PACIFICHEALTH LABORATORIES INC
Form 10-Q
October 29, 2010

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

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2010

-OR-

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from...to...

Commission File No. 333-36379

PACIFICHEALTH LABORATORIES, INC.
(Exact name of registrant as specified in its charter)

DELAWARE	22-3367588
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

100 Matawan Road, Suite 420	
Matawan, NJ	07747
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (732) 739-2900

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 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files)
Yes ¨ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer”, “accelerated filer”, and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-25 of the Exchange Act) Yes ¨ No x

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date: 16,485,257 shares of common stock, par value $0.0025, outstanding as of October 29, 2010.

PACIFICHEALTH LABORATORIES, INC.

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Cautionary Note Regarding Forward-Looking Statements

As used herein, unless we otherwise specify, the terms the “Company,” "we," "us," and "our" means PacificHealth Laboratories, Inc.

This Report contains forward-looking statements concerning our financial condition, results of operations and business, including, without limitation, statements pertaining to:

- The development, testing, and commercialization of new products and the expansion of markets for our current products;
- The receipt of royalty payments from our agreements with business partners;
- Implementing aspects of our business plan;
- Financing goals and plans;
- Our existing cash and whether and how long these funds will be sufficient to fund our operations; and
- Our raising of additional capital through future equity financings.

These and other forward-looking statements are primarily in the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations". Generally, you can identify these statements because they include phrases such as "anticipates," "believes," "expects," "future," "intends," "plans," and similar terms. These statements are only predictions. Although we do not make forward-looking statements unless we believe we have a reasonable basis for doing so, we cannot guarantee their accuracy, and actual results may differ materially from those we anticipated due to a number of uncertainties, many of which are unforeseen. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this Report on Form 10-Q. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including those stated in this Report. We undertake no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise. We cannot be sure when or if we will be permitted by regulatory agencies to undertake clinical trials or to commence any particular phase of clinical trials. Because of this, statements regarding the expected timing of clinical trials cannot be regarded as actual predictions of when we will obtain regulatory approval for any “phase” of clinical trials.

We believe it is important to communicate our expectations to our investors. There may be events in the future, however, that we are unable to predict accurately or over which we have no control. Cautionary language in this Report provides examples of risks, uncertainties and events that may cause our actual results to differ materially from the expectations we describe in our forward-looking statements.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PACIFICHEALTH LABORATORIES, INC.
BALANCE SHEETS

	September 30, 2010 (Unaudited)	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 427,561	$ 281,159
Other short-term investments	150,000	175,000
Accounts receivable, net	753,934	763,288
Inventories	776,281	806,212
Prepaid expenses	102,021	92,702
Tax loss receivable	-	303,931
Total current assets	2,209,797	2,422,292
Property and equipment, net	63,192	110,904
Deposits	10,895	10,895
Total assets	$ 2,283,884	$ 2,544,091
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Line of credit	$ 75,000	$ -
Notes payable	41,815	12,182
Accounts payable and accrued expenses (Includes related party of $11,000 and $0, respectively)	1,031,426	1,042,051
Deferred revenue	52,034	306,239
Total current liabilities	1,200,275	1,360,472
Stockholders' equity:		
Common stock, $.0025 par value; authorized 50,000,000 shares; issued and outstanding: 16,485,257 and 15,624,017 shares, respectively	41,213	39,060
Additional paid-in capital	20,149,312	20,031,599
Accumulated deficit	(19,106,916)	(18,887,040)
	1,083,609	1,183,619
Total liabilities and stockholders' equity	$ 2,283,884	$ 2,544,091

The accompanying notes should be read in conjunction with the financial statements.

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PACIFICHEALTH LABORATORIES, INC.
STATEMENTS OF OPERATIONS
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009
(UNAUDITED)

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Revenues:				
Net product sales	$ 1,999,489	$ 2,376,291	$ 6,204,060	$ 6,796,964
Cost of goods sold	1,123,711	1,170,550	3,369,381	3,564,018
Gross profit	875,778	1,205,741	2,834,679	3,232,946
Operating expenses:				
Sales and marketing	324,056	569,705	908,403	1,340,717
General and administrative (Includes related party consulting of $22,000 for the periods ended September 30, 2010)	637,654	808,973	2,146,247	2,460,474
	961,710	1,378,678	3,054,650	3,801,191
Loss before other (expense) income and provision for income taxes	(85,932)	(172,937)	(219,971)	(568,245)
Other (expense) income:				
Other income	-	-	4,000	4,000
Interest income	286	343	791	3,445
Interest expense	(1,725)	(1,501)	(4,696)	(3,758)
	(1,439)	(1,158)	95	3,687
Loss before provision for income taxes	(87,371)	(174,095)	(219,876)	(564,558)
Provision for income taxes	-	-	-	2,080
Net loss	$ (87,371)	$ (174,095)	$ (219,876)	$ (566,638)
Basic and diluted loss per share	$ (0.01)	$ (0.01)	$ (0.01)	$ (0.04)
Weighted average common shares - basic and diluted	16,366,561	15,296,300	16,032,559	14,815,232

The accompanying notes should be read in conjunction with the financial statements.

PACIFICHEALTH LABORATORIES, INC.
STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009
(UNAUDITED)

	2010	2009
Cash flows from operating activities:		
Net loss	$ (219,876)	$ (566,638)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation	84,361	141,659
Bad debts	9,144	9,000
Equity instrument-based expense	111,276	232,615
Changes in assets and liabilities:		
Accounts receivable	210	(1,081,013)
Inventories	29,931	(192,549)
Prepaid expenses	(9,319)	(5,281)
Tax loss receivable	303,931	-
Deposits	-	12,000
Accounts payable and accrued expenses (Includes related party of $11,000 and $0 respectively)	(2,035)	975,275
Deferred revenue	(254,205)	(24,732)
Net cash provided by (used in) operating activities	53,418	(499,664)
Cash flows from investing activities:		
Proceeds from sales of other short-term investments	25,000	125,000
Purchase of property and equipment	(36,649)	(182,386)
Net cash used in investing activities	(11,649)	(57,386)
Cash flows from financing activities:		
Net borrowings on line of credit	75,000	-
Issuance of notes payable	70,293	59,751
Repayments of notes payable	(40,660)	(83,970)
Common stock issued	-	150,000
Net cash provided by financing activities	104,633	125,781
Net increase (decrease) in cash and cash equivalents	146,402	(431,269)
Cash and cash equivalents, beginning balance	281,159	888,993
Cash and cash equivalents, ending balance	$ 427,561	$ 457,724
Supplemental disclosures of cash flow information:		
Cash paid for interest	$ 4,696	$ 3,758
Cash paid for income taxes	$ 17,157	$ 2,080
Non-cash operating activity:		
Issuance of common stock as payment for consulting services	$ 8,590	$ -

The accompanying notes should be read in conjunction with the financial statements.

PACIFICHEALTH LABORATORIES, INC.
NOTES TO FINANCIAL STATEMENTS
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009
(UNAUDITED)

1. Basis of Presentation

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the rules and regulations of the SEC. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. The unaudited financial statements should be read in conjunction with the financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2009.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain 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 amount of revenue and expenses during the reporting period. Actual results may differ from these estimates. The significant estimates and assumptions made by the Company are in the area of revenue recognition, as it relates to customer returns, inventory obsolescence, allowance for doubtful accounts, valuation allowances for deferred tax assets, and valuation of share-based payments issued under Accounting Standards Codification (“ASC”) 718, “Compensation - Stock Compensation”.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. The Company has incurred significant operating losses and has an accumulated deficit of $19,106,916 as of September 30, 2010. These factors raise substantial doubt about the Company’s ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. In response to this, the Company has made changes to its operating structure by planning to reduce its fixed overhead by streamlining its management team, reallocating its sales budget by investing in three dedicated Regional Sales Managers to give greater and more effective coverage of key retailers, implementing new manufacturing and inventory procedures to maximize cash flow, increasing marketing investment against core business without increasing total sales and marketing expenses by eliminating non-productive line items and reallocating them into the 2011 marketing strategy, and reinstituting an aggressive research program that will lead to the introduction of two breakthrough products in 2011. The results of the above are not expected to be recognized until sometime in 2011.

2. Revenue Recognition

Sales are recognized when all of the following criteria are met: (1) persuasive evidence that an arrangement exists; (2) delivery has occurred or services have been rendered; (3) the seller’s price to the buyer is fixed and determinable; and, (4) collectability is reasonably assured. Sales are recorded net of incentives paid to customers.

The Company has a sales agreement with GNC, a significant customer of the Company, whereby unsold product is subject to return provisions. In determining revenue recognition for products shipped to this customer, the Company follows the guidance in ASC 605,”Revenue Recognition” (“ASC 605”). Certain of the products shipped are under a “pay on scan” model and revenue is deferred by the Company until such time as the customer sells through such products to the end consumer. The amount of deferred revenue relating to pay on scan products reflected in the accompanying balance sheets as of September 30, 2010 and December 31, 2009 amounted to $52,034 and $306,239, respectively.

Prior to April 1, 2009, for certain products not under a pay on scan model, the Company recognized revenue identical to the pay on scan model. Effective April, 1, 2009, the Company commenced recognizing revenue on these products upon shipment as the Company determined that it has met the criteria established in ASC 605, specifically as it relates to the ability to estimate future returns. This change in estimate for these product shipments was based primarily on the Company's determination that it could, based on historical secular analysis, estimate its returns of such product shipments with such historical data covering a five-year period.

3. Other Short-Term Investments

Excess cash is invested in auction rate securities with long-term maturities, the interest rates of which are reset periodically (typically between 7 and 35 days) through a competitive bidding process often referred to as a "Dutch auction".

Accordingly, the Company has classified such investments as other short-term investments. During the nine months ended September 30, 2010, the Company redeemed $25,000 of these investments.

The Company measures fair value utilizing a hierarchy that prioritizes into three levels the components of valuation techniques that are used to measure fair value. The fair value hierarchy gives the highest priority to quoted market prices (unadjusted) in active markets for identical assets or liabilities (Level 1); lower priority to inputs other than quoted prices that are observable for assets or liabilities, either directly or indirectly (Level 2); and the lowest priority to unobservable inputs (Level 3).

The Company has measured these investments as Level 2 inputs.

4. Inventories

Inventories consisted of the following:

	September 30, 2010 (Unaudited)	December 31, 2009
Raw materials	$ 2,022	$ -
Work-in-process	-	-
Packaging supplies	79,475	80,611
Finished goods	669,239	645,095
Finished goods on consignment	25,545	80,506
	$ 776,281	$ 806,212

Included above are reserves against finished goods of $51,893 and $387,971, respectively, at September 30, 2010 and December 31, 2009.

5. Property and Equipment

Property and equipment consist of the following:

	September 30, 2010 (Unaudited)	December 31, 2009
Furniture and equipment	$ 839,187	$ 815,724
Molds and dies	231,732	218,546
	1,070,919	1,034,270
Less accumulated depreciation	1,007,727	923,366
	$ 63,192	$ 110,904

6. Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses consist of the following:

	September 30, 2010 (Unaudited)	December 31, 2009
Trade payables	$ 857,245	$ 826,236
Accrued expenses	130,155	180,086
Commissions payable	25,078	23,265
Deferred rent	18,948	12,464
	$ 1,031,426	$ 1,042,051

7. Stock-Based Compensation

The Company accounts for equity instrument issuances (including common stock, options, and warrants) in accordance with ASC 718. Such equity issuances encompass transactions in which an entity exchanges its equity instruments for goods or services including such transactions in which an entity obtains employee services in share-based payment transactions and issuances of stock options to employees. The Company recorded charges of $30,971 and $111,276, respectively, in the three and nine month periods ended September 30, 2010, representing the effect on loss from continuing operations, loss before income taxes and net loss. The Company recorded charges of $93,819 and $232,615, respectively, in the three and nine month periods ended September 30, 2009, representing the effect on loss from continuing operations, loss before income taxes and net loss.

Employee Compensation

The Company recorded charges of $7,355 and $22,281, respectively, in the three and nine month periods ended September 30, 2010 for previously issued equity instruments to employees. The Company recorded charges of $38,541 and $117,973, respectively, in the three and nine month periods ended September 30, 2009 for previously issued equity instruments to employees.

The Company granted 500,000 stock options to employees during the three months ended September 30, 2010 with an exercise price of $0.145 per share. Of these options, 166,664 of these options vest in the third quarter of 2011; 166,667 of these options vest in the third quarter of 2012; and 166,669 of these options vest in the third quarter of 2013. The Company granted 750,000 stock options to employees during the nine months ended September 30, 2010 with exercise prices ranging from $0.122 per share to $0.145 per share. Of these options, 83,333 vest in the first quarter of 2011; 166,664 of these options vest in the third quarter of 2011; 83,333 of these options vest in the first quarter of 2012; 166,667 of these options vest in the third quarter of 2012; 83,334 of these options vest in the first quarter of 2013; and 166,669 of these options vest in the third quarter of 2013. These options were determined to have a total fair value of approximately $80,750. Compensation expense recognized during the three and nine months ended September 30, 2010 for these options amounted to $3,507 and $6,667 respectively. The Company did not grant any options to employees in the three months ended September 30, 2009. The Company granted 200,000 stock options to a former Chief Executive Officer/President during the nine months ended September 30, 2009 with an exercise price of $0.28 per share. Of these options, 50,000 vest in the second quarter of 2010, 50,000 of these options vest in the second quarter of 2011, 50,000 of these options vest in the second quarter of 2012, and 50,000 of these options vest in the second quarter of 2013. These options were determined to have a total fair value of approximately $43,000. Compensation expense recognized during the three and nine months ended September 30, 2009 for these options amounted to $2,688. These options were subsequently canceled as part of a former CEO's Separation Agreement on January 27, 2010.

The Company recognized $18,000 and $72,000, respectively, for the three and nine month periods ended September 30, 2010 as a component of employee compensation for common shares issued as payment of directors' fees. The Company recognized $24,000 and $78,000, respectively, for the three and nine month periods ended September 30, 2009 as a component of employee compensation for common shares issued as payment of directors' fees. The Company recognized $0 and $3,363, respectively, for the three and nine month periods ended September 30, 2010 as a component of employee compensation for common shares issuable as payment to a director of the Company for advisory services. The Company did not recognize any expense as a component of employee compensation for common shares issuable as payment to a director of the Company for advisory services for the three and nine month periods ended September 30, 2009.

Non-Employee Compensation

The Company granted no stock options to consultants during the three and nine month periods ended September 30, 2010 and 2009.

The Company recorded charges of $2,051 and $6,791, respectively, in the three and nine month periods ended September 30, 2010 for previously issued warrants to non-employee athlete endorsers. The Company did not record any charges in the three and nine month periods ended September 30, 2009 for previously issued warrants to non-employee athlete endorsers.

The Company did not grant any warrants to non-employee athlete endorsers during the three months ended September 30, 2010. The Company granted 10,000 warrants to non-employee athlete endorsers during the nine months ended September 30, 2010 with an exercise price of $0.12 per share. Of these warrants, 5,000 warrants vest in the fourth quarter of 2010 and 5,000 of these warrants vest in the fourth quarter of 2011. These warrants were determined to have a total fair value of $460. Compensation expense recognized during the three and nine months ended September 30, 2010 for these warrants amounted to $58 and $174, respectively. These amounts were charged to operations and added to additional paid-in capital in accordance with ASC 718. The Company did not grant any warrants to non-employee athlete endorsers during the three months ended September 30, 2009. The Company granted 402,500 warrants to non-employee athlete endorsers during the nine months ended September 30, 2009 with an exercise price of $0.14 per share. Of these warrants, 109,167 warrants vest in the fourth quarter of 2009; 4,167 warrants vest in the first quarter of 2010; 109,167 of these warrants vest in the fourth quarter of 2010; 4,167 warrants vest in the first quarter of 2011; 109,166 of these warrants vest in the fourth quarter of 2011; 4,166 warrants vest in the first quarter of 2012; and 62,500 of these warrants vest in the fourth quarter of 2012. These warrants were determined to have a total fair value of $38,713. Compensation expense recognized during the three and nine months ended September 30, 2009 for these warrants amounted to $2,689 and $8,053 respectively. These amounts were charged to operations and added to additional paid-in capital in accordance with ASC 718.

In summary, compensation charges to operations for the periods presented are as follows:

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Employee compensation	$ 28,862	$ 65,229	$ 104,311	$ 198,661
Consultant compensation	2,109	28,590	6,965	33,954
	$ 30,971	$ 93,819	$ 111,276	$ 232,615

A summary of employee options activity under the plans as of September 30, 2010 and changes during the nine-month period then ended is presented below:

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Balance, January 1, 2010	2,438,500	$ 0.64		
Granted during the period	750,000	0.14		
Exercised during the period	-	-		
Forfeited during the period	(1,000,000)	0.56		
Outstanding, September 30, 2010	2,188,500	$ 0.51	2.64	$ 9,500
Exercisable, September 30, 2010	1,213,500	$ 0.79	1.32	$ -0-

The market value of the Company's common stock as of September 30, 2010 was $0.15 per share.

A summary of the non-vested stock options for employees during the nine months ended September 30, 2010 is as follows:

Weighted

Non-vested Options	Shares	Average Exercise Price Per Share Outstanding
Non-vested, January 1, 2010	1,129,583	$ 0.46
Granted during the period	750,000	0.14
Vested during the period	(362,917)	0.50
Forfeited during the period	(541,666)	0.52
Non-vested, September 30, 2010	975,000	$ 0.16

As of September 30, 2010, the total fair value of non-vested awards amounted to $114,283. The weighted average remaining period over which such options are expected to be recognized is 2.87 years.

A summary of warrant activity as of September 30, 2010 and changes during the nine-month period then ended is presented below:

Warrants	Shares	Weighted-Average Exercise Price	Aggregate Intrinsic Value
Balance, January 1, 2010	402,500	$ 0.14	
Granted during the period	10,000	0.12	
Canceled during the period	(90,000)	0.14	
Outstanding, September 30, 2010	322,500	$ 0.14	$ 3,425
Exercisable, September 30, 2010	83,332	$ 0.14	$ 833

A summary of the non-vested warrants during the nine months ended September 30, 2010 is as follows:

Non-vested Warrants	Shares	Weighted Average Exercise Price Per Share Outstanding
Non-vested, January 1, 2010	289,343	$ 0.14
Granted during the period	10,000	0.12
Vested during the period	(175)	0.14
Canceled during the period	(60,000)	0.14
Non-vested, September 30, 2010	239,168	$ 0.14

As of September 30, 2010, the total fair value of non-vested awards amounted to $17,000. The weighted average remaining period over which such options are expected to be recognized is 2.10 years.

8. Common Stock Issuances

On January 20, 2010, the Company issued 61,359 shares of its common stock as payment of certain sales commissions that were accrued at December 31, 2009 for an amount totaling $8,590.

On March 10, 2010, the Company issued 32,966 shares of its common stock valued at $3,363 to a director of the Company for advisory services.

On March 31, 2010, the Company issued 317,646 shares of its common stock valued at $27,000 as payment of directors' fees for the first quarter of 2010.

On June 30, 2010, the Company issued 329,269 shares of its common stock valued at $27,000 as payment of directors' fees for the second quarter of 2010.

On September 30, 2010, the Company issued 120,000 shares of its common stock valued at $18,000 as payment of directors' fees for the third quarter of 2010.

9. Income Taxes

The Company has approximately $16,611,000 in Federal and $3,243,000 in state net operating loss carryovers available as of September 30, 2010 that can be used to offset future taxable income in calendar years 2010 through 2030. The net operating loss carryovers begin to expire in the year 2016 through the year 2030. As of September 30, 2010, the Company has fully reserved for these net operating loss carryovers.

ASC 740, “Income Taxes”, clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements. It prescribes a threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. ASC 740 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure, and transition.

The Company has recorded a liability related to uncertain tax positions in the amount of approximately $23,000 and $40,000, respectively, at September 30, 2010 and December 31, 2009 relating to certain states in which the Company is required to file state tax returns as they have effectively established nexus in these states. These amounts have been recorded as a component of accounts payable and accrued expenses on the balance sheet.

The Company's 2007, 2008 and 2009 Federal and state income tax returns are open for examination.

10. Concentrations

The Company's two largest customers accounted for approximately 24% and 10%, respectively, of net sales for the three months ended September 30, 2010 and the Company's two largest customers accounted for approximately 23% and 18%, respectively, of net sales for the three months ended September 30, 2009. The Company's three largest customers accounted for approximately 19%,15% and 10%, respectively, of net sales for the nine months ended September 30, 2010 and the Company's two largest customers accounted for approximately 20% and 16%, respectively, of net sales for the nine months ended September 30, 2009. At September 30, 2010, amounts due from these three customers represented approximately 27%, 5%, and 2%, respectively, of net accounts receivable. At December 31, 2009, amounts due from these three customers represented approximately 52%, 6%, and 1%, respectively, of net accounts receivable. No other customers exceeded 10% of respective captions noted above.

Two of the Company's suppliers accounted for approximately 76% and 18%, respectively, of total inventory purchases for the three months ended September 30, 2010 and two of the Company's suppliers accounted for approximately 56% and 25%, respectively, of total inventory purchases for the three months ended September 30, 2009. Two of the Company's suppliers accounted for approximately 76% and 17%, respectively, of total inventory purchases for the nine months ended September 30, 2010 and two of the Company's suppliers accounted for approximately 64% and 15%, respectively, of total inventory purchases for the nine months ended September 30, 2009. At September 30, 2010, amounts due to these two vendors represented approximately 59% and 4%, respectively, of accounts payable and accrued expenses. At December 31, 2009, amounts due to these two vendors represented approximately 42% and 0%, respectively, of accounts payable and accrued expenses. No other vendors exceeded 10% of respective captions noted above.

11. Line of Credit

In April 2008, the Company obtained a one-year revolving line of credit with a financial institution with an interest rate equal to the Wall Street Journal Prime Rate (3.25% as of September 30, 2010) with a floor of 5.00%. This line is collateralized by the short-term investments that are deemed auction rate securities. The maximum amount that the Company may borrow is limited to 50% of the value of these auction rate securities. The Company renewed this one-year revolving line of credit that now matures in May 2011 in the amount of $87,500. On February 22, 2010, the Company drew down $87,500, the maximum amount allowed under this line of credit at that time. The Company paid back $12,500 of this line in May 2010.

12. Deferred Rent

In September 2009, the Company entered into a lease extension for its current office space that was set to expire in June 2012. The terms of the lease extension call for the term to begin September 2009 and conclude in June 2015. Monthly payments commence at $9,583 and increase to $11,250 by the last year with the first month of rent free. The Company records monthly rent expense on a straight line basis over the term of the lease. The difference between rent expense recorded and the amount paid is credited or charged to "Deferred rent" which is included as a component of accounts payable and accrued expenses in the accompanying balance sheet. As of September 30, 2010, this amounted to $18,948.

13. CEO Separation Agreements

The Company entered into a Separation and Release Agreement with the former CEO on January 27, 2010. Under the terms of the agreement, the former CEO had agreed to provide consulting services for a period of 90 days following the date of the agreement for which he was entitled to $5,673 per week. During the one-year period commencing on January 11, 2010, the former CEO is entitled to the sum of $295,000, less the sum of consulting fees paid during such period and less any income, wages and/or salary received by him during such period in respect of full-time or substantially full-time employment. The Company also agreed to pay the former CEO $50,000 for relocation costs under certain circumstances, the cost of life insurance premiums during the period in which he provides consulting services, and the cost of health insurance coverage for a period of six months. In the three and nine months ended September 30, 2010, the Company recognized $88,750 and $261,868, respectively, of expense under this Agreement.

The Company entered into a Separation Agreement with a former CEO effective August 1, 2008. The terms of the agreement consisted of twelve equal monthly payments that aggregate $295,000 and include a non-compete clause. In the three and nine months ended September 30, 2009, the Company recognized $24,583 and $172,081, respectively, of expense under this Agreement.

14. Consulting Agreement

On July 27, 2010, the Company entered into a consulting agreement with Signal Nutrition LLC (“Signal”), a company controlled by a director of the Company. Under terms of the Agreement, Signal will work with outside researchers, assist in developing new products, and formulate sales and marketing plans for the Company. The Agreement has an initial term of six months, with options by either party to renew for an additional six months, subject, however, to the right of either party to terminate on 15 days notice. The Company will pay Signal a fee of $11,000 per month, commencing September 1, 2010, during the term of the Agreement. Expense for the three and nine months ended September 30, 2010 is $22,000. Included in accounts payable and accrued expenses as of September 30, 2010 is $11,000 relating to this agreement.

Item 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

In this Report on Form 10-Q, the terms the “Company,” “we”, “us,” and “our” refer to PacificHealth Laboratories, Inc.

(a) Introduction

PacificHealth Laboratories is a leading nutrition company that was incorporated in the State of Delaware in April 1995. We focus on the development, marketing and selling of patented premium nutrition tools that enable our consumers to enhance their health and improve their performance. Our principal area of focus is exercise performance and recovery, including optimal weight management. Our products can be marketed without prior Food and Drug Administration (“FDA”) approval under current regulatory guidelines.

Following the departure of a former CEO in January 2010, we are evolving into a more consumer-oriented, brand-driven company that derives value from our own brands based on our science-based nutrition technology. Today, we employ multiple strategies for the commercialization of our technologies. We will continue to place emphasis on the creation of brands while also expanding on the benefits of our core endurance nutrition products. We will direct new research and development in this category to drive both new product development and consumer communications across all our brands, both existing and potential new brands.

Sports Performance

Our research into factors influencing exercise performance, muscle endurance, and recovery has led to the development and commercialization of a new generation of sports and recovery drinks. The key to our technology is the specific ratio in which protein is combined with carbohydrates. We have received two patents on this technology and over 18 studies have been published demonstrating that products based on this technology can extend endurance, reduce muscle damage, improve rehydration, and accelerate muscle recovery. Our research in exercise performance has led to the introduction and commercialization of a number of products for the aerobic athlete including:

· ENDUROX R4® Recovery Drink – Introduced in February 1999

· ACCELERADETM Sports Drink – Introduced in May 2001

· ACCELERADE HYDROTM Sports Drink with 30% less calories and 55% less sugar – Introduced in June 2008

· ACCEL GEL® – Introduced in February 2004

· ENDUROX® EXCEL® Natural Workout Supplement – Introduced in March 1997

Weight Regulation

Satiety peptides have been shown to suppress appetite and reduce food intake. Our research has specifically focused on developing nutritional formulations that can stimulate cholecystokin (CCK), one of the body’s primary satiety peptides. CCK is normally released after a meal, particularly one high in fat and protein. CCK is often called the “feel full” protein because when it is released it gives a feeling of fullness and signals the brain to terminate the meal. The objective of our research is to develop a nutritional composition that stimulates and extends the duration of action of CCK in a calorically efficient way, i.e. to cause a release of CCK with 45-50 calories of specific nutrients rather than 1,000 calories. We have seven patents on our appetite suppressant technology.

In the first quarter of 2009, we launched FORZE GPS™ in our sports specialty channel. FORZE GPS was the first appetite management nutrition tool designed specifically for athletes. We were not successful in 2009 in achieving adequate sales for this product line. We therefore decided not to continue to aggressively market this product in 2010 as we did in 2009 but we will continue to sell this product line on a limited basis in 2010.

(b) Results of Operations – Three and Nine Months Ended September 30, 2010 and 2009

Revenues for the three-month period ended September 30, 2010 decreased by $376,802, or approximately 16%, to $1,999,489 from $2,376,291 for the same period in 2009. Revenues for the nine-month period ended September 30, 2010 decreased by $592,904, or approximately 9%, to $6,204,060 from $6,796,964 for the same period in 2009. The decrease in revenues in the three- and nine- month periods ended September 30, 2010 as compared to the same periods in 2009 is the result of a reduction in promotional sales-through to one of our major customers and a change in 2009 in the way we reported certain product sales to another major customer. A major customer's gross sales were down $404,000 and $220,000, respectively, for the three and nine month periods ended September 30, 2010 as compared to the same periods in 2009. One of the key changes we will be implementing in 2011 is an increase in consumer messaging and new product support to drive consumer awareness versus a heavy reliance on trade promotion to drive revenue. Also, in 2009, we changed the way we reported certain product sales to another major customer. Effective April 1, 2009, we commenced recognizing revenue for certain products not under a pay on scan (consignment) model upon shipment as we determined that we have met the criteria established in ASC 605, specifically as it relates to the ability to estimate future returns. This change in estimate for these product shipments was based primarily on our determination that we could, based upon historical secular analysis, estimate our returns of such product shipments with such historical data covering a five-year period. This resulted in additional revenues in the three and nine month periods ended September 30, 2009 of approximately $279,000.

For the three months ended September 30, 2010, gross profit margin on product sales was 43.8% compared to 50.7% for the three months ended September 30, 2009. For the nine months ended September 30, 2010, gross profit margin on product sales was 45.7% compared to 47.6% for the nine months ended September 30, 2009. The lower gross profit margins in the three and nine month periods ended September 30, 2010 compared to the same periods in 2009 are due primarily to promotional allowances given to major accounts in order to facilitate sales of our products.

Sales and marketing ("S & M") expenses decreased $245,649, or approximately 43%, to $324,056 for the three-month period ended September 30, 2010 from $569,705 for the three-month period ended September 30, 2009. S & M expenses decreased as a percentage of product sales to approximately 16% in the three-month period ended September 30, 2010 compared to approximately 24% in the three-month period ended September 30, 2009. S & M expenses decreased $432,314, or approximately 32%, to $908,403 for the nine-month period ended September 30, 2010 from $1,340,717 for the nine-month period ended September 30, 2009. S & M expenses decreased as a percentage of product sales to approximately 15% in the nine-month period ended September 30, 2010 compared to approximately 20% in the nine-month period ended September 30, 2009. The decrease in S & M expenses is due to the 2009 public relations and marketing campaign (including sample expense) associated with the launch of FORZE GPS as well as initial costs incurred for rolling out a national sales representation organization. We have assessed our return on investment in the third party outside sales group as well and decided to replace them with three PHLI-employed dedicated Regional Sales Managers. These new regional managers will be spending 100% of their time supporting our new consumer efforts across triathlon, bicycle, and running stores in the U.S.

General and administrative ("G & A") expenses decreased $171,319, or approximately 21%, to $637,654 for the three-month period ended September 30, 2010 from $808,973 for the three-month period ended September 30, 2009. G & A expenses decreased $314,227, or approximately 13%, to $2,146,247 for the nine-month period ended September 30, 2010 from $2,460,474 for the nine-month period ended September 30, 2009. The decrease for the three and nine month periods is due primarily to lower CEO severance payments (see below), investor relations, travel and entertainment, and options expenses. Included in G & A in the three and nine month periods ended September 30, 2010 is approximately $89,000 and $262,000, respectively, paid to a former CEO for transition expenses and in the form of a non-compete clause pursuant to his Separation Agreement. These payments will continue under the terms of the Separation Agreement until January 27, 2011. Included in G & A in the three and nine month periods ended September 30, 2009 is approximately $25,000 and $172,000, respectively, paid to a former CEO in the form of a non-compete clause pursuant to his Separation Agreement. These payments ended under the terms of the Separation Agreement effective as of July 31, 2009.

We recorded a net loss of ($87,371), or ($0.01) per share (basic and diluted), for the quarter ended September 30, 2010 compared to a net loss of ($174,095), or ($0.01) per share (basic and diluted), for the quarter ended September 30, 2009. We recorded a net loss of ($219,876), or ($0.01) per share (basic and diluted), for the nine months ended September 30, 2010 compared to a net loss of ($566,638), or ($0.04) per share (basic and diluted), for the nine months ended September 30, 2009. The lower net loss in the three and nine month periods ended September 30, 2010 as compared to the same periods in 2009 is due primarily to decreases in S & M and G & A expenses as detailed above.

(c) Liquidity and Capital Resources

At September 30, 2010, our current assets exceeded our current liabilities by approximately $1,010,000 with a ratio of current assets to current liabilities of approximately 1.8 to 1. At September 30, 2010, cash on hand was $427,561, an increase of $146,402 from December 31, 2009, primarily as the result of a decrease in accounts receivable (net of reserves) of $210, a decrease in inventory of $29,931 (net of reserves), an increase in prepaid expenses of $9,319, a decrease in tax loss receivable of $303,931, net borrowings under a line of credit of $75,000, issuances of notes payable of $70,293, repayments of notes payable of $40,660, a decrease in accounts payable and accrued expenses of $2,035, and a decrease in deferred revenue of $254,205 from December 31, 2009. Inventories decreased due to better inventory management. Tax loss receivable decreased as we received the net proceeds related to the sale of a portion of our unused net operating loss carryovers for the State of New Jersey (see below). Accounts payable and accrued expenses decreased primarily due to aggressive inventory control. The line of credit increased as we drew down the maximum amount allowed under our auction rate securities line of credit (see below) and subsequently repaid a portion of this line. Deferred revenue decreased primarily as a result of a major customer discontinuing selling a number of products previously recorded as deferred revenue. Inventory associated with this deferred revenue previously recorded as consignment inventory has been returned to us in salable condition and recorded as finished goods.

On February 8, 2010, we received $303,931 of net proceeds related to the sale of a portion of our unused net operating loss carryovers for the State of New Jersey to a third party through the 2009 NJEDA Technology Business Tax Certificate Transfer Program. We used these proceeds for working capital purposes.

Net cash provided by operating activities for the nine months ended September 30, 2010 was $53,418 compared to net cash used in operating activities for the same period in 2009 of $499,664. The net cash provided by operations for the nine months ended September 30, 2010 as compared to the net cash used in operations in the same period in 2009 is due to a slight decrease in accounts receivable in 2010 as compared to an increase in accounts receivable in 2009, the receipt of the net proceeds from the tax loss sale in 2010 (see above) and a slight decrease in accounts payable and accrued expenses in 2010 compared to an increase in accounts payable and accrued expenses in 2009. Accounts receivable decreased slightly in 2010 compared to an increase in 2009 due to less days sales outstanding in 2010 as we offered payment discounts to our major customers in 2010. Accounts payable and accrued expenses decreased slightly in 2010 compared to an increase in 2009 as we better managed inventory levels in 2010 as well as used the proceeds from the tax loss sale to increase payments to our vendors. Historically, we have funded inventory purchases through trade credit and we expect that to continue.

As of September 30, 2010, we had $150,000 invested in auction rate securities that are presented as short-term investments on the balance sheet. During the first nine months of 2010, we were able to redeem $25,000 of these investments. We have obtained a revolving line of credit with a financial institution with a maturity of May 2011 that will accept these securities as collateral. The maximum amount that we may borrow is limited to 50% of the value of these auction rate securities. On February 22, 2010, we drew down the $87,500 maximum amount allowed under this line of credit and on May 20, 2010 we paid down $12,500 on this line from the proceeds of the redeemed securities.

In September 2009, we entered into a lease extension for our current office space that was set to expire in June 2012. The terms of the lease extension call for the term to begin September 2009 and conclude in June 2015. Monthly payments commence at $9,583 and increase to $11,250 by the last year with the first month of rent free. We record monthly rent expense on a straight line basis over the term of the lease. The difference between rent expense recorded and the amount paid is credited or charged to “deferred rent” which is included as a component of accounts payable and accrued expenses in the accompanying balance sheet. As of September 30, 2010, this amounted to $18,948.

We have no material commitments for capital expenditures.

(d) Off-Balance Sheet Arrangements

There are no off-balance sheet arrangements between us and any other entity that have, or are reasonably likely to have, a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources that is material to investors.

(e) Going Concern

We have incurred significant operating losses and have an accumulated deficit of $19,106,916 as of September 30, 2010. These factors raise substantial doubt about our ability to continue as a going concern. In response to this, we have made changes to our operating structure by planning to reduce our fixed overhead by streamlining our management team, reallocating our sales budget by investing in three dedicated Regional Sales Managers to give greater and more effective coverage of key retailers, implementing new manufacturing and inventory procedures to maximize cash flow, increasing marketing investment against core business without increasing total sales and marketing expenses by eliminating non-productive line items and reallocating them into the 2011 marketing strategy, and reinstituting an aggressive research program that will lead to the introduction of two breakthrough products in 2011. The results of the above are not expected to be recognized until sometime in 2011.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Per Item 305(e) of Regulation S-K, a smaller reporting company is not required to provide the information required by this item.

ITEM 4T. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures. Based on their evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Exchange Act) as of September 30, 2010, the end of the period covered by this Report, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms; that such information is accumulated and disclosed to management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure; and that such disclosure controls and procedures are effective.

Changes in internal control over financial reporting. During the quarter ended September 30, 2010, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. REMOVED AND RESERVED

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit Number	Description of Exhibit
31.1*	Rule 13a-14(a) Certification of Chief Executive Officer
31.2*	Rule 13a-14(a) Certification of Chief Financial Officer
32**	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Filed herewith
** Furnished herewith

SIGNATURES

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

PACIFICHEALTH LABORATORIES, INC.

By: /S/ STEPHEN P. KUCHEN
STEPHEN P. KUCHEN
Chief Financial Officer (Principal Financial Officer
and Principal Accounting Officer)

Date: October 29, 2010

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