NUTRASTAR INC
Form 10QSB
December 06, 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 SEPTEMBER 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, 23,965,065 issued and outstanding as of October 31, 2002.

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PART 1 - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

NUTRASTAR INCORPORATED AND SUBSIDIARIES
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September 30, 2002 (unaudited)

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

ASSETS

Current assets	
Cash	$ 23,230
Accounts receivable	40,440
Inventory, net	85,987
Prepaid expenses	17,247
Total current assets	166,904
Property and equipment, net	189,734
Patents and trademarks, net	53,481
Goodwill	250,001
Total assets	$660,120

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

LIABILITIES AND SHAREHOLDERS' DEFICIT

Current liabilities	
Accounts payable	$ 708,187
Accrued salaries and benefits	87,419
Deferred compensation	186,923
Accrued expenses	117,570
Due to officer	13,457
Due to related parties	13,214
Notes payable	100,000
Notes payable to officer	112,000
Total current liabilities	1,338,770
Put option	130,000

Total liabilities	1,468,770
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	1,960,249
Shareholders' deficit	
Common stock, no par value 50,000,000 shares authorized 21,649,520 shares issued and outstanding	5,012,296
Common stock committed	806,674
Deferred compensation	(894,240)
Accumulated deficit	(7,693,629)
Total shareholders' deficit	(2,768,899)
Total liabilities and shareholders' deficit	$ 660,120

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NUTRASTAR INCORPORATED AND SUBSIDIARIE
CONDENSED, CONSOLIDATED STATEMENTS OF OPERATION
For Three and Nine Months Ended September 30

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2002	2001	2002	2001
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Revenues				
Net sales	$ 247,367	$ 513,450	$ 1,078,094	$ 1,176,918
Commissions revenue	--	93,852	--	206,138
Total revenues	247,367	607,302	1,078,094	1,383,056
Cost of goods sold	135,549	295,076	689,547	865,273
Gross profit	111,818	312,226	388,547	517,783
Operating expenses	612,798	346,197	2,567,130	1,176,202
Loss from operations	(500,980)	(33,971)	(2,178,583)	(658,419
Other income (expense)				
Interest income	--	--	636	--
Interest expense	(72,261)	(46,451)	(78,061)	(133,719

Total other income (expense)	(72,261)	(46,451)	(77,425)	(133,719
Net loss	(573,241)	(80,422)	(2,256,008)	(792,138
Cumulative preferred dividend	(36,482)	--	(109,447)	--
Net loss available to common shareholders	$ (609,723)	$ (80,422)	$ (2,365,455)	$ (792,138
Basic and diluted loss available to common shareholders per share	$ (0.03)	$ (0.01)	$ (0.11)	$ (0.04
Basic and diluted weighted-average common shares outstanding	21,649,520	16,419,790	21,649,520	17,776,193

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

	2002 (unaudited)	2001 (unaudited)
Cash flows from operating activities		
Net loss	$(2,256,008)	$ (792,138)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	95,066	72,849
Inventory obsolescence	8,702	--
Loss reserve for patents and trademarks	75,359	--
Amortization of deferred compensation	176,947	--
Non-cash issuances of stock options	227,288	--
Non-cash issuances of warrants	850	--
Non-cash issuances of committed stock	162,500	--
Beneficial conversion feature	66,000	--
(Increase) decrease in		
Accounts receivable	(38,847)	(300,915)
Inventory	(803)	336,008
Prepaid expenses	(8,459)	28
Deposits	316,071	100,525
Increase (decrease) in		
Accounts payable	191,070	(70,705)
Accrued salaries and benefits	26,405	67,784
Deferred compensation	186,923	--

Accrued expenses	30,201	173,816
Due to officer	(18,572)	27,197
Due to related parties	13,214	--
Net cash used in operating activities	(746,093)	(385,551)
Cash flows from investing activities		
Purchase of property and equipment	(66,149)	(234,349)
Purchase of patents and trademarks	(27,030)	(28,367)
Net cash used in investing activities	(93,179)	(262,716)
Cash flows from financing activities		
Refunds of deposits payable		(455,500)
Proceeds from notes payable	114,000	--

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

	2002	2001
	(unaudited)	(unaudited)
Payments on notes payable	(14,000)	(10,187)
Proceeds from notes payable to officer	112,000	
Proceeds from convertible note payable	--	1,125,000
Proceeds from committed stock	245,000	32,500
Net cash provided by financing activities	457,000	691,813
Net increase (decrease) in cash	(382,272)	43,546
Cash, beginning of period	405,502	5,865
Cash, end of period	$ 23,230	$ 49,411
Supplemental disclosures of cash flow information		
Interest paid	$ 2,875	$ --
Income taxes paid	$ 1,600	$ --

NUTRASTAR INCORPORATED AND SUBSIDIARIES
NOTES TO CONDENSED, CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2002 (unaudited)

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 September 30, 2002 (see Note 9).

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 September 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) NutraBeauticals(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, Incorporated 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 accounting principles generally accepted in the United States of America 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 accounting principles generally accepted in the United States of America 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 nine months ended September 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 nine months ended September 30, 2002 and 2001 was $57,264 (unaudited) and $12,172 (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 nine months ended September 30, 2002, three customers accounted for 82% of the Company's accounts receivable.

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 Pronouncements

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 Pronouncements (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.

In October 2002, the FASB issued SFAS No. 147, "Acquisitions of Certain Financial Institutions." SFAS No. 147 removes the requirement in SFAS No. 72 and Interpretation 9 thereto, to recognize and amortize any excess of the fair value of liabilities assumed over the fair value of tangible and identifiable intangible assets acquired as an unidentifiable intangible asset. This statement requires that those transactions be accounted for in accordance with SFAS No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." In addition, this statement amends SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," to include certain financial institution-related intangible assets. This statement is not applicable to the Company.

NOTE 3 - PROPERTY AND EQUIPMENT

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

Furniture and equipment	$ 18,417
Software	352,773

	371,190
Less accumulated depreciation	181,456
Total	$189,734

Depreciation expense was $87,370 (unaudited) and $69,407 (unaudited) for the nine months ended September 30, 2002 and 2001, respectively.

NOTE 4 - PATENTS AND TRADEMARKS

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

Patents	$ 92,210
Trademarks	51,809
	144,019
Less accumulated amortization	15,179
Less loss reserve	75,359
Total	$ 53,481

Amortization expense was $7,696 (unaudited) and $3,442 (unaudited) for the nine months ended September 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 - 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.

NOTE 6 - NOTES PAYABLE (Continued)

- 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.

- 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.

- On September 19, 2002, the Company entered into a convertible promissory note agreement with an investor for $50,000. Interest accrues at 4% monthly, and the note payable is due on December 30, 2002. The note is convertible into shares of common stock at the holder's discretion in part or in whole at a price equal to

60% of the market price. As this note is convertible at a price below market value, a total of $33,000 of interest expense was recorded relative to a beneficial conversion feature. In addition, as part of the agreement, the Company committed 500,000 shares of common stock to the investor as collateral for the note.

- On September 20, 2002, the Company entered into a convertible promissory note agreement with an investor for $50,000. Interest accrues at 2% monthly, and the note payable is due on December 20, 2002. The note is convertible into shares of common stock at the option of the holder at a price of $0.12 per share. As this note is convertible at a price below market value, a total of $33,000 of interest expense was recorded relative to a beneficial conversion feature. In addition, the note is guaranteed by a third party.

NOTE 7 - NOTES PAYABLE TO OFFICER

Activities related to notes payable to officer are as follows:

- 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 September 30, 2002, the note payable balance was $100,000.

- 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. As of September 30, 2002, the note had been renegotiated, and the due date was extended to November 8, 2002.

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

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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.

NOTE 9 - COMMITMENTS AND CONTINGENCIES (Continued)

Agreements (Continued)

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.

Termination of Agreement

During the nine months ended September 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 September 30, 2002 totaled $237,805. The Company has recorded a loss reserve for the license agreement totaling $75,359 as of September 30, 2002.

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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NUTRASTAR INCORPORATED AND SUBSIDIARIES
NOTES TO CONDENSED, CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2002 (unaudited)

NOTE 9 - COMMITMENTS AND CONTINGENCIES (Continued)

Litigation (Continued)

Certain of the Company's accounts receivable totaling $26,342 as of September 30, 2002 have been attached to secure an accounts payable balance to MISI of $189,990 as of September 30, 2002. The Company believes that the settlement of this case may have a material effect on the Company's cash flows.

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. As of September 30, 2002,

management believes the maximum exposure for the Company is approximately $500,000, plus interest and fees.

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 September 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.

Common Stock Committed (Continued)

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.

During the three months ended September 30, 2002, the Company committed to issue 594,611 shares of common stock to various investors for cash totaling $120,000.

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	808,550	245,000
Committed for consulting services	260,000	162,500
Total	1,467,724	$ 806,674

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 September 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.

Common Stock and Stock Options (Continued)

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.

On August 13, 2002, the Company issued options to purchase 28,000 shares of common stock at an exercise price of $0.25 per share to a debtor. In relation to this transaction, the Company recorded interest expense of $5,600.

NOTE 11 - RELATED PARTY TRANSACTIONS

During the nine months ended September 30, 2002, certain expenses of the Company totaling $35,243 were paid by RiceX. Certain of these expenses were reimbursed by the Company, and at September 30, 2002, $13,214 was owed to RiceX.

NOTE 12 - LINES OF BUSINESS

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

	NutraStar	NutraGlo	Eliminations	Total
Total revenues	$ 624,011	$ 454,083	$ --	$ 1,078,094
Loss from operations	$(2,002,315)	$ (176,268)	$ --	$(2,178,583)
Identifiable assets	$ 371,565	$ 743,898	$(455,343)	$ 660,120
Capital expenditures	$ 66,149			$ 66,149
Depreciation and amortization	$ 95,066	$ --	$ --	$ 95,066

NOTE 12 - LINES OF BUSINESS (Continued)

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

NOTE 13 - SUBSEQUENT EVENTS

In October 2002, the Company entered into a promissory note agreement with its Chief Executive Officer for $50,000. Interest accrues at 10% per annum, and the note payable is due on November 1, 2002. In November 2002, the Company repaid $18,000 and signed an amendment to the agreement, extending the due date for the remaining balance of $32,000 to December 8, 2002.

In October 2002, the Company issued 675,217 shares of common stock from committed stock totaling $225,000.

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 $2.5 million to $5 million in financing. The Company anticipates that it will need up to $2.5 million to develop distribution channels for its proprietary products 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

Third Quarter 2002 versus Third Quarter 2001

During the quarter ended September 30, 2002, NutraStar generated net sales of $247,367 compared to $513,450 for the third quarter of 2001, a decrease of 52% in comparison to 2001. The decrease was caused by several factors including certain key customers deferring purchases to a later date, a loss of two customers related to legal proceedings in which the Company is involved and an overall lack of working capital which prevented the Company from aggressively pursuing its marketing plan. Since July, 2002 the Company's primary supplier, RiceX, has required cash on delivery for product sold to the Company. The net sales also reflect the Company's focus on the marketing of its own products, as opposed to cross-selling RiceX products which explains the absence of commission revenues from the sale of RiceX products during the most recent quarter.

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During the third quarter of 2001, the Company recognized commission revenues from RiceX of $93,852. This commission revenue resulted in total revenues of $607,302 for the quarter ended September 30, 2001.

The cost of goods sold for the quarter ended September 30, 2002 decreased 54% to $135,549 compared to $295,076 for the quarter ended September 30, 2001. This decrease reflects the reduced production of products for resale during the third quarter of 2002 due to the lack of adequate rice soluble inventory. The Company's gross profit decreased to $111,818 for the quarter ended September 30, 2002 compared to $312,226 for the quarter ended September 30, 2001; while the gross profit margin decreased from 51% in the third quarter of 2001 to 45% in the same period of 2002. Operating expenses of $612,798 in the third quarter of 2002 reflects an increase of 77% over the comparable quarter in fiscal year 2001 which had operating expenses of $346,197. This increase reflects the Company's increase in employee related expenses of $29,022 over 2001 and the increase in professional fees of $103,900 to $152,530 in the third quarter of 2002 as the Company is using outside consultants in such areas as legal, financial and

marketing in an attempt to limit direct hires until additional funding is obtained.

The Company incurred an operating loss of $500,980 during the quarter ended September 30, 2002 compared to an operating loss of $33,971 during the quarter ended September 30, 2001. This material increase in operating loss reflects the significant increase in operating expenses relating to the Company's expanded business operations, coupled with the Company's decline in net sales during the most recent quarter.

During the quarter ended September 30, 2002, the Company recognized interest expense of $72,261, which reflects interest paid on short-term promissory notes outstanding during all or part of the third quarter and represents an increase in interest expense compared to $46,451 for the quarter ended September 30, 2001. This increase in interest expense reflects an increase in the amount of promissory notes and other debt instruments outstanding during the quarter ended September 30, 2002. This expense increased the Company's overall net loss for the third quarter of 2002 to $573,241 compared to a net loss of $80,422 recorded for the comparable quarter of 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 might not be deemed relevant.

Nine Month Period Ended September 30, 2002 versus 2001

Total revenue for the nine months ended September 30, 2002 was $1,078,100 compared to $1,383,056 for the nine months ended September 30, 2001. This 22% decrease reflects the Company's substantially reduced sales in the third quarter

of 2002. Cost of sales decreased by 20% from $865,273 for the nine months ended September 30, 2001 to $689,547 for the first nine months of 2002. This decrease was due to increased production of higher margin products for resale as well as lower production costs due to lower sales incurred in the third quarter of 2002. The 25% decrease in gross profits to $388,547 for the nine months ended September 30, 2002 from $517,783 in the similar period of 2001 was due primarily to the lower gross profits realized in the third quarter of 2002.

Operating expenses increased 118% from $1,176,202 for the first nine months of 2001 to $2,567,130 for the comparable period of 2002. The significant increase in operating expenses represents the Company's continued expansion of operations during fiscal year 2002 in a number of areas as well as increased legal fees related to the preparation of the Company's SB-2 registration statement and handling various legal proceedings, increased consulting fees and accounting costs. During the nine months ended September 30, 2002 employee related expenses rose $114,325 to $761,651 primarily as a result of additional hired employees during the first quarter of 2002. These higher costs resulted in a loss from operations of $2,178,583 for the nine month period ended September 30, 2002 compared to an operating loss of $658,419 for the same period in 2001.

Factoring in the interest expense for the nine months ended September 30, 2002 and 2001 of $78,061 and $133,719 respectively, resulted in a net loss of $2,256,008 for the nine months ended September 30, 2002 which represents a 185%

increase compared to a loss of $792,138 for the same period in 2001.

Liquidity and Sources of Capital

NutraStar has incurred significant operating losses since its inception, and, as of September 30, 2002 NutraStar has an accumulated deficit of $7,693,629. At September 30, 2002, NutraStar had cash and cash equivalents of $23,230 and a net working capital deficit of $1,171,866.

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 quarter ended September 30, 2002, NutraStar raised a total of $100,000 from the sale of convertible promissory notes. For the nine months ended September 30, 2002, NutraStar has raised a total of $471,000 from the sale of equity and debt securities, which includes proceeds of $112,000 from notes payable to the Chairperson of NutraStar.

The Company is dependent on the proceeds from future debt or equity investments to fund 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 concentrate products in the United States except to NutraStar. On July 9, 2002, this Agreement was terminated. 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 has continued to buy such products from RiceX on a nonexclusive basis.

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.

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 next 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

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

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

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.

In October 2002, the FASB issued SFAS No. 147, "Acquisitions of Certain Financial Institutions." SFAS No. 147 removes the requirement in SFAS No. 72 and Interpretation 9 thereto, to recognize and amortize any excess of the fair value of liabilities assumed over the fair value of tangible and identifiable intangible assets acquired as an unidentifiable intangible asset. This statement requires that those transactions be accounted for in accordance with SFAS No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." In addition, this statement amends SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," to include certain financial institution-related intangible assets. This statement is not applicable to the Company.

Critical Accounting Policies

Our discussion and analysis of our financial condition 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.

ITEM 3. CONTROLS AND PROCEDURES

Within 90 days prior to the date of this Form 10-QSB, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer along with the Company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, the Company's Chief Executive Officer along with the Company's Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely recording, processing summarizing and reporting material information relating to the Company required to be disclosed in this Form 10-QSB.

There have been no significant changes in the Company's internal controls or in other factors, which could significantly affect internal controls subsequent to the date the Company carried out its evaluation.

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 September 30, 2002, Company accounts receivable totaling $26,342 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.

On July 16, 2002, a Complaint was filed against NTI by Faraday Financial, Inc. ("Faraday"), in the United States District Court, for the District of Utah (Case No. 02-CV-00959). 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 seeking a judgment against NutraStar for $500,000 plus accrued, but unpaid interest. Faraday is also claiming attorneys' fees and other costs related to the lawsuit. On August 29, 2002, NutraStar filed a motion to dismiss the Complaint due to lack of personal jurisdiction for both itself and Ms. McPeak. On November 27, 2002, NutraStar's motion to dismiss was denied as to both NutraStar and Ms. McPeak. The case is in its early stages. Consequently, Management is not able to determine the impact on NutraStar's financial condition.

ITEM 5. OTHER INFORMATION

Subsequent to the end of the quarter for which this Form 10-QSB is being filed, Joseph Ferrara resigned as president of NutraStar effective November 1, 2002. As a result of Mr. Ferrara's departure, an "Office of the President" was created which includes Patricia McPeak, the Chief Executive Officer, and two outside consultants, Etienne Taylor and Brian Jones. The Office of the President will be responsible for the management of the day-to-day operations of the company.

Messrs. Taylor and Jones, who is a CPA, specialize in managing corporate restructuring.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

(i) 99.1 - Certification by CEO pursuant to Sections 302 of the Sarbanes-Oxley Act of 2002.

(ii) 99.2 - Certification by CFO pursuant to Sections 302 of the Sarbanes-Oxley Act of 2002.

(iii) 99.3 - Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K:

(i) On August 13, 2002, the Company filed a Form 8-K reporting an Item 5 event regarding the termination of its exclusive selling agreement with The RiceX Company

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: December 6, 2002

/s/ James Kluber

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