

VITACUBE SYSTEMS HOLDINGS INC  
Form 10KSB/A  
March 04, 2005

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**Amendment No. 1 to  
FORM 10-KSB**

ý **ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934**

**For the fiscal year ended December 31, 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**  
(State of incorporation)

**84-1575085**  
(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)

Check whether the issuer (1) filed all reports to be filed by Section 13 or 15(d) of the Exchange Act during the past 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

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. ý

As of March 26, 2004, the Company had 16,844,980 shares of its \$.001 par value common stock issued and outstanding.

Issuer's revenues for the year ended December 31, 2003 were \$1,211,402.

## Edgar Filing: VITACUBE SYSTEMS HOLDINGS INC - Form 10KSB/A

Aggregate market value of voting stock held by non-affiliates of 4,515,223 shares outstanding at March 26, 2004 was approximately \$4,786,136. Amount was computed using the average bid and ask price as of March 26, 2004, which was \$1.06. Shares of common stock held by the officers and directors named in Item 9, and each person who owns 10% or more of the common stock have been excluded from the calculation in that such persons may be deemed affiliates.

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**EXPLANATORY NOTE**

VitaCube Systems Holdings, Inc. ("VSHI" or "the Company") is filing this Amendment No. 1 to Form 10-KSB primarily to reflect the restatement of its financial statements for the fiscal year ended December 31, 2003 and related disclosures as filed in the Company's Form 10-KSB filed with the Securities and Exchange Commission on March 30, 2004. During the course of our 2004 financial statement audit, a calculation error was identified in computing the fair value of options granted using the Black-Scholes option pricing model, resulting in an understatement of stock-based compensation for the year ended December 31, 2004. Please refer to Note 1 to our consolidated financial statements included in this amendment under "Item 7 Financial Statements" for a further discussion of the restatement and reclassifications.

Except as discussed above, we have not modified or updated disclosures presented in the original annual report on Form 10-KSB. Accordingly, this Form 10-KSB/A does not reflect events occurring after the filing of our original Form 10-KSB or modify or update those disclosures affected by subsequent events. Information not affected by the restatement is unchanged and reflects the disclosures made at the time of the original filing of the Form 10-KSB. This Form 10-KSB/A should be read in conjunction with our filings made with the Securities and Exchange Commission subsequent to the filing of the original Form 10-KSB, including any amendments to those filings. The following items have been amended as a result of the restatement:

Part II Item 6 Management's Discussion and Analysis of Financial Condition and Results of Operations; and

Part II Item 7 Financial Statements.

## **CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This Form 10-KSB contains forward-looking statements and information relating to VitaCube Systems Holdings, Inc. ("VSHI" or "the Company"). VSHI intends to identify forward-looking statements in this report by using words such as "believes," "intends," "expects," "may," "will," "should," "plan," "projected," "contemplates," "anticipates," "estimates," "predicts," "potential," "continue," or similar terminology. These statements are based on the Company's beliefs as well as assumptions the Company made using information currently available to us. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise. Because these statements reflect the Company's current views concerning future events, these statements involve risks, uncertainties, and assumptions. Actual future results may differ significantly from the results discussed in the forward-looking statements. Some of the risks that may affect our performance are discussed below under "Risk Factors Associated with Our Business."

## **RISK FACTORS ASSOCIATED WITH OUR BUSINESS**

The Company is subject to various risks that could have a negative effect on the Company and its financial condition. These risks could cause actual operating results to differ from those expressed in certain "forward looking statements" contained in this Form 10-KSB as well as in other Company communications. Before you invest in our securities you should carefully consider these risk factors together with all other information included in our publicly filed documents.

### **Risks associated with distributors**

Our success will depend in large part on our ability to attract, maintain and motivate a large base of distributors. In recruiting and keeping distributors, we will be competing with other network marketing organizations, both inside and outside the nutritional supplement industry. We cannot ensure that we will be successful in attracting and retaining productive distributors, especially since network marketing organizations often experience high turnover rates. Distributors are independent contractors who purchase products from us for their own use or for resale at retail. Distributors typically work on a part-time basis and may engage in other business activities, which may take away from their work for us. We cannot accurately predict fluctuations in the number and productivity of distributors because we will rely upon existing distributors to sponsor and train new distributors and to motivate new and existing distributors. Attrition in the distributor force, seasonal or other decreases in purchase volume, costs of training new distributors, and the lag in initial sales may combine to reduce our profits and revenues.

We anticipate that the distributor organization will be headed by a relatively small number of key distributors who will be responsible for a disproportionate amount of revenues. The loss of any key distributor will materially and adversely affect revenues and our ability to attract other distributors, especially if the distributor takes downline distributors to a competitor or any other organization.

Our distributors will be required to sign agreements, which require compliance with our policies and procedures. Although our policies forbid distributors from making claims regarding our products and income potential of distributors, distributors may make unauthorized statements or create promotional materials which are incorrect or contrary to applicable laws and regulations. Legal actions against distributors can lead to increased regulatory scrutiny, attendant cost and reduced sales. In order to ensure that the actions of distributors comply with our policies, we will attempt to carefully monitor the distribution network and our distributors but cannot ensure the complete absence of violations or that no distributor will make predictive or other unauthorized statements, which may subject us to litigation or bad publicity.

### **Governmental regulation of the network marketing and nutrition industries**

Network marketing programs frequently are subject to laws and regulations directed at ensuring that product sales are made to consumers of the products and not just purchased by the distributors and that compensation is based on sales and not recruitment of other sales personnel. These laws and regulations include securities laws and statutes and regulations under the aegis of the Federal Trade Commission and various state laws. Some of these laws may be interpreted or enforced in a manner that could result in our program being found to be illegal. The attendant costs, limitations, and publicity would cause a material adverse impact on our business.

The two principal federal agencies that regulate nutritional dietary supplements are the U.S. Food and Drug Administration ("FDA") and the Federal Trade Commission ("FTC"). Among other matters, FDA regulations govern claims about the health or nutritional value of a product. Under Federal statutes and regulations, the FDA and FTC can initiate civil proceedings and impose significant monetary fines and penalties against companies and persons who made illegal product claims and refer any such conduct for criminal prosecution. Similar enforcement actions may also result from noncompliance with other regulatory requirements, such as FDA labeling rules. The FDA also reviews some product claims that companies must submit for agency evaluation and may find them unacceptable. Also, state and local authorities may bring enforcement actions for violations of these laws. In addition, because of recently released governmental studies and pronouncements relating to nutritional dietary supplements, we believe that the current regulatory scheme could change but we cannot predict the direction or impact of any changes. We may be subject to additional laws or regulations administered by the FDA or other Federal or state authorities regulating the processing of food and manufacturing of nutritional supplements, the repeal of laws or regulations favorable to our industry or more stringent interpretations of current laws or regulations. Among other considerations, these regulations may require:

changes in manufacturing, expanded or different labeling for our products

the recall, reformulation, or discontinuance of certain products

scientific substantiation regarding ingredients, product claims or safety

### **Public perception of network marketing industry**

Network marketing programs have been associated or confused with illegal pyramid schemes. Publicity about those schemes may adversely impact legal, proper network marketing programs in the eyes of the public and may reduce both sales and our ability to attract new distributors.

### **Risks associated with our inventory and suppliers**

We may not have substantial inventory to fill orders generated by our distributors. If the network marketing program obtains an unexpectedly high number of orders, we may not be able to fill all of the orders. Failure to timely deliver orders will adversely impact our business and prospects.

We rely entirely on third parties for the materials used to make our products, the manufacture of our products and for packaging and labeling of our products. We rely substantially on third parties for significant aspects of the marketing, distribution and advertising of our products. Fees charged by these third parties constitute significant operating costs. These businesses may be unable to satisfy our supply requirements, manufacture our products timely, fill and ship our orders promptly, provide services at competitive costs and offer reliable products and services. Our third party manufacturers may determine to make products similar to our products at lower prices for competitors and may also delay producing our products while they work on more lucrative projects for others. In addition, because third parties manufacture our products as well as the products of other companies, we are subject to the risk of cross-contamination of our products. Suppliers may also increase fees to levels that make

our business uneconomic. In addition, while we require that our suppliers verify the accuracy of the contents of our products, we have not devoted sufficient expertise or personnel to monitor the production of products by these third parties. We rely almost exclusively, without independent verification, on certificates of analysis regarding product content provided by our third party manufacturers. Our practices in turn increase the risk to us of violation of laws and regulations governing such matters and consequent governmental sanctions, sales disruptions and possible litigation.

Because we require high quality materials in our products, we may face supply shortages as well as a shortage of third party manufacturers who have the capability to meet our standards. These limitations may result in suppliers not being able to fulfill our requirements, and we may have to cut back production, reformulate our products, or be unable to fill orders, which would result in decreased sales and losses of customers. Reformulation of our products would likely require that we also change our marketing and labeling at significant cost to us.

Our product distribution relies primarily on third-party delivery services, including the United States Postal Service and United Parcel Service, as we currently do not sell products in stores. Poor service, strikes and other interruptions may delay the timely delivery of customer orders, and customers may refuse to purchase our products because of this lack of convenience.

#### **Risks associated with computer, technology, information, and communications systems**

Our success, and in particular our ability to receive and fulfill orders and provide quality customer service, depends on the efficient and uninterrupted operation of our computer systems. System interruptions may result from fire, power loss, water damage, telecommunications failures, vandalism and other malicious acts, and problems related to our equipment. We depend on communications providers and our website host to provide our customers with access to our website. In addition, our customers depend on their own Internet service providers for access to our website. Periodic system interruptions will occur. These occurrences may cause customers to perceive our website as not functioning properly and therefore cause them to stop using our services. Our success depends upon the ability of the Internet infrastructure to support increased use. Concerns about inadequate Internet infrastructure, reliability, accessibility and the availability of cost-effective, high-speed service also may inhibit growth in Internet usage. Even if the necessary infrastructure or technologies develop, we may incur significant costs to adapt our operating strategy.

Consumer concerns over the security of transactions conducted on the Internet or the privacy of users may inhibit the growth of the Internet and online commerce. To transmit confidential information securely, we rely on encryption and authentication technology licensed to us by third parties. Events or developments may result in a compromise or breach of the algorithms that we use to protect customer transaction data. We cannot ensure the absence of penetration of our network security or misappropriation of our customers' personal or credit card information, any of which could subject us to liability. We may also be liable for claims based on unauthorized purchases with credit card information, impersonation or other similar fraud claims. Under current credit card practices, a merchant may be liable for fraudulent credit card transactions where, as is the case with the transactions we process, that merchant does not obtain a cardholder's signature. Our business may also be harmed if our security measures do not prevent security breaches or if our systems are perceived as not secure.

#### **Risks associated with our merger with Instanet**

In undertaking the share exchange between VitaCube and Instanet, we relied, without complete and detailed due diligence activities, on representations by former principals of Instanet. Prior to the transaction, Instanet had completed a public offering of its stock, filed periodic reports with the Securities and Exchange Commission and entered into a Master Agency Agreement, making Instanet

the exclusive master agent for the distribution of certain funds transfer products and services. Significant liability can arise from improper actions in the sale of stock and incomplete or misleading reports. Although prior management of Instanet represented that the Master Agency Agreement had terminated, we did not independently ensure the accuracy of that claim but relied on representations by Instanet principals. Liabilities may arise from that agreement. Although we have obtained the guaranty of these representations by a former principal of Instanet, actions by prior management could result in materially adverse litigation, damages, publicity and rulings.

#### **Risks associated with a start-up company**

We have a limited operating history on which to base an evaluation of our business and prospects. Our products were formulated in 2000 and 2001, and we began sales of our products to the public in early 2002. We recently changed our marketing focus to network marketing. We may not be successful in addressing such early stage challenges such as establishing a position in the market, developing brand awareness and expanding our market presence. As with most companies in the early stage of product sales, our lack of operations is compounded by and must be considered in light of numerous risks, including an evolving and unpredictable business model, differentiation of our products from competing products, creating awareness, acceptance by customers of our products and the management of growth with limited capital.

If we require future additional financing, we cannot be certain that it will be available to us on favorable terms or at all. Our inability to obtain additional funding would limit the competitiveness and corporate growth that we believe is necessary to succeed in our business. If we raise additional funds in the future through the issuance of equity or debt securities, then these securities may have rights, preferences or privileges senior to the rights of our common stock, and current stockholders may also experience additional substantial dilution.

In addition, our current management has had only limited experience managing a public company or a large operating company. There can be no assurance that we will be able to effectively manage the expansion of our operations, that our systems, procedures or controls will be adequate to support our operations or that our management will be able to achieve the rapid execution necessary to fully exploit the market opportunity for our products. Any inability to manage growth effectively could have a material adverse effect on our future success.

#### **Difficulties with pricing and consumer education**

Our products contain high quality ingredients, which tend to be more expensive than ingredients used by some of our competitors. As a consequence, our products are among the highest priced meal replacement and nutritional dietary supplements on the market. We believe that our high quality products provide a comprehensive solution for nutritional needs, but that consumers must be educated about this feature of our products. This educational process may be lengthy and at a significant cost to us and does not ensure that consumers will buy our products over competing products with similar ingredients. To date, most of our products are marketed and sold predominantly to persons with significant disposable income, and we expect that our future customers for many of our products will also be in that category. Consequently, a further risk may be the lack of a sizable market for our high quality products

#### **History of unprofitability**

We have incurred a net loss in each quarter since inception and expect to incur net losses for the foreseeable future. We have numerous past due obligations to suppliers, vendors and others. Our expenses currently exceed our income and may do so for a period of time until our network marketing program can be established, if it is indeed ultimately successful. Significant expenditures are required to



produce high quality products, increase awareness of our products, differentiate our products from competing products, obtain and maintain repeat customers and invest in systems and technology that will support increased customer sales. These continuing significant expenditures are expected to result in losses and negative cash flow for a considerable period of time.

#### **Risks associated with our competition**

We face intense competition from numerous resellers, manufacturers and wholesalers of meal replacement products and nutritional dietary supplements, including retail, online and mail order providers. We also are in competition with other network marketing companies, both inside and outside the nutritional supplement industry. Many of our competitors have longer operating histories, established brands in the marketplace with sales vastly in excess of ours, and greater access to capital than we do. These competitors may use their resources to engage in aggressive advertising and marketing campaigns, conduct extensive research, development and testing significantly beyond our capabilities, modify existing products or develop new products that could result in reduced sales of our products. At this time, we do not expect to devote significant resources to research and development, because we believe that our products are reflective of current nutritional science. However, other companies with greater capital and research capabilities could formulate products that could gain wide marketplace acceptance, which could have a depressive effect on our future sales. In addition, aggressive advertising and promotion by our competitors may require us to compete by lowering prices, and the economic viability of our operations likely would be diminished. In particular, if we are required to reduce the prices of our meal replacement product, our profitability will be impaired because the operating margins on VitaPro are significantly less than those of our nutritional dietary supplements. Also, many of our well-financed competitors have the resources that provide them with a significant advantage in market education and development. Because we believe that market education is an integral component of our sales efforts, we are at a disadvantage to our better-financed competitors in this area due to our limited resources.

The nutritional dietary supplement and meal replacement markets historically have been influenced by products that became popular due to changing consumer tastes and media attention. Our products may be rendered obsolete by changes in popular tastes as well as media attention. We currently do not intend to devote any significant resources to develop new products that may be needed for us to capitalize on changing markets or new market opportunities or to continue relationships with customers who may desire different supplement and meal replacement needs. This course of action may make it very difficult for us to adapt our product line to changing tastes.

#### **Dependency on our key personnel**

The active involvement and participation of our key personnel is critical to our success. The loss of a key member of our team would likely have a material adverse effect on our business and could slow our growth. Our success also depends on hiring, retaining and integrating senior management and skilled employees in order to expand our business. Because our principal management does not have substantial experience in the nutritional dietary supplement industry, we must retain third party manufacturers, consultants and employees with expertise in the production, marketing, distribution and sales of nutritional dietary supplements. Our inability to maintain a relationship with these persons for the long-term may have a material adverse effect on our business and profitability.

#### **Risks associated with our use of endorsers in professional sports**

One of our principal marketing efforts is the use and endorsement of the Company's products by well-known athletes, sports teams and entertainers. Among others, we have received endorsements from Mike Shanahan, Curt Schilling, Randy Johnson, Brian Griese and Amy Van Dyken. We cannot ensure that we can attract other such endorsements at all or on terms favorable to the Company. We

also cannot ensure that the individuals who provide such endorsements will continue to succeed in their sports and will not engage in activities which may bring disrepute on themselves and possibly on the Company's products, all to the detriment of the Company.

#### **Potentially adverse publicity and studies regarding nutritional industry**

If negative publicity relating to the nutritional dietary supplement industry in general and products marketed by our competitors adversely impacts the entire industry, our business and prospects likely will suffer. Our industry has been damaged by criticism of certain producers of nutritional dietary supplements for allegedly having omitted ingredients from packaging and for listing ingredients that are not contained in their dietary supplements. Also, some companies have received adverse publicity for marketing allegedly dangerous products, including ingredients that metabolize into possibly dangerous substances and/or those banned by governing bodies of certain sports, and for making unsubstantiated claims of benefits from the use of their products. The mass media often has difficulty differentiating between diet supplements and dietary supplements, and widespread adverse publicity about the former, ephedra in particular, may adversely impact our products among consumers who may not be able to make the distinction. Recently, studies conducted by and for our industry have received criticism as not being conducted in an unbiased, scientific manner or as having been influenced by the sponsors. Some high profile athletes have been criticized for their use of certain nutritional dietary supplements. Because consumers may not be able to differentiate between products receiving adverse publicity and our products, our business may suffer from adverse publicity relating to nutritional dietary supplements and to other companies in our industry.

The federal government, research institutes, colleges and others regularly conduct research into the use, effectiveness and potential for adverse results from the use of nutritional dietary supplements. The results of any such studies could be contrary to studies and assumptions on which the formulation and marketing of our products are based and could materially and adversely impact our business. Even if adverse studies are subject to substantial criticism or not supported by accepted scientific methodology, publicity surrounding the reports of these studies may result in decreased sales of our products. Recently, the effectiveness of, and potential for harm from, some of the leading herbal supplements have come into question as a result of research studies. These negative study results and other negative publicity could adversely affect the potential market and sales of our products.

#### **A slower growth rate in the nutritional supplement industry**

Nutritional supplement companies, analysts, publications and other industry sources have indicated that the nutritional dietary supplement industry has experienced a significantly slower rate of growth in recent years. This slowdown may be attributable in part, among other factors, to the maturing of the market for nutritional dietary supplements, the lack of any significant developments of new products to stimulate consumer demand, negative publicity concerning the efficacy of certain ingredients contained in some nutritional dietary supplements, the proliferation of the number of products and companies competing in the industry, and the increased number of private label brands which may have the tendency to create confusion for consumers in product selection. This slowdown in the industry's rate of growth could continue over the long-term and impair the prospects for significantly increasing the sale of and the demand for our products.

#### **Risks associated with product liability**

Like any other distributor or manufacturer of products that are ingested, we face an inherent risk of exposure to product liability claims if the use of our products results in, or is believed to have resulted in, illness or injury. Some of our products contain innovative combinations of ingredients, and there is little long-term experience with the effect of these combinations. In addition, interactions of these products with other products, prescription medicines and over-the-counter drugs have not been

fully explored or understood and may have unintended consequences. While our third party manufacturers may perform tests in connection with the formulations and production of our products, these tests are not designed to evaluate the safety or efficacy of our products. There are no conclusive clinical studies regarding any of our products. Manufacturers and distributors of vitamins and nutritional dietary supplements have been named as defendants in product liability lawsuits from time to time. Although the Company maintains product liability insurance it may not be sufficient to cover product liability claims and product liability claims could have a material adverse effect on our business. While we use our best efforts to ensure that the independent contractors who sell our products do not make false claims about the products, we are not able to monitor them on a regular basis so that we can prevent claims based on those kinds of statements. The successful assertion or settlement of an uninsured claim, a significant number of insured claims or a claim exceeding the limits of our insurance coverage would harm us by adding further costs to our business and by diverting the attention of our senior management from the operation of our business. Even if we successfully defend a products liability claim, the uninsured litigation costs and adverse publicity may be harmful to our business.

#### **Potentially inadequate protection of our proprietary products**

Our existing proprietary rights may not afford remedies and protections necessary to avoid infringement, reformulation, theft and other improper use of our products by competitors. We developed the formulations contained in our products. If our products are successful, the formulations will constitute critical proprietary material, which must be protected from competitors. Although trade secret, copyright and patent laws generally provide such protection and we may attempt to protect ourselves through contracts with developers and manufacturers of our products, we may not be successful in enforcing our rights. In addition, enforcement of our proprietary rights may require lengthy, expensive litigation. In addition, we have attempted to protect the trade names and trademarks used for our products through registering them. To the extent our trademarks are not issued, we will rely on common law trademark rights to protect our unregistered trademarks. Common law trademark rights do not provide the same level of protection as those trademarks with U.S. federal registrations and the rights of a common law trademark are limited to the geographic area in which the trademark is actually used. Our inability to protect against the copying and theft of our proprietary property and to obtain relief from these actions could have a material, adverse impact on our prospects and the Company.

#### **Investment Risks**

The Company has not paid and does not intend to pay dividends on its common stock.

The Company has very little trading activity in its common stock, making it susceptible to tremendous volatility. Over 90% of its issued and outstanding common stock is restricted. When holding periods for that stock expire, large amounts of stock may be sold into the market and depress the market price.

The market price of the Company's common stock could be significantly affected by factors such as actual or anticipated fluctuations in operating results; new products or contracts; industry trends; actions of competitors; government regulation; results of studies on similar products; general economic and market conditions; and changes in financial estimates by securities analysts.

**PART I**

**ITEM 1. DESCRIPTION OF BUSINESS**

**Overview**

VitaCube Systems Holdings, Inc. through its subsidiaries provides a high quality meal replacement product and premium nutritional dietary supplements to health and fitness conscious consumers. We offer a comprehensive product line of vitamins, minerals, amino acids, a rehydration/electrolyte powder drink, and a chocolate and vanilla flavored meal replacement powder drink.

The foundation for our products is a comprehensive line of nutritional dietary supplements. Unlike many of our competitors, none of our products contain substances that have been the subject of health concerns, in one form or another, by the medical community in the immediate past. Those substances, which have raised health concerns include ephedra, creatine, androstene, androstenedione, aspartame, steroids and human growth hormones. Our product line is reviewed on an ongoing basis as to compatibility with current research, efficacy, dosage, and safety by our scientific review advisors, which currently consists of three experts in nutritional science and sports conditioning.

One of our major innovations is our unique, easy-to-use, packaging system known as the VitaCube. Historically, a major challenge with nutritional dietary supplements is getting consumers to use them on a consistent basis. The VitaCube compartmentalizes, indexes and describes components of the various supplements to be taken each day. This simple, organized approach allows the consumer to quickly and easily take our supplements at regular intervals in proper combinations without the confusion or clutter associated with purchasing and storing supplements in multiple bottles and containers. Our VitaCubes are available in a wide variety of sizes and configurations, which allows a customer to choose a VitaCube consistent with his or her budget and health and fitness goals.

With a VitaCube System, each consumer knows:

what nutritional dietary supplements to take

when to take the supplements

how many supplements to take

the proper combinations to take

VitaCube Systems Holdings, Inc. was incorporated on January 9, 2001, under the name Instanet, Inc. The Company changed its name to VitaCube Systems Holdings, Inc. on September 8, 2003. Instanet was originally founded to exploit an agency agreement with an outside company for the marketing and sale of electronic funds transfer services and systems through the Internet. Instanet had no revenues from operations and was considered a development stage company. In March 2003, Instanet abandoned its business plan and sought to find an operating company to combine with.

On June 20, 2003, Instanet acquired VitaCube Systems, Inc. ("V3S"), a Colorado corporation, incorporated in October 2000, in a stock-for-stock exchange. In the exchange all of the stock of V3S was exchanged for 13,572,000 shares of common stock of Instanet, then representing a controlling interest in Instanet. After the exchange, the business of V3S became the operating business of Instanet and V3S's management took over management of Instanet. The description of our historic business describes the business conducted by V3S.

Since inception in October 2000, we developed and began marketing our products primarily to elite athletes and professional and collegiate sports teams in 2001. We launched our marketing program to the public in early 2002 targeting consumers who use meal replacements or take multiple nutritional dietary supplements regularly. While our potential customers are generally consumers who are aware of the importance of good health and fitness through proper exercise and nutrition, the marketing

primarily focused on individuals who are in their 20's and 30's, as well as the aging "baby boomer" generation, which is concerned about health and well being and generally has a high level of disposable income. During this time we marketed our products through a variety of sales channels, including specialty retail stores, athletic clubs and personal trainers, television and radio, direct mail, the Internet and through our direct sales force.

In 2003, the Company changed its marketing focus to network marketing and on July 9, 2003, formed VitaCube Network, Inc., ("VNI") a wholly owned Colorado corporation. All of the Company's marketing efforts are now focused on the network marketing program along with continued support to elite athletes and professional and collegiate sports teams.

## **Our Products**

### *Vitamins and Minerals*

The vitamin and mineral primary line consists of 12 tablets, capsules and soft gel formulations and 4 proprietary and function specific specialty formulations. VitaCube systems are divided into three primary, gender-specific packages: VitaCube Basic®, designed for individuals who are new to nutritional supplement programs; VitaCube Essential®, for the intermediate active individual; and VitaCube Elite®, for the highly active individual and athlete. Our Research and Development Team extensively investigated optimum nutritional needs in order to formulate the primary line. We have formulated these products to be both effective and safe, as well as intended to meet the nutritional needs of most individuals. By balancing our formulas, all 11 products in the Elite System can be taken without concern for potential "overdosing" effects. At the same time, variations of these individual formulas are used in the Essential System and Basic System levels of nutritional support.

Many of our formulas also contain an exclusive, proprietary blend of 17 essential cellular metabolic factors known as the VitaCube Activating System. No other products on the market have this proprietary combination of cellular factors, which can result in quick absorption and greater absorption into the digestive tract and blood stream.

#### *Primary Line of Supplements in the VitaCube Systems:*

**M32+® (Multi System Formula):** 32 vitamins and minerals a solid and complete multivitamin

**Cal/Mag+®:** Calcium, Magnesium and Boron supports healthy bones and muscles

**Absorbit:** Digestive Enzymes & Aminogen® promotes and aids digestion of nutrients

**CP Complex®:** Vitamin C and Potassium aids metabolic function and regulates heartbeat and blood pressure

**AO Elite®:** L-Arginine and L-Ornithine increases circulation and builds muscle

**ZMA Pro:** Zinc and Magnesium Aspartate supports strength and endurance in the male system

**WNB:** Women's Natural Balance works with the female system to help create hormonal balance

**GC Elite®:** L-Glutamine and L-Carnitine amino acids that enhance muscle activity

**Ultra EFA®:** Essential Fatty Acids with Vitamin E supports healthy joints, connective tissue, and cellular function

**AlphaNac®:** Alpha Lipoic Acid & N-Acetyl-L-Cysteine two of the body's most powerful antioxidants may help neutralize and eliminate stress

**JSH® (Joint Support Health):** Glucosamine and Chondroitin promotes joint flexibility and mobility

**Q-Zyme®:** CoEnzyme Q10 supports proper heart function and cellular energy

*Specialty Line of Supplements:*

**Complex SPP®:** Saw Palmetto improves and supports prostate health in men over 30

**Visual Eyes®:** Lutein and Vitamin A promotes proper eye health

**Enduro Max:** 6 Types of Ginsengs promotes sustained endurance and stamina

**Pure Heat®:** Cayenne, Boswellia, & Turmeric promotes proper blood circulation and healthy muscles, tissues, and joints

***VitaPro® Nutrition Shake***

VitaPro is a completely balanced, nutritionally wholesome shake that has an optimal ratio of protein, carbohydrates and safe sugars. It will help to increase your metabolism, promote energy, and improve your overall health and wellness. Controlling weight and energizing the body is the foundation of VitaPro.

VitaPro is blended with 5 of the world's finest protein sources, to offer a complete amino acid profile helping to support the growth and repair of muscle cells. Fortifying VitaPro with 27 essential vitamins, minerals and antioxidants helps balance this amazing nutrition shake and provide for complete nourishment. Weight management is truly about good nutrition and exercise. No other nutrition shake combines the sensibility of various protein sources, vitamins, and minerals with innovative ingredients such as Aminogen® an ingredient that helps to increase amino acid absorption by over 200 percent and Fibersol-2®, a special fiber that aids in digestion. Some other important aspects of VitaPro include the following:

Aminogen®, a patented enzyme system, increases amino acid absorption by over 200 percent

A wide spectrum of digestive enzymes facilitate the proper breakdown of all protein and respective elements

1 gram of soluble fiber helps eliminate any excess or unused protein

The VitaCube's exclusive Activating System, featuring 17 enzymes, antioxidants and herbs activates the body's most important metabolic/energy functions

Available in rich vanilla and creamy chocolate, VitaPro is aspartame-free, low in fat and calories, and is perfect for a quick and easy breakfast, mid-afternoon snack or bedtime dessert.

***We Stress High Quality in Our Products***

To maintain and assure high quality in our products, we require that all:

our products be reviewed on an ongoing basis by our scientific review advisors as to efficacy, dosage and safety

our supplements are supported with publicly available scientific research and references

ingredients come from high quality and reliable sources

ingredients are combined to avoid impairing the effectiveness of each other

ingredients are used in their scientifically supported dosages

our products do not contain potentially harmful ingredients such as ephedra, creatine, androstenedione, aspartame, steroids or human growth hormones

our formulations meet 100% of label claims for two years

our products are 100% lead, wheat, corn and yeast free

our tablets, capsules and soft gels dissolve in 25 minutes or less to maximize absorption

### **Our Distributors and Customers**

VNI distributes products through a network marketing system and sells directly to preferred customers. Network marketing is a type of face-to-face direct selling. The network is organized like a family tree, consisting of independent distributors who purchase products at wholesale prices from VNI for their own consumption or to make retail sales to customers. Alternately, distributors may earn commissions by referring customer orders directly to VNI. The emergence of readily available means of communication such as computers, fax machines, low-cost long distance telephone services, tele-conferencing, and the Internet have contributed to the rapid growth of network marketing around the globe. The concept of network marketing is based on the strength of personal recommendations that frequently come from friends, neighbors, relatives and close acquaintances. VSHI believes that network marketing is an effective way to distribute its products because it allows person-to-person product education, which is not as readily available through other distribution channels.

Individuals who join VNI, sell our products, and earn commissions become a distributor by being sponsored into the program by an existing distributor. From that point on, they are a part of that sponsoring distributor's downline. If they come to VNI unrefereed, they are placed into an orphan account, and are randomly placed in existing downlines. New distributors must agree to a written contract and agree and adhere to VNI's Policies and Procedures. Distributors are also generally required to purchase a starter kit that includes the detailed manual of Policies and Procedures, along with marketing collateral, order forms, and instructional media.

VNI also offers a preferred customer program designed for consumers who only desire to purchase VNI products for their personal use and choose not to resell or distribute the products. We believe this program provides access to a market that would otherwise be missed by targeting customers who enjoy VNI products, but prefer a mail-order type relationship versus a sales, distribution, or other type of business relationship. Preferred customers may not engage in retail sales of products purchased through the program, although they may enroll as distributors at any time if they desire.

An integral part of our customer base is our group of over 300 professional athletes. Many of these athletes purchase our products at a discounted price, although some endorse our products in return for receiving them at no charge. People know that these athletes' bodies and their ability to perform are their livelihoods, and so the endorsements of these high-profile athletes provide instant credibility to our brand.

We are not dependent on one or a few major customers.

### **The Nutrition Industry**

According to the *Nutrition Business Journal*, (May/June 2003), the past year has been monumental for the nutrition industry. A year of political challenges and opportunities, of legislative victories and attacks, and a year in which a tough supplement market forced significant ownership changes, while expanding organic food sales inspired consolidation. While supplement manufacturers and suppliers endured another tough year, other segments of the nutrition industry enjoyed greater stability and better growth, contributing significantly to the 7% rise in the \$58.1 billion total nutrition industry sales for 2002. Vitamin sales rebounded in 2002, growing 2.5% to \$6.2 billion across all channels. Information Resources, Inc. (IRI) data indicated that multivitamin and nearly all single-vitamin categories experienced price increases in 2002, helping to push total sales growth above the 0.8% achieved in 2001.



Fortunately, there were positive signs for our long-term future. Welcome macro-trends included interest by the U.S. government in making nutritional information more available to the public and in reducing health care spending through disease prevention. Blamed for billions in medical costs, obesity rates recently spurred a direct challenge by the Department of Health and Human Services to the fast food industry to review its role in this national scandal. Food corporations fearing tobacco-style liability claims and seeking to offer better choices for health-conscious shoppers are keen to prove that they, too, are part of the solution not the problem.

Granted, broad national health issues do not necessarily provide clearly defined opportunities for nutrition companies. But when government enlists large corporations in this way, it can only be good news for an industry whose products are dedicated to health, longevity and disease prevention.

We believe that the size of the market is due to an increasing public awareness of the positive effects of nutritional dietary supplements. This interest has been heightened by reports and industry marketing based on medical research that demonstrates a correlation between the consumption of nutritional dietary supplements and better health. Both the United States government and universities have increased sponsorship of research relating to nutritional dietary supplements. For example, in fiscal 2000 and fiscal 2001, the National Institutes of Health spent \$665 million and \$756 million in nutrition related research and programs and has budgeted \$859 million and \$943 million of these expenditures for fiscal 2002 and fiscal 2003. In addition, as part of the National Institutes of Health, Congress has established the Office of Alternative Medicine, which focuses on alternative medical treatments, and the Office of Dietary Supplements to conduct and coordinate research regarding the role of dietary supplements in maintaining health and preventing disease.

Important developments in early 2004 have been the FDA's ban on ephedra and the steroid scandal swelling through the ranks of Major League Baseball ("MLB"). While these could be viewed as negative events, VSHI can capitalize on them by promoting how we've been bucking the trend from the start, never using any potentially harmful substances, such as creatine, ephedra, Aspartame, Ma Huang, and androstenedione. The Major League Baseball scandal, in particular, puts us in a unique position, and consequently, we expect to add new clubs to the list of teams using our products.

#### **The Network Marketing Industry**

Firms that use direct sales and network marketing (NM) as their distribution methods are growing in numbers, sales, and profits, both domestically and abroad. The Direct Selling Association (DSA) states that worldwide retail sales are estimated at near (USD) \$90 billion with more than 47 million distributors. In the United States, there are over 13 million distributors (an increase of 136% between 1992 and 2002), accounting for nearly \$29 billion in sales in 2002, an increase of 104% between 1992 and 2002.

We believe the prospects for continued, rapid growth are good, and we perceive several reasons as to why such growth has occurred:

First, the growth of NM has given it visibility, credibility and acceptance. By prosecuting illegal pyramid, blue sky and ponzi schemes, government agencies have given credibility to legitimate networks. Furthermore, the visibility of well-known direct selling companies, like AVON, Mary Kay, and Tupperware who have successfully added multi-level compensation components to their sales-force commission programs adds credibility. Finally, many Fortune 100 companies are choosing to sell via the NM channel; companies like AOL/Time (Southern Living At Home), Hallmark Cards (Binney & Smith / Crayloa At Home), Berkshire Hathaway/Warren Buffett (The Pampered Chef), and Citigroup (Primerica) all have launched NM divisions or subsidiaries.

Second, the current economic climate of business closures, lay-offs, downsizing, outsourcing, and merging has resulted in numerous highly educated white-collar professionals turning to NM.

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These white-collar workers have professional and social networks, which afford personal credibility to the industry. A recently USA TODAY poll of 20,000 Americans on home-based businesses showed that 80% would entertain the opportunity of a home-based business and another 16% wanted more information.

Third, with enhanced and improved technology and the expanding Internet awareness, NM firms can become more streamlined (the Wall Street Journal recently reported that 63% of Americans personally have access to a computer and 45% of Americans have a personal computer in their home). The recent "Gartner Dataquest" study estimated e-commerce could grow from nearly \$29 billion in 2000 to \$142 billion by 2004. Improved information systems management makes operations simple for all associates. No VNI distributors will be required to carry inventory or personally conduct public presentations, and sophisticated computers through corporate management will keep track of and communicate with all associates and their organizations; VNI's sophisticated programs will calculate commissions from sales and perform electronic banking around the globe.

Fourth, Internet globalization has created enormous opportunities for NM companies. Foreign markets are rapidly expanding into capitalism. Overseas sales of NM products are rising briskly, in some cases faster than in the U.S.A. A recent study shows Japan among the highest in sales of NM products in the world, with estimates approaching \$24.5 billion. Most of the countries that desire consumer goods do not have the manufacturing and distribution capabilities to fill the needs of consumers, and where they do, prices are exorbitant. NM affords what we believe to be the best means of expanding operations globally. Because distribution costs far outweigh manufacturing costs, the use of independent contractor distributors being shipped only what they sell dramatically reduces overhead costs.

### **Our Competition**

#### ***Primary Supplement Companies***

The retail side is characterized by a few dominant national companies including General Nutrition Centers (GNC), Vitamin World, Vitamin Shoppe, and Great Earth Vitamins. Others establish a presence within a local market, such as the Vitamin Cottage in Denver, Colorado. Three companies dominate the Internet including Vitamins.com (owned by WebRx.com), GNC.com, and VitaminShoppe.com, the latter two being hybrid bricks and clicks companies.

#### ***Nutrition Sector Companies***

Competition in the performance nutrition market consists primarily of three companies with sales in excess of \$100 million Royal Numico, Experimental and Applied Sciences (EAS), and Weider International Nutrition. The majority of companies (100 of 121 total companies) in this category have gross annual sales less than \$10 million. This area of competition in the dietary supplement industry is supported by very strong consumer demand for innovative products that enhance health and wellness as well as performance.

#### ***Performance Network Marketing Companies***

We will compete with a number of large firms selling nutritional, diet, health, personal care and environmental products, and numerous small competitors. The principal competitors are Amway, Nature's Sunshine, Sunrider, New Vision, Herbalife, USANA, and Melaleuca.

## **Our Suppliers**

The Company uses eight principal suppliers for the components of its products, three packaging suppliers and two labeling vendors. The Company does not have contracts with all of its suppliers and its relationship with any such entity may be terminated at any time. The Company has established relationships with other vendors, which it believes can satisfy its needs if its relationship with any principal supplier terminates.

## **Regulatory Issues**

The manufacturing, packaging, labeling, advertising, distribution and sale of the Company's products are subject to regulation by one or more federal agencies, including the United States Food and Drug Agency ("FDA"), the United States Federal Trade Commission ("FTC") and the United States Environmental Protection Agency ("EPA"), and various agencies of the states, localities and foreign countries in which the Company's products will be sold. The FDA, pursuant to the Federal Food, Drug and Cosmetic Act ("FFDCA"), regulates the production, packaging, labeling and distribution of dietary supplements, drugs and cosmetics. The FTC regulates the advertising of such products.

On March 7, 2003, the FDA published its long awaited proposed good manufacturing practices ("GMP") and labeling rules for dietary supplements. Adoption of GMP is intended to prevent adulteration of supplements with contaminants and to assure that products are accurately labeled to reflect ingredients. The measure was prompted by incidences such as supplements recalled due to lead contamination and products found to contain inadequate levels of active ingredients in some cases, less than 1% of amounts claimed on labels. The proposal includes requirements for design and construction of facilities, establishment of quality control procedures, and testing of ingredients and supplements.

Under the direction of a new commissioner, the FDA is taking a more proactive stance in cracking down on manufacturers of dietary supplements engaged in illegal or questionable practices. The FDA does not appear to be limiting its targets to high-profile products such as ephedra. In recent months, the FDA has taken enforcement actions against supplements marketed as street drug alternatives, forced withdrawal from the market of supplements containing prescription drugs, and cracked down on supplements making unsupported medical claims to cure conditions ranging from colds to cancer. Most recently, the FDA sent warning letters out to several manufacturers of coral calcium supplements.

The U.S. Institute of Medicine has published a series of studies on vitamin and mineral daily allowances, including establishment of upper safe levels of tolerable intake. The Council for Responsible Nutrition, which has been monitoring meetings on the subject, anticipated that recommended levels for some nutrients be raised and others lowered. From these meetings, the National Academy of Science ("NAS") assessed objectives, rationale and made recommendations for methodology to select reference values for labeling based on the new Dietary Reference Intake ("DRI") reports released by the FDA. The FDA does intend to issue proposed regulations that will update Daily Values ("DV") used in nutrition labeling, however there has been no deadline set for this change to take place.

On October 25, 1994, the Dietary Supplement Health and Education Act of 1994 ("DSHEA") was signed into law to amend the FFDCA. The DSHEA creates a new statutory class of "dietary supplements," including vitamins, minerals, herbs, amino acids and other dietary substances for human use to supplement the diet. A dietary supplement which contains a new dietary ingredient, one not on the market as of October 15, 1994, will require evidence of a history of use or other evidence of safety establishing that it will reasonably be expected to be safe, such evidence to be provided by the manufacturer or distributor to the FDA before it may be marketed. The legislation also recognizes the need for the dissemination of information about the link between nutrition and health and provides

that publications, which are not false and misleading and present a balanced view of available scientific information on dietary supplements, may be used in connection with the sale of dietary supplements to consumers. Among other changes, the law prevents the further regulation of dietary ingredients as "food additives" and allows the use of statements of nutritional support on product labels and in other labeling.

The DSHEA also creates a statutory framework governing the composition and labeling of dietary supplements. Under the DSHEA, "dietary supplements" are defined as any product (except tobacco) intended to supplement the diet that contains at least one of the following dietary ingredients: (i) a vitamin, (ii) a mineral, (iii) an herb or botanical, (iv) an amino acid, (v) other dietary ingredients for human use to supplement the diet or (vi) concentrates, metabolites, extracts or combinations of (i) through (v) above. Dietary ingredients meeting this definition are excluded from regulation as a food additive.

Under the DSHEA, dietary ingredients that were on the market in the United States prior to October 15, 1994 or listed in "Herbs of Commerce" may be sold without the FDA's pre-market approval and without notifying the FDA. The marketing of a product containing a new dietary ingredient (one not on the market prior to October 15, 1994) requires that: (i) it has been used as an article of food without being chemically altered or (ii) there is evidence of a history of use or other evidence of safety establishing that it is reasonably expected to be safe and such evidence is supplied to the FDA at least 75 days before the initial use of any new dietary ingredient. On September 23, 1997, the FDA issued final regulations reiterating the FDA's position that dietary supplements must maintain 100% of the declared value of added vitamins and minerals for the entire shelf life of the product. Under the DSHEA, the burden of proving the safety of the dietary supplement is shifted from the manufacturers to the FDA. The FDA may object only if a product or ingredient presents a "significant and unreasonable risk of illness or injury" or poses an imminent safety hazard.

The DSHEA also allows the dissemination of third party literature to promote the sale of dietary supplements to consumers at retail or by mail order. Such literature, if distributed, must (i) not be false or misleading; (ii) not promote a particular manufacturer or brand; (iii) present a balanced view of the available information; and (iv) be physically separated from supplement products if displayed in a store.

The DSHEA provides for specific nutrition labeling requirements for dietary supplements. The DSHEA permits the manufacturer of a dietary supplement to make substantiated, truthful and non-misleading "statements of nutritional support" with respect to the product, including an accurate description of how a nutrient affects the structure or function of the human body and a general description of well-being resulting from consumption of a dietary ingredient. The claim must be accompanied by a disclaimer stating that the product has not been evaluated by the FDA. There can be no assurance that the FDA will not determine that a given statement of nutritional support is not adequately substantiated, or is an unapproved drug claim rather than a statement of nutritional support. Either determination may entail costly and time-consuming clinical studies and may entail the deletion or modification of such statement. The FDA has finalized certain regulations to implement the labeling provisions of the DSHEA. Further, FDA regulations may be proposed by the FDA in response to a report issued in November 1997 by the Commission on Dietary Supplement Labels, which was established to provide recommendations on labeling claims for dietary supplements. The Company will exercise significant control over the labeling of its nutritional and dietary supplement products and perform a review of the proposed structure/function claims made on the labels of the dietary supplement products for compliance with the DSHEA. The Company will submit these claims for FDA review and submit to the FDA labels for many of the dietary supplements that contain structure/function claims. The Company also must maintain substantiation for such claims as required under the FFDCa and make the required submissions to the FDA for any new dietary ingredients.

The Nutrition Labeling and Education Act of 1990 ("NLEA") prohibits the use of any health claim describing the relationship between a nutrient and a disease or health-related condition for foods, including dietary supplements, unless the claim is supported by significant scientific agreement and is approved by the FDA by regulation. Regulations promulgated by the FDA to date allow the use of health claims for dietary supplements only in connection with osteoporosis and the use of folic acid for neural tube defects. The NLEA also prohibits the use of most nutrient content descriptors ("high" or "low") unless the specific descriptor complies with the FDA regulations governing nutrient content claims. Under the Food and Drug Administration Modernization Act of 1997, both health claims and nutrient claims are permitted to be made on the basis of authoritative statements of governmental bodies other than the FDA, so long as the FDA is notified of the claim and the authoritative statement and is presented with a balanced representation of the scientific literature concerning such claim.

The Company is also subject to regulation under various foreign, state and local laws that include provisions regulating, among other things, the marketing of dietary supplements and the operations of direct sales programs.

The USP is a non-governmental, voluntary standard-setting organization. Its drug standards are incorporated by reference into the FDCA as the standards that must be met for the listed drugs, unless compliance with those standards is specifically disclaimed. USP standards exist for most prescription and non-prescription pharmaceuticals as well as some vitamins. The USP began adopting standards for vitamin and mineral dietary supplements in 1994. These standards cover composition (nutrient ingredient potency and combinations), disintegration, dissolution, manufacturing practices and testing requirements. These standards are codified in the USP Monographs and the USP Manufacturing Practices. In 1995, USP compliance included the standards for disintegration and dissolution. While USP standards for vitamins are voluntary, and not incorporated into federal law, customers of the Company may demand that products they are supplied meet these standards. Inaccurate label claims of compliance with the USP may expose a company to FDA scrutiny for such claims. In addition, the FDA may in the future require compliance, or such a requirement may be included in new dietary supplement legislation. All of the Company's vitamin products (excluding certain dietary supplements products for which no USP standards have been adopted) will be produced according to USP manufacturing standards.

### **Sales and Marketing**

We began marketing our products primarily to elite athletes and professional and collegiate sports teams during 2001. We launched our sales and marketing programs to the general public in early 2002. In 2002, sales to the general public were undertaken through a direct sales force and variety of other sales channels, consisting primarily of specialty retail stores, health clubs, personal trainers and other health practitioners, radio, direct mail from customer referrals, and the Internet. During 2003, we decided to focus the Company's sales and marketing efforts on our new network marketing program. We believe that our products are most effectively sold through the face-to-face sales method afforded by network marketing and that the success of producers of similar products through that sales channel shows promise for the successful sales of our products.

An integral part of our marketing strategy, outside of our network marketing program, is the endorsement of our products by high profile sports celebrities. Our leading celebrity endorser is Mike Shanahan, head coach of the Denver Broncos a team in the National Football League ("NFL"). Some of the other celebrities who have entered into endorsement contracts with us and comprise part of "Team VitaCube" include:

Curt Schilling Pitcher, Boston Red Sox, former World Series Co-MVP

Randy Johnson Pitcher, Arizona Diamondbacks and Cy Young Award Winner and World Series Co-MVP

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Mike Alstott Fullback, World Champion Tampa Bay Buccaneers

Brian Griese All Pro Quarterback, Tampa Bay Buccaneers

Eric Karros First Baseman, Oakland Athletics

Amy Van Dyken Swimmer, six-time Olympic Gold Medalist

In addition, we currently work with athletes from the following professional sports teams to supply supplements and advice concerning nutrition; Denver Broncos (NFL), Buffalo Bills (NFL), Chicago Bears (NFL), Green Bay Packers (NFL), New England Patriots (NFL), Seattle Seahawks (NFL), Arizona Diamondbacks (MLB), Boston Red Sox (MLB), Cincinnati Reds (MLB), Chicago White Sox (MLB), Milwaukee Brewers (MLB), Oakland Athletics (MLB) and Tampa Bay Devil Rays (MLB). From the National Basketball Association ("NBA") the Denver Nuggets, Los Angeles Clippers, Memphis Grizzlies, Washington Wizards and from the National Hockey League ("NHL") the Columbus Blue Jackets and Florida Panthers.

### **Research and Development**

We spent no funds during the year ended December 31, 2003, on research and development. We spent \$88,456 for the year ended December 31, 2002, in research and development completing the development of the current line of products.

### **Patents, Trademarks and Proprietary Rights**

During the year ended December 31, 2003, we obtained registration on trademarks for 11 of our individual supplements or specialty items "Alpha Nac," "AO Elite," "Complex SPP," "CP Complex," "GC Elite," "JSH," "M32+," "Muscle MR3," "Pure Heat," "Q-Zyme," "Visual Eyes". Also obtained were the trademark for our rehydration drink "E-Force" and our meal replacement product "VitaPro." We have abandoned trademarking the other items in our product line due to various reasons such as non-unique names. We also received registration on trademarks for the 7 names or expressions that we either use or intend to use to distinguish ourselves from others, "Cube Up," "Get Cubed," "Simple, Innovative, Complete Nutrition," "The Power of Nutrition," "VitaCube" and "V3S." All of the registrations are protected for a period of 10 years.

On January 21, 2004, the Company abandoned its pursuit of obtaining a patent for the VitaCube delivery system. The Company felt that to continue this effort was not in its best interest and we are currently not pursuing any new patents or trademarks at this time.

### **Employees**

We had 11 employees as of March 26, 2004.

## **ITEM 2. DESCRIPTION OF PROPERTY**

We lease an office, located at 480 S. Holly Street, Denver, Colorado 80246, from a related party. We have a 1-year lease due to expire on June 30, 2004. Our annual rent for 2003 was approximately \$42,000. On July 1, 2003, the Company commenced with a renegotiated lease for its office space, reducing our monthly liability from \$6000 to \$3000 per month.

On June 1, 2003, the Company contracted on a month-to-month basis with Quantum Logistics, Inc. to manage and store our bulk and overflow products. Quantum stores our products in a controlled-environment warehouse in East Denver, and accepts bulk shipments on our behalf. We pay for these services on a per-pallette and per-transaction basis.

**ITEM 3. LEGAL PROCEEDINGS**

We are not a party to any legal proceedings, and we have no knowledge of any threatened or pending legal proceedings against us or against our property.

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

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

## PART II

## ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

## Market for common stock

Our common stock commenced trading on the OTC Bulletin Board on December 26, 2001. Since there is only a limited trading market for our stock, stockholders may find it difficult to sell their shares. Prior to June 20, 2003, the stock traded reflected the business of Instanet prior to the share exchange with VitaCube Systems, Inc. (see Description of Business Overview)

The following table sets forth high and low bid prices for our stock for the calendar quarters indicated as reported by the OTC BB for the fiscal quarters indicated. These prices represent quotations between dealers without adjustment for retail markup, markdown, or commission and may not represent actual transactions.

	<u>High</u>	<u>Low</u>
First Quarter 2003	\$ 1.25	\$ 0.15
Second Quarter 2003	\$ 3.00	\$ 0.51
Third Quarter 2003	\$ 3.40	\$ 2.80
Fourth Quarter 2003	\$ 3.05	\$ 1.40
First Quarter 2002	\$ 1.25	\$ 1.25
Second Quarter 2002	\$ 0.16	\$ 0.15
Third Quarter 2002	\$ 0.16	\$ 0.15
Fourth Quarter 2002	\$ 1.50	\$ 0.75

## Holders

As of March 26, 2004, we had 16,844,980 shares issued and outstanding, and had approximately 85 registered holders of our outstanding common stock.

## Dividends

The Company has never declared or paid dividends on its common stock, and it does not expect to do so in the foreseeable future. Management anticipates that all cash flow generated from operations in the foreseeable future will be retained and used to develop and expand the Company's business.

## Equity compensation plans

The following table provides information about our equity compensation plans as of December 31, 2003.

Plan Category	Equity Compensation Plan Information		
	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plan
Equity compensation plans approved by shareholders	2,751,375	\$ 1.00	1,248,625
Equity compensation plans not approved by shareholders	-0-	N/A	-0-
<b>Total</b>	<b>2,751,375</b>	<b>\$ 1.00</b>	<b>1,248,625</b>



**Recent sales of unregistered securities:**

During the year ended December 31, 2003, the Company issued 1,010,000 shares of its \$.001 par value common stock to accredited investors through its private placement stock offering at a price of \$1.00 per share raising a net total of \$965,619 after commissions and other associated expenses with the private placement. On August 12, 2003, the Company entered into a Selling Agent Agreement appointing GunnAllen Financial, Inc, ("GunnAllen") as its non-exclusive selling agent in connection with sales of its securities. As of December 31, 2003, GunnAllen had sold 280,000 shares of the 1,010,000 shares from the private placement offering of the Company's common stock and earned a 10% commission totaling \$28,000. In addition, the Company granted GunnAllen an option to purchase 200,000 shares of its common stock at \$1.00 per share, which option was fully vested and exercisable for 5 years as per the terms of the Selling Agent Agreement.

The Company issued these shares in reliance on the exemption from registration provided in Sections 4(2) and 4(6) of the Act based on the limited number of purchasers, and on the recipients' sophistication in financial matters, access to material information, and on representations received from the recipients, including those establishing their status as accredited investors.

**ITEM 6. MANGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Results of Operations**

**For the year ended December 31, 2003 compared to the year ended December 31, 2002**

**Net Revenue**

Revenue for the year ended December 31, 2003 was \$1,211,402 compared to \$983,557 for the year ended December 31, 2002, an increase of 23%. The increase was the result of our continuing to mature and create a brand awareness and demand for our products.

The percentage that each product category represented of our net sales for the period indicated is as follows:

	Year Ended December 31,	
	2003	2002
	% of Sales	% of Sales
<b>Product Category</b>		
eForce® sports drink	1%	2%
VitaPro® Nutrition shake	33%	29%
Vitamins and minerals	64%	65%
Other educational materials, apparel	2%	4%

**Gross Profit**

Gross profit decreased to \$585,426 for the year ended December 31, 2003 from \$692,425 for the year ended December 31, 2002, a decrease of 15%. Gross profit as a percentage of revenue (gross margin) decreased from 71% for the year ended December 31, 2002 to 48% for the year ended December 31, 2003. The decrease in gross profits was the result of a charge against inventory of \$177,896 for items that we determined would not sell well through the independent distributor marketing plan. We discontinued the following products: specialty items Balanced Mood, Ginko Clear, Muscle MR3 and 17 different supplement combinations sold as part of our VitaCube®. We also established a provision for future obsolete inventory of \$31,782. The decrease in gross margin was a result of our selling products below cost at a closeout sale for the discontinued items. Also contributing

to the decrease in gross margin were sales made during the first half of 2003, of our protein shake VitaPro® to retail outlets, which carried a lower profit margin.

#### **Sales and marketing expenses**

Sales and marketing expenses decreased by 6% for the years ended December 31, 2003 compared to 2002 from \$1,273,361 to \$1,353,335, respectively. The decrease is attributed to transitioning into our direct selling through independent distributors, the conversion of our inside sales force into independent distributors and the termination of all print and radio advertising.

#### **General and administrative expenses**

General and administrative expenses of \$1,273,830 for the year ended December 31, 2003 represents an increase of 106% from \$617,457 for the year ended December 31, 2002. The increase was a result of \$106,866 of legal, accounting and other associated expenses in 2003 due to an abandoned public offering, \$50,975 of costs incurred in the reverse acquisition of Instanet and \$131,848 of costs due to becoming a public entity that were non-recurring.

#### **Research and development expenses**

There were no research and development expenses for the year ended December 31, 2003 as compared with \$88,456 for year ended December 31, 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 our network marketing program, it may need to develop a unique product to continue to distinguish itself from our competition.

#### **For the year ended December 31, 2002 compared to the year ended December 31, 2001**

##### **Net Revenue**

Revenue for the year ended December 31, 2002 was \$983,557 compared to \$203,448 for the year ended December 31, 2001, an increased of 383%. The increase can be attributed to the Company initiating sales to the general public on January 1, 2002, where prior to that the Company was still in development stages and sales were only to elite athletics.

##### **Gross Profit**

Gross profit increased to \$692,425 for the year ended December 31, 2002 from \$79,581 for the year ended December 31, 2001, an increase of 770%. Gross profit as a percentage of revenue (gross margin) increased to 71% for the year ended December 31, 2002 from 39% for the year ended December 31, 2001. The increase in gross profits is the result of sales to the general public at non-discounted prices as compared special discount pricing given to elite athletics. The gross margin will fluctuate depending upon the mix of products sold.

##### **Sales and marketing expenses**

Sales and marketing expenses increased by 234% for the year ended December 31, 2002 compared to 2001 from \$1,353,335 to \$405,503, respectively. The increase is attributed to launching the product to the general public in the form of print and radio advertising, educational literature to assist in educating the consumers on the Company's products and the building of an internal sales and customer service force to support the sales.

**General and administrative expenses**

General and administrative expenses of \$792,168 for the year ended December 31, 2002 represents an increase of 28% from \$617,457 for the year ended December 31, 2001. The increase is a result of establishing the operational components of the Company to support the launch to the general public.

**Research and development expenses**

Research and development expenses decreased by 6% from 94,421 for the year ended December 31, 2001 as compared with \$88,456 for year ended December 31, 2002. Development of the product line was completed during the first half of 2002 attributing to the decrease and it is the Company's belief that the current product offering is reflective of current nutritional science and forms a solid basis for its customers.

**Liquidity and Capital Resources**

The Company's operations used \$1,073,761 of cash in the year ended December 31, 2003 on net sales of \$1,211,402 and used \$1,305,365 of cash in the year ended December 31, 2002 on net sales of \$983,557. 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. Working capital decreased by \$694,911 from a deficit of \$361,292 at December 31, 2002 to a deficit of \$1,056,203 at December 31, 2003. As of December 31, 2003, the company has \$356,149 in current assets and \$1,412,352 in current liabilities.

As of December 31, 2003, the Company has raised a net total of \$965,619 from its private stock offering and repaid \$172,500 of its bridge financing. The Company does not have sufficient capital to meet its anticipated working capital needs through fiscal year 2004. In addition, with the change of marketing focus to a network marketing program the Company anticipates slower sales. The Company must raise additional capital and/or make other financial arrangements to obtain funds to continue its business operations. Previously, the principal shareholders have advanced funds to meet current needs. They have converted some of these loans into stock to reduce the Company's debt. The Company cannot assume that these individuals will be willing or able to provide capital in the future. The best course will always be to expand business and generate revenues sufficient to fund operations, however the Company will continue to actively pursue additional funding through equity or debt offerings or arrangements with other companies. For all the reasons described in this Report, the Company believes that establishing its network marketing program is the most advantageous method to achieve profitability.

**Contractual Obligations**

The Company leases office space from a related party with the lease expiring at June 30, 2004 and has various operating leases. At December 31, 2003 the Company's commitments under these obligations were as follows:

Contractual Obligations	Less than 1 year	2-3 years	4-5 years
Office lease	\$ 18,000	\$	\$
Operating leases	45,194	66,774	9,581