants in such areas as legal, financial and marketing in an attempt to limit direct hires until additional funding is obtained. This increase also reflects the professional costs related to the preparation and filing of the Company's SB-2 Registration Statement during the quarter.

The Company incurred an operating loss of $608,020 during the quarter ended June 30, 2002 compared to an operating loss of $268,350 during the quarter ended June 30, 2001. This 127% increase in operating loss reflects the significant increase in operating expenses relating to the Company's expanded business operations, increased cost of product inventory and increased expenditures for product marketing and development during the most recent quarter.

During the quarter ended June 30, 2002, the Company recognized interest expense of $5,024, which reflects interest paid on short-term promissory notes outstanding during all or part of the second quarter and represents a decrease from interest expense of $83,139 for the quarter ended June 30, 2001. This

decrease in interest expense reflects the significant reduction in the amount of promissory notes outstanding as a result of conversion of debt to equity. This expense increased the Company's overall net loss to $613,044 compared to a net loss of $351,489 recorded in the quarter ended June 30, 2001.

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

Six Month Period Ended June 30, 2002 v. 2001

Total revenue for the six months ended June 30, 2002 was $830,727 compared to $775,754 for the six months ended June 30, 2001. This 7% increase reflects the Company's increased marketing and product selection primarily for the retail consumer. Cost of sales decreased slightly due to increased production of higher

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margin products for resale as well as a higher amount of start-up costs included in the six month period of 2001. The increase in operating expenses represents the Company's continued expansion of operations during fiscal year 2002 in a number of areas. During the six months ended June 30, 2002 employee related expenses rose $390,336 to $474,816 as a result of additional hired employees both after the second quarter of 2001 and during the first quarter of 2002.

The 35% increase in gross profits to $276,729 for the six months ended June 30, 2002 from $205,557 in the similar period of 2001 was offset by the 135% increase in operating expenses of $1,954,332 for the six months ended June 30, 2002 compared to 2001. This increase in operating expenses reflects the Company's expanded operations and increase in personnel. These higher costs resulted in a loss from operations of $1,677,603 for the six month period ended June 30, 2002 compared to an operating loss of $624,448 for the same period in 2001.

Factoring in the interest expense for the six months ended June 30, 2002 and 2001 of $5,368 and $87,268 respectively, resulted in a net loss of $1,682,767 for the six months ended June 30, 2002 which is a 136% increase compared to a loss of $711,716 for the same period in 2001.

Liquidity and Sources of Capital

NutraStar has incurred significant operating losses since its inception, and, as of June 30, 2002 NutraStar has an accumulated deficit of $7,083,906. At June 30, 2002, NutraStar had cash and cash equivalents of $10,816 and a net working capital deficit of $836,835.

To date, NutraStar has funded its operations, in addition to sales revenues, through a combination of short-term debt and the issuance of common and preferred stock. During the six months ended June 30, 2002, NutraStar raised a total of $100,000 from the sale of 153,333 Units (each Unit representing one common share and one warrant), as well as received proceeds of $100,000 from a note payable to the Chairperson of NutraStar.

The Company is dependent on the proceeds from future debt or equity investments to expand its operations and fully implement the Company's business plan. If the Company is unable to raise sufficient capital, the Company will be required to

delay or forego some portion of its business plan, which will have a material adverse effect on the Company's anticipated results from operations and financial condition. Alternatively, the Company may seek interim financing in the form of bank loans, private placement of debt or equity securities, or some combination thereof. Such interim financing may not be available in the amounts or at the times when the Company requires, and will likely not be on terms favorable to the Company.

Due to the Company's need for outside capital and its operating losses, the financial statements include a going concern footnote explaining the uncertainties relating to the Company's ability to continue operations.

Contract With Key Supplier

NutraStar had entered into an agreement with The RiceX Company ("RiceX"), whereby RiceX would sell NutraStar its rice bran solubles and rice bran fiber concentrates at prices equal to the lower of RiceX's standard price or the price

negotiated by other customers for like quantities and products (the "RiceX Agreement"). The RiceX Agreement also provided that RiceX would not sell any rice bran solubles or rice bran fiber concentrates products in the United States except to NutraStar. Subsequent to the end of the second quarter, this Agreement was terminated by RiceX due to NutraStar's inability to meet increasing volume purchase requirements and to maintain the required security deposit with RiceX. As a result of this termination, NutraStar no longer has the right to be the exclusive distributor of the RiceX rice solubles and rice bran fiber concentrates in the United States; however, NutraStar will continue to buy such products from RiceX on a nonexclusive basis. NutraStar will continue to purchase RiceX products in sufficient amounts to support its sales of dietary supplements for its e-commerce direct sales programs, products for its strategic alliances and for new product research and development needs.

Unless and until other competitors seek to acquire rice solubles and rice bran fiber concentrates from RiceX, NutraStar does not anticipate a material adverse impact on its business operations resulting from the termination of the RiceX Agreement. The RiceX Agreement also provided for a license from RiceX to NutraStar to utilize three patents relating to the use of rice bran supplements to treat diabetes and hyperlipidemia. NutraStar will continue to be allowed to utilize these patents until a new use agreement can be negotiated.

In addition to the risks associated with the termination of the RiceX Agreement, the potential inability of RiceX to deliver the amount of product that NutraStar requires or the possible interruption in product delivery for any reason, would all have a material adverse effect on NutraStar's business, results from operations, and financial condition, because NutraStar could not readily find and implement alternative suppliers and likely not on advantageous terms. NutraStar has lost the exclusive right to distribute certain of RiceX's products in the United States. Although NutraStar is negotiating with RiceX to reacquire those exclusive rights, there is no assurance that it will be successful or that NutraStar may lose this exclusive right again if it does not meet the terms of any subsequent agreement. RiceX's ability to manufacture certain of NutraStar's core products is currently limited to the production capability of RiceX's Dillon, Montana plant (the "Dillon Plant"). Currently, the Dillon Plant is capable of producing only a limited quantity of NutraStar's products, which may not be sufficient to meet NutraStar's long-term sales goals. NutraStar and RiceX are exploring ways to add production capacity during the later part of the current year.

Recent Accounting Pronouncements

In June 2001, the FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations. This statement applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development, and/or the normal operation of long-lived assets, except for certain obligations of lessees. This statement is not applicable to the Company.

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

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

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

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." This statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force ("EITF") Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." This statement requires that a liability for a cost associated with an exit or disposal activity to be recognized when the liability is incurred. Under EITF Issue 94-3, a liability for an exit cost, as defined, was recognized at the date of an entity's commitment to an exit plan. The provisions of this statement are effective for exit or disposal activities that are initiated after December 31, 2002 with earlier application encouraged. This statement is not applicable to the Company.

Critical Accounting Policies

Our discussion and analysis of our financial conditions and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the

United States of America. The preparation of financial statements require managers to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses and disclosures on the date of the financial statements. On an on-going basis, we evaluate our estimates, including, but not limited to, those related to revenue recognition. We use authoritative pronouncements, historical experience and other assumptions as the basis for making judgments. Actual results could differ from those estimates. We believe that the following critical accounting policies affect our more significant judgments and estimates in the preparation of our consolidated financial statements.

Revenue Recognition

Revenue is recorded at the time of merchandise shipment, net of provisions for returns in accordance with interpretative guidance provided by Staff Accounting Bulletin (SAB) No. 101. The majority of the Company's sales are to distributors and these distributors generally have no right to return products. Commission revenue is generally recognized when earned and collection is reasonably assured.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On April 4, 2002, a Complaint was filed against NTI by Millennium Integrated Services, Inc. ("MISI") in Superior Court, Sacramento County, (Case No. 02A502006). MISI provided website development services to NTI, at a cost of $204,405. MISI is seeking contract payment of $204,405 plus interest of $32,031 as well as damages for alleged conversion and misappropriation of trade secrets. On April 9, 2002, MISI filed a Motion for a Writ of Attachment which would allow MISI to seize and hold NTI assets worth $236,436 pending the resolution of the lawsuit. On April 10, 2002, a Writ of Attachment was granted by the Court. As of June 30, 2002, Company accounts receivable totaling $20,245 had been attached pursuant to the Writ of Attachment. NTI believes it has valid defenses and offsets to the payment for these services and either will appeal the Court's action or attempt to settle this matter. Settlement of this case could have a material affect on the Company's cash flow depending on how quickly any settlement would need to be paid. Conversely, litigating this matter could also have a material adverse affect on NutraStar's operations and financial results.

Subsequent to the quarter ended June 30, 2002, a Complaint was filed against NTI by Faraday Financial, Inc. ("Faraday"), in the Third Judicial District Court, Salt Lake County, Utah (Case No. 020906477). The lawsuit stems from a settlement

agreement entered into in December, 2001, pursuant to which Faraday converted $500,000 of debt into 735,730 shares of NutraStar preferred stock. Among other terms, the settlement agreement required that a registration statement covering the resale of the 735,730 shares be in effect by June 30, 2002. Although NutraStar filed a registration statement on June 4, 2002, such registration statement has not been declared effective. In the event that NutraStar failed to effect a registration statement by June 30, 2002, NutraStar's Chief Executive Officer, Ms. Patricia McPeak, was to transfer to Faraday an additional 735,730 shares of her common stock and become personally liable to Faraday for the original $500,000 debt amount plus 12% interest per annum. Faraday is also claiming attorneys' fees and other costs related to the lawsuit. Management does not believe that the resolution of this matter will have a material adverse impact on NutraStar's financial condition.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits: 99.1 - Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K: None.

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SIGNATURES

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

NUTRASTAR INCORPORATED

Dated: August 16, 2002

/s/ James Kluber

James Kluber, Authorized Officer and
Chief Financial Officer
(Principal Accounting Officer)

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Exhibit 99.1

CERTIFICATION
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002
(SUBSECTIONS (a) AND (b) OF SECTION 1350, CHAPTER 63 OF

TITLE 18, UNITED STATES CODE)

Pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of section 1350, chapter 63 of Title 18, United States Code), each of the undersigned officers of NutraStar Incorporated, a California corporation (the "Company"), does hereby certify with respect to the Quarterly Report of the Company on Form 10-QSB for the quarter ended June 30, 2002 as filed with the Securities and Exchange Commission (the "10-QSB Report") that:

(1) the 10-QSB Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in the 10-QSB Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 16, 2002

NUTRASTAR INCORPORATED

/s/ Patricia McPeak

Patricia McPeak
President and Chief Executive Officer

/s/ James Kluber

James Kluber
Chief Financial Officer

EXHIBIT 99.1