INSTANET INC
Form 10QSB
November 14, 2003

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-QSB

ý **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended September 30, 2003

or

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
Commission file No. 0-33259

VITACUBE SYSTEMS HOLDINGS, INC.

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

Nevada	**84-1575085**
(State of incorporation)	(I.R.S. Employer Identification Number)

480 South Holly Street
Denver, CO 80246
(Address of principal executive offices)

(303)-316-8577
(Issuer's telephone number)

INSTANET, INC.
(Former name, if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the proceeding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES ý NO o

As of November 11, 2003, the Company had 16,135,000 shares of its $.001 par value common stock issued and outstanding.

VITACUBE SYSTEMS HOLDINGS, INC.
FORMERLY INSTANET, INC.

CONSOLIDATED BALANCE SHEETS

	September 30 2003	December 31 2002
	(unaudited)	
ASSETS		
Current Assets		
Cash	$ 9,604	$ 28,673
Accounts receivable, net of allowance $3,120	10,106	79,892
Inventory, net of allowance $34,922	314,296	527,055
Other	37,184	27,550
Total Current Assets	371,190	663,170
Intangible assets, net	59,544	56,038
Property and equipment, net	187,062	246,472
	$ 617,796	**$ 965,680**
LIABILITIES AND SHAREHOLDERS' DEFICIT		
Current Liabilities		
Accounts payable and accrued expenses	$ 1,035,460	$ 511,020
Due to shareholder	98,834	13,442
Related party bridge loan	200,000	200,000
Bridge loan	57,500	300,000
Total Current Liabilities	1,391,794	1,024,462
Long term subordinated loans	1,635,861	1,635,861
SHAREHOLDERS' DEFICIT		
Preferred stock, authorized 5,000,000 shares, $.001 par value, none issued or outstanding		
Common stock, authorized 50,000,000 shares, $.001 par, 15,801,555 and 13,310,087 issued and outstanding respectively	15,802	13,310
Additional paid in capital	1,911,710	1,075,470
Deficit	(4,337,371)	(2,783,423)
	(2,409,860)	(1,694,643)
	$ 617,796	**$ 965,680**

VITACUBE SYSTEMS HOLDINGS, INC.
FORMERLY INSTANET, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

	Three months ending September 30,		Nine months ending September 30,	
	2003	**2002**	**2003**	**2002**
REVENUE:				
Sales	$ 290,241	$ 328,901	$ 1,043,325	$ 709,997
Less: sales discounts	10,966	11,625	24,996	24,449
Net sales	279,275	317,276	1,018,329	685,548
COST OF GOODS SOLD	90,360	92,560	362,691	179,052
Gross Profit	188,915	224,716	655,638	506,496
Selling and marketing expenses	303,020	359,248	987,200	996,533
General and administrative expenses	501,738	201,309	1,027,588	531,169
Research and development expenses		1,250		28,415
Depreciation and amortization	20,895	20,579	62,554	61,355
Total operating expenses	825,653	582,386	2,077,342	1,617,472
Net loss from operations	(636,738)	(357,670)	(1,421,704)	(1,110,976)
Interest Expense	40,315	31,088	132,244	115,638
NET LOSS	**$ (677,053)**	**$ (388,758)**	**$ (1,553,948)**	**$ (1,226,614)**
NET LOSS PER SHARE	**$ (.043)**	**$ (.029)**	**$ (.108)**	**$ (.059)**
WEIGHTED AVERAGE SHARES OUTSTANDING	**15,651,764**	**13,310,087**	**14,335,551**	**20,806,348**

VITACUBE SYSTEMS HOLDINGS, INC.
FORMERLY INSTANET, INC.

CONSOLIDATED STATEMENTS OF
CHANGES IN SHAREHOLDERS' DEFICIT
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2003
AND THE YEARS ENDED DECEMBER 31, 2002 AND 2001

Common Stock

	Common Stock			
	Shares	Amount	Additional Paid In Capital	Deficit
Balances, December 31, 2001 (as restated)	24,554,479	$ 24,554	$ 575,446	$ (1,177,566)
Common stock converted to subordinated loan	(10,659,762)	(10,660)	(289,340)	
Cancellation of shares	(584,630)	(584)	584	
Conversion of shareholder advances to capital (Note 2)			788,780	
Net loss				(1,605,857)
Balances, December 31, 2002	**13,310,087**	**13,310**	**1,075,470**	**(2,783,423)**
Issuance of common stock for services	261,913	262	66,939	
Common stock issued in private placement	606,555	607	605,949	
Shares issued in connection with reverse Acquisition	1,508,000	1,508	27,292	
Bridge loans converted to common stock	115,000	115	114,885	
Stock Based Compensation			21,175	
Net loss				(1,553,948)
Balances, September 30, 2003 (unaudited)	**15,801,555**	**$ 15,802**	**$ 1,911,710**	**$ (4,337,371)**

VITACUBE SYSTEMS HOLDINGS, INC.
FORMERLY INSTANET, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Nine months ending September 30	
	2003	**2002**
OPERATIONS:		
Net Loss	**$ (1,553,948)**	**$ (1,226,614)**
Add: Depreciation and amortization	62,554	61,355
Stock and stock options issued for services	88,376	
Provision for obsolete inventory	212,818	
Provision for allowance for doubtful accounts	3,120	
Accrued interest forgiven	(22,240)	
Decrease (increase) in accounts receivable	66,666	(12,202)
Decrease (increase) in inventory	(58)	(6,959)
Decrease (increase) in other assets	(9,634)	27,221
Increase in accounts payable & accrued exp	409,436	196,101
Increase in accrued interest	132,244	115,638
Net cash used in operating activities	(610,666)	(845,460)

FINANCING:

	Nine months ending September 30	
Increase advance from shareholder	85,392	697,550
Payments of bridge loans	(147,500)	
Proceeds from bridge loans	25,000	250,000
Issuance of common stock	606,555	
Acquisition of VitaCube Systems, Inc net of cash received	28,800	
Net cash provided by financing activities	598,247	947,550
INVESTING:		
Purchase of intangible assets	(6,650)	(30,530)
Purchase of Equipment		(2,845)
Net cash used in investing activities	(6,650)	(33,375)
INCREASE (DECREASE) IN CASH	(19,069)	68,715
CASH, BEGINNING OF PERIOD	28,673	9,236
CASH, END OF PERIOD	$ 9,604	$ 77,951
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINACING ACTIVITIES:		
Shareholder advances converted to subordinated note	$	$ 1,635,861
Shareholder advances converted to common stock	$	$ 788,780
Bridge Loans converted to common stock	$ 115,000	$
Interest on shareholder notes added to principal	$	$ 159,547
Stock and stock options issued for services	$ 88,376	$
Interest and debt forgiveness	$ 27,240	$

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VITACUBE SYSTEMS HOLDINGS, INC.
FORMERLY INSTANET, INC.

NOTES TO FINANCIAL STATEMENTS
NINE MONTHS ENDED SEPTEMBER 30, 2003

(UNAUDITED)

NOTE 1 ORGANIZATION, OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

Organization and Business

VitaCube Systems Holdings, Inc formerly Instanet, Inc., a Nevada corporation, ("VSHI" or the "Company") was incorporated in January 2001. On September 8, 2003 the Company changed its name from Instanet, Inc. to VitaCube Systems Holdings, Inc. Prior to March 2003, the Company was organized to exploit an agency agreement with an outside company for the purpose of providing market extensions, including on the Internet, for an electronic cash transmission system. The Company had no revenue from operations since inception and was considered a development stage company. In March 2003, the Company abandoned its business plan and sought to find an operating company with whom to combine.

On June 20, 2003, VSHI acquired VitaCube Systems, Inc. ("VitaCube"), a Colorado corporation, incorporated October 2000, in a stock-for-stock exchange. The acquisition was accomplished through the exchange of all of the outstanding shares of VitaCube for 13,572,000 common shares of VSHI, then representing a controlling interest in VSHI. The acquisition of VitaCube by VSHI is considered a reverse acquisition and accounted for under the purchase method of accounting. Under reverse acquisition accounting, VitaCube is considered the acquirer for accounting and financial purposes, and acquired the assets and assumed the liabilities of VSHI. Assets acquired and liabilities assumed are reported at their fair values, and no adjustments were required to the carrying values since management considers the carrying values to approximate fair value. The accompanying unaudited financial statements as of September 30, 2003, include the accounts of VitaCube since inception (October, 2000) and the accounts of VSHI since June 20, 2003. All significant inter-company accounts and transactions have been eliminated in consolidation.

In connection with the reverse acquisition, all historical common share amounts of VitaCube have been retroactively restated to reflect the capital structure of VSHI in connection with reverse acquisition mentioned above.

VitaCube operates, develops, markets and sells a line of nutrition and sports supplement products supported by customer education and a packaging delivery system intended to make those products convenient to use. During the 3 months ended, September 30, 2003, the Company has changed its focus to network marketing. Network marketing will be conducted through VitaCube Networking Inc., a wholly-owned Colorado corporation, formed on July 9, 2003. The network marketing program consists of independent distributors establishing a network of people buying our products and developing a network of like-minded distributors underneath them. Qualified distributors then earn commissions based upon their sales and sales of distributors underneath them.

The Company has developed a line of nutritional supplements that consists of vitamins, minerals, amino acids, and proteins. Its vitamin/mineral complexes are organized into systems of nutrition called VitaCubes that explicitly tell the consumer what supplements to take and when to take them. The Company has also developed a high-quality meal replacement beverage called the "VitaPro Nutrition Shake."

In the opinion of management, all adjustments (consisting of normal reoccurring adjustments) considered necessary for a fair presentation have been included. Operating results for the nine months

ended September 30, 2003 are not necessarily indicative of the results that maybe expected for the year ending December 31, 2003.

Going Concern

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplates continuation of the Company as a going concern. The Company has incurred a net loss of $1,553,948 for the nine months ended September 30, 2003 and has accumulated a shareholders' deficit of $2,409,860.

In view of these matters, realization of a significant portion of the assets in the accompanying balance sheet is dependent on the continued operations of the Company, which in turn is dependent on the success of future operations. The Company has been developing awareness of its product and has actively marketed its product at sporting events and within the fitness community. However, the Company is relying on additional capital raised through a private placement of its securities to continue operations as it develops its customer base. Within time, management believes that demand for its products will develop to allow the Company to become profitable.

Cash Equivalents

All highly liquid investments purchased with an original maturity of three months or less are considered to be cash equivalents.

Accounts Receivable

The Company uses the allowance method in accounting for bad debts. At September 30, 2003, the Company has recorded a net allowance of $3,120 to encompass both uncollectible receivables and an allowance for return products.

Property and Equipment

The Company provides for depreciation of property and equipment using the straight-line method of depreciation based on estimated useful lives of between three and ten years.

Revenue Recognition

The Company ships its products by common carrier and receives its product sales price in the form of cash, credit card or approved credit terms. The Company offers a 30-day money back guarantee on initial orders to new customers and historically averages less than 3% in credits for returned or unsold products. Sales discounts include discounts provided to professional athletes, resellers, and other customers to promote and increase sales of the Company's products. Sales revenue and related discounts, volume incentives and estimated returns are recorded when the merchandise is shipped since performance by the Company is considered met when products are in the hands of the common carrier. Amounts received for unshipped merchandise are recorded as customer deposits and are included in accrued liabilities.

Long-Lived Assets

The Company reviews its long-lived assets for impairment whenever changes in circumstances indicate that the carrying amount of an asset may not be recoverable. For purposes of evaluating the recoverability of long-lived assets, the recoverability test is performed using undiscounted net cash flows estimated to be generated by the asset.

Inventory

Inventory is stated at the lower of cost or market on a FIFO (first-in first-out) basis. Provision is made to reduce excess or obsolete inventory to the estimated net realizable value. The Company purchases vitamins, packages them, and resells them in various forms and containers.

Inventory is comprised of the following:

	September 30, 2003	December 31, 2002
Raw materials	$ 31,632	$ 389,849
Finished goods	317,586	137,206
Provision for obsolete inventory	(34,922)	0
	$ 314,296	$ 527,055

Summary of the Company's inventory reserve for the three months ended September 30, 2003 is as follows:

Balance as of June 30, 2003	$ 0.00
Expense	212,818
Write off for obsolete	(177,896)
Balance as of September 30, 2003	$ 34,922

Advertising Costs

Advertising and marketing costs are expensed as incurred.

Intangible Assets

The Company's intangible assets are being amortized over their estimated life of 15 years.

Income Taxes

Prior to January 1, 2003, VitaCube had elected to be treated under Subchapter S of the Internal Revenue Code. Accordingly, in lieu of corporation income taxes, the shareholders were taxed on the Company's taxable income, whether or not distributed. VitaCube terminated its "S" election on January 1, 2003. Any losses prior to that date were allocated to the shareholders and may not be used by the Company after January 1, 2003. For the nine months ended September 30, 2003, VitaCube will be taxed as a C Corporation.

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes." Under the asset and liability method of Statement 109, deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to difference between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the

date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Management believes that the estimates utilized in the preparation of the financial statements are prudent and reasonable. Actual results could differ from these estimates.

Stock-Based Compensation

The Company has adopted the disclosure-only provisions of SFAS NO. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"), and applies Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25"), and related interpretations in accounting for stock options granted to employees.

The Company accounts for stock-based compensation issued to non-employees and consultants in accordance with the provisions of SFAS 123 and the emerging issues task force consensus in issue No. 96-18 ("EITF 96-18"), "Accounting for Equity Instruments that are issued to Other Than Employees for Acquiring or in Conjunction with Selling Goods or Services".

If the Company had accounted for its stock-based compensation plans to employees in accordance with SFAS 123, the Company's net income or loss and pro forma net income or loss per basic and diluted common share for the three and nine months ended September 30, 2003 would have been reported as follows:

		Three Months Ended September 30, 2003		Nine Months Ended September 30, 2003
				(as restated)
Net loss, as reported	$	(677,053)	$	(1,553,948)
Add: Stock-based compensation expense included in reported net income, net of related tax effects		21,175		88,376
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects		(24,430)		(119,050)

	Three Months Ended September 30, 2003	Nine Months Ended September 30, 2003
Pro forma net loss	$ (680,308)	$ (1,584,622)
Earnings per share:		
Basic and diluted earnings (loss) per common share		
As reported	(.043)	(.108)
Pro forma	(.043)	(.111)

Net Loss Per Share

Earnings per share requires presentation of both basic earnings per common share and diluted earnings per common share. Since the Company has a net loss for all periods presented since inception, any common stock equivalents would not be included in the weighted average calculation since their effect would be anti-dilutive.

Weighted average shares include the historical common shares outstanding of VitaCube since inception (after taking into effect the share exchange with VSHI), and VSHI since September 30, 2003.

Fair Value of Financial Instruments

Substantially all of the Company's assets and liabilities are carried at fair value or contracted amounts that approximate fair value. Estimates of fair value are made at a specific point in time, based on relative market information and information about each financial instrument, specifically, the value of the underlying financial instrument. Assets that are recorded at fair value consist largely of short-term receivables and other assets, which are carried at contracted amounts that approximate fair

value. Similarly, the Company's liabilities consist primarily of short term liabilities recorded at contracted amounts that approximate fair value.

Recent Accounting Pronouncements

In November 2002, the FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"), which requires that, for guarantees within the scope of FIN 45 issued or amended after December 31, 2002, a liability for the fair value of the obligation undertaken in issuing the guarantee be recognized. FIN 45 does not apply to certain guarantee contracts, such as for a lessee's residual value guarantee embedded in a capital lease. FIN 45 also requires additional disclosures in financial statements for periods ending after December 15, 2002, which we have adopted. However, as of September 30, 2003, the Company believes that, other than product warranty, it has no material items subject to the new disclosure requirements.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation Transition and Disclosure" ("SFAS No. 148"), which (i) amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based compensation; (ii) amends the disclosure provisions of SFAS No. 123 to require prominent disclosure about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based employee compensation; and (iii) amends APB Opinion No. 28, "Interim Financial Reporting," to require disclosure about those effects in interim financial information. Items (ii) and (iii) of the new requirements in SFAS No. 148 are effective for financial statements for fiscal years ending after December 15, 2002. We have included the disclosure requirements of item (ii) and (iii) in the Summary of Significant Accounting Policies.

NOTE 2 SHAREHOLDERS' EQUITY

The authorized capital stock of the Company consists of 50,000,000 shares of common stock at $.001 par value and 5,000,000 shares of preferred stock at $.001 par value. The holders of the common stock are entitled to receive, when and as declared by the Board of Directors, dividends payable either in cash, in property or in shares of the common stock of the Company. Dividends have no cumulative rights and dividends will not accumulate if the Board of Directors does not declare such dividends. Through September 30, 2003, no dividends have been declared or paid by the Company.

In January 2003, VitaCube issued 67,201 (261,913 common shares after the reverse acquisition) shares of common stock at $1.00 per share to certain individuals and entities as compensation.

In June 2003, the Company converted bridge loans in the amount $115,000 to 115,000 shares of common stock at $1.00 per share.

In connection with the Private Placement of securities for the period ended September 30, 2003, the Company sold 606,555 shares of common stock for $1.00 per share.

NOTE 3 PROPERTY AND EQUIPMENT

Property and equipment consisted of the following:

	September 30, 2003	December 31, 2002
Furniture & fixtures	$ 50,963	$ 50,963
Office equipment	6,815	6,815
Software	175,649	175,649
Leasehold improvements	121,605	121,605
	355,032	355,032
Accumulated depreciation	(167,970)	(108,560)
	$ 187,062	**$ 246,472**

NOTE 4 INTANGIBLE ASSETS

VitaCube has incurred costs to patent its "VitaCube" delivery system, which it uses to package its vitamins. Patents are being amortized over a period of 15 years, at approximately $4,400 per year.

Patents is comprised of the following:

	September 30, 2003	December 31, 2002
Patents	$ 66,236	$ 59,586
Accumulated amortization	(6,692)	(3,548)
	$ 59,544	**$ 56,038**

NOTE 5 DUE TO SHAREHOLDERS AND SHAREHOLDER SUBORDINATED LOAN

VitaCube's shareholders advanced monies to VitaCube, totaling $1,276,552 as of December 31, 2001. Additional advances were made during 2002. Promissory notes for the advances were due on demand and earned interest at 8%. As of December 31, 2001, accrued interest on these advances amounted to $73,621. During the year ended December 31, 2002, one of the shareholders converted $788,780 of advances made by him into equity in VitaCube and $300,000 of subordinated promissory notes. In addition, during 2002, the other shareholder converted all of his of advances and accrued interest and returned some of his VitaCube stock for a subordinated promissory note in the amount of $1,335,861. The notes to both shareholders ("Notes") bear interest at 8% per annum with principal and interest payable from a total of 25% of adjusted quarterly net income (as defined). The notes, if not satisfied in five years, will be due on June 30, 2007 and September 30, 2007, respectively. Accrued interest on these notes for the year ended December 31, 2002 amounted to $70,677. As of December 31, 2002, one of the shareholders advanced an additional $13,442 to VitaCube. During 2003, prior to the exchange, one of the shareholders advanced an additional $85,392 to the Company.

NOTE 6 COMMITMENTS AND CONTINGENCIES

VitaCube leases office and warehouse space from a related party. Minimum future rentals at September 30, 2003, under this agreement approximate:

December 31,		
2003	$	9,000
2004		36,000
Total	**$**	**45,000**

Rent expense approximated $33,000 and $9,000 for the nine months and three months ended September 30, 2003. Effective July 1, 2003, the Company renegotiated the lease for its office space from $6,000.00 to $3,000.00 per month.

VitaCube is involved in litigation that is in the preliminary stages. In this matter, indeterminate amounts are sought. Management, after review and discussion with counsel, believes VitaCube has meritorious defenses and intends to vigorously defend itself in this matter, but it is not feasible to predict or determine the final outcome at the present time.

NOTE 7 BRIDGE LOANS

During the year ending December 31, 2002, VitaCube obtained bridge financing from two unrelated persons totaling $300,000, bearing interest at 10%, payable one year from the date received. In addition, the VitaCube's president and major shareholder advanced $200,000 of bridge loan financing as of December 31, 2002. During the nine months ending September 30, 2003, VitaCube obtained additional bridge financing from an unrelated entity totaling $25,000. In connection with the share exchange, the last bridge loan lender agreed to convert his $25,000 note into 25,000 shares of the Company's common stock under the Company's Private Placement. In connection with this transaction, accrued interest of $1,130 was waived. In addition, a second bridge lender agreed to convert $90,000 of the amount due him for 90,000 shares of the Company's common stock (at $1.00 per share) under the Company's Private Placement, and he waived $15,000 of accrued interest; the due date of his note was also modified. Also, another bridge loan lender forgave $5,000 of the principal amount of his bridge loan and $2,644 of accrued interest in exchange for a modification of the due date. As of September 30, 2003, the Company prepaid $147,500 of the outstanding bridge loan financing.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

Results of Operations

For the three months ended September 30, 2003 compared to the three months ended September 30, 2002.

Net revenue. Revenue for the quarter ended September 30, 2003 was $279,275 compared to $317,276 for the quarter ended September 30, 2002, a decrease of 12%. The decrease in revenue can be attributed to the Company changing its marketing focus from sales directly to consumers and retail establishments to sales through a network marketing program. The network marketing sales will be handled by VitaCube Network, Inc., a wholly owned subsidiary of VitaCube Systems Holdings, Inc. Roll out of the network marketing program is scheduled during first quarter 2004 with a hard launch in second quarter 2004.

Gross Profit. Gross profit decreased to $188,915 for the quarter ended September 30, 2003 from $224,716 for the quarter ended September 30, 2002, a decrease of 16%. Gross profit as a percentage of revenue (gross margin) decreased from 71% for the quarter ending September 30, 2002 to 68% in the quarter ended September 30, 2003. The decrease in gross profit follows the decrease in net revenue and the additional decrease in gross margin is a result of discounts given for discontinued products that will not be sold in the network marketing program.

Sales and marketing expenses. Sales and marketing expenses were $303,020 for the quarter ended September 30, 2003 a decrease of 18% from $359,248 for the quarter ended September 30, 2002. Sales and marketing activities decreased in the third quarter due to the transition into the network marketing program. Advertising was halted in both print and radio mediums. The Company will start to incur advertising expenses in the fourth quarter of 2003 for the launch of its network marketing program.

General and administrative expenses. General and administrative expenses of $501,738 for the quarter ended September 30, 2003, increased by 149% compared to $201,309 for the quarter ended September 30, 2002. The increase is a result of increased legal, accounting and other associated expenses due to the Company becoming a public entity. There is also a $212,818 charge against inventory for discontinued items that the Company elected not to offer in the network marketing program and the Company setup a provision of $34,922 for future obsolete inventory.

Research and development expenses. There were no research and development expenses for the quarter ended September 30, 2003 as compared with $1,250 for quarter ended September 30, 2002. While it is the Company's belief that the current product offering is reflective of current nutritional science and forms a solid basis for its network marketing program, the Company may need to develop a unique product to continue to distinguish itself from its competition.

For the nine months ended September 30, 2003 compared to the nine months ended September 30, 2002.

Net Revenue. Revenue for the nine months ended September 30, 2003 was $1,018,329, compared to $685,548 for the nine months ended September 30, 2002, an increase of 49%. The increase is attributed to the increasing market awareness of the Company's brand and the sales to resellers in the first six months of 2003. As anticipated, the Company's revenue is flattening as it transitions into its network marketing program, and the Company does not expect any significant revenue increases until second quarter 2004, after the hard launch of the network marketing program.

Gross Profit. The gross profit for the nine months ended September 30, 2003 of $655,638 increased by 30% from $506,496 for the nine months ended September 30, 2002. Gross profit as a percentage of revenue (gross margin) decreased from 74% for the nine months ended September 30, 2002 to 64% in the quarter ended September 30, 2003. The Company's profit margin decline is attributed to the product mix purchased by its customers. Its sales to direct consumers carry a larger profit margin than sales to retailers who purchase at wholesale prices. Also, retailers primarily purchase

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the Company's VitaPro product, which has lower profit margins than most of its other products. As the Company moves forward into its network marketing program there will be less fluctuation of the gross profit and gross margin numbers.

Sales and marketing expenses. Sales and marketing expenses of $987,200 for the nine months ended September 30, 2003 decreased by less than .01% compared to $996,533 for the nine months ended September 30, 2002. As the Company transitions into the network marketing program, through natural attrition the Company has been in the process of depleting its inside sales force. Existing sales staff will become independent distributors for the network marketing program in the fourth quarter 2003. Advertising costs have been temporarily halted and other sales expenses remain relative constant with the previous year.

General and administrative expenses. General and administrative expenses of $1,027,588 for the nine months ended September 30, 2003 increased by 93% compared to $531,169 for the nine months ended September 30, 2002. The increase is the result of additional legal costs, attributable to general business issues, the Company's abandoned public offering, and the reverse acquisition. While the need for legal advice for business issues will recur from time to time, the fees for the abandoned public offering and reverse acquisition are non-recurring. The Company's general counsel has taken some of their fees in the Company's stock. The Company also took a $212,818 inventory write off for obsolete and discontinued inventory that will not be offered in its network marketing program and setup a provision of $34,922 for future obsolete inventory. In addition, the Company anticipates that the type and amounts of operating expenses will change with the institution of its network marketing program. The network market distributors will assume much of the advertising and marketing expenses. Accounting and administrative costs may increase to communicate with, provide products to and track sales by network sellers. While selling and marketing expenses may remain steady or decline, general and administrative expenses will increase with increased payments to consultants, legal and accounting fees.

Research and development expenses. There were no research and development expenses for the nine months ended September 30, 2003 as compared with $28,415 for nine months ended September 30, 2002. While it is the Company's belief that the current product offering is reflective of current nutritional science and forms a solid basis for its network marketing program, the Company may need to develop a unique product to continue to distinguish itself from the competition.

Liquidity and Capital Resources

The Company's operations used $610,666 of cash in the nine months ended September 30, 2003 on net sales of $1,018,329 and used $845,460 of cash in the nine months ended September 30, 2002 on net sales of $685,548. The use of cash in the Company's operations results from incurring and accruing expenses to suppliers, necessary to generate business and service its customers, and legal fees at a time when revenues did not keep pace with expenses, along with a one-time inventory expense for discontinued and obsolete inventory. W