

VITACUBE SYSTEMS HOLDINGS INC
Form 10QSB
August 15, 2005

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-QSB

**ý Quarterly Report Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934**

For the quarterly period ended June 30, 2005

or

**o Transition Report Pursuant to Section 13 or 15 (d) of
the Securities Exchange Act of 1934**

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)

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

YES NO

As of August 12, 2005 the Company had 9,588,900 shares of its \$.001 par value common stock issued and outstanding.

Table of Contents

PART I FINANCIAL INFORMATION

<u>Item 1.</u>	<u>Financial Statements (Unaudited)</u> <u>Condensed Consolidated Balance Sheets</u> <u>June 30, 2005 and December 31, 2004</u> <u>Condensed Consolidated Statements of Operations</u> <u>Three Months Ended June 30, 2005 and 2004 and</u> <u>Six Months Ended June 30, 2005 and 2004</u> <u>Condensed Consolidated Statements of Cash Flows</u> <u>Six Months Ended June 30, 2005 and 2004</u> <u>Notes to Financial Statements</u>
<u>Item 2.</u>	<u>Management's Discussion and Analysis or Plan of Operation</u>
<u>Item 3.</u>	<u>Controls and Procedures</u>

PART II OTHER INFORMATION

<u>Item 1.</u>	<u>Legal Proceedings</u>
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>
<u>Item 3.</u>	<u>Defaults Upon Senior Securities</u>
<u>Item 4.</u>	<u>Submission of Matters to a Vote of Security Holders</u>
<u>Item 5.</u>	<u>Other Information</u>
<u>Item 6.</u>	<u>Exhibits</u>

Part I **FINANCIAL INFORMATION**

Item 1 **CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

VITACUBE SYSTEMS HOLDINGS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

Edgar Filing: VITACUBE SYSTEMS HOLDINGS INC - Form 10QSB

	June 30, 2005 (Unaudited)	December 31, 2004
ASSETS		
Current assets:		
Cash	\$ 5,800,184	\$ 114,794
Accounts receivable, net of allowance for doubtful accounts of \$2,343 and \$237, respectively	9,697	4,358
Inventory, net of allowance for obsolescence of \$81,500 and 43,300, respectively	372,719	478,300
Prepaid expenses and other current assets	248,843	108,315
Total current assets	6,431,443	705,767
Intangible assets, net	37,887	40,015
Property and equipment, net	98,603	109,275
Deferred offering costs		269,106
Total assets	\$ 6,567,933	\$ 1,124,163
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	\$ 390,273	\$ 611,398
Total current liabilities	390,273	611,398
SHAREHOLDERS EQUITY (Note 2):		
Preferred stock, authorized 5,000,000 shares, \$.001 par value, none issued or outstanding		
Common stock, authorized 50,000,000 shares, \$.001 par value, 9,588,900 and 6,534,043 issued and outstanding respectively	9,589	6,534
Additional paid in capital	15,549,706	8,071,186
Accumulated (deficit)	(9,381,635)	(7,564,955)
Total shareholders equity	6,177,660	512,765
Total liabilities and shareholders equity	\$ 6,567,933	\$ 1,124,163

The accompanying notes are an integral part of these condensed consolidated financial statements

VITACUBE SYSTEMS HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

Edgar Filing: VITACUBE SYSTEMS HOLDINGS INC - Form 10QSB

Three and Six Months Ended June 30, 2005 and 2004

	For the Three Months Ended June 30, 2005	For the Three Months Ended June 30, 2004	For the Six Months Ended June 30, 2005	For the Six Months Ended June 30, 2004
Net sales	\$ 222,670	\$ 156,483	\$ 459,726	\$ 331,017
Cost of goods sold	105,893	57,470	190,454	103,055
Gross profit	116,777	99,013	269,272	227,962
Operating expenses:				
Selling and marketing expenses	477,920	251,158	904,767	414,288
General and administrative expenses	680,007	271,544	1,162,048	727,714
Research and development expenses	10,294	4,547	18,956	4,547
Depreciation and amortization	6,188	20,625	12,800	41,251
Total operating expenses	1,174,409	547,874	2,098,571	1,187,800
Net (loss) from operations	(1,057,632)	(448,861)	(1,829,299)	(959,838)
Other income (expense)				
Interest income	15,344	2,143	15,460	2,143
Interest (expense)	(1,200)		(2,841)	(300,872)
Total other income (expense)	14,144	2,143	12,619	(298,729)
Net (loss)	\$ (1,043,488)	\$ (446,718)	\$ (1,816,680)	\$ (1,258,567)
Net (loss) per common share				
Basic and diluted net (loss) per share	\$ (.11)	\$ (.07)	\$ (.23)	\$ (.26)
Weighted average common shares outstanding, basic and diluted				
	9,291,757	6,478,820	7,912,900	4,903,098

The accompanying notes are an integral part of these condensed consolidated financial statements

VITACUBE SYSTEMS HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

Edgar Filing: VITACUBE SYSTEMS HOLDINGS INC - Form 10QSB

Six Months Ended June 30, 2005 and 2004

	For the Six Months Ended June 30, 2005	For the Six Months Ended June 30, 2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss)	\$ (1,816,680)	\$ (1,258,567)
Adjustments to reconcile net (loss) to net cash (used in) operating activities:		
Depreciation and amortization expense	12,800	41,251
Beneficial conversion feature interest		255,000
Stock issued in payment of accounts payable		100,000
Stock and stock options issued for services	96,000	138,463
Change in allowance for inventory obsolescence	38,200	(3,011)
Change in allowance for doubtful accounts	2,106	16
Change in allowance for product returns	11,639	(162)
(Increase) decrease in accounts receivable	(7,445)	4,725
Decreases in inventory	67,381	35,481
(Increases) in prepaids and other current assets	(228,529)	(104,787)
(Decreases) in accounts payable and accrued expenses	(232,764)	(334,062)
Increase in accrued interest		45,872
Net cash (used in) operating activities	(2,057,292)	(1,079,781)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures		(4,006)
Net cash (used in) investing activities		(4,006)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Advances from shareholders	170,000	12,482
Proceeds from notes payable	195,000	205,000
Re-payments of shareholder advances	(170,000)	(132,173)
Re-payments of notes payable	(195,000)	(47,500)
Issuance of common stock, net of offering costs	7,742,682	2,448,308
Net cash provided by financing activities	7,742,682	2,486,117
NET INCREASE IN CASH	5,685,390	1,402,330
CASH, BEGINNING OF PERIOD	114,794	7,963
CASH, END OF PERIOD	\$ 5,800,184	\$ 1,410,293
SUPPLEMENTAL DISCLOSURE OF NONCASH FINANCING ACTIVITIES:		
Subordinated notes and interest converted to common stock	\$	\$ 1,861,643
Bridge loans and interest converted to common stock	\$	\$ 224,986
Interest and debt forgiveness	\$	\$ 8,964
Notes payable converted to common stock	\$	\$ 305,000
SUPPLEMENTAL CASH FLOW		
Cash paid for interest	\$ 2,841	\$ 45,872

The accompanying notes are an integral part of these condensed consolidated financial statements

VITACUBE SYSTEMS HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - ORGANIZATION, OPERATIONS AND BASIS OF PRESENTATION

Organization and Business

The consolidated financial statements include those of VitaCube Systems Holdings, Inc., (VSHI) and its wholly owned subsidiaries, VitaCube Systems, Inc. and VitaCube Network, Inc. Collectively, they are referred to herein as the the Company .

The Company is in the business of selling, marketing and distributing nutritional supplement products. We market our products through direct selling or network marketing in which independent distributors sell our products, as well as purchase them for their own personal use. We also sell our products directly to professional and Olympic athletes and to professional sports teams.

Our independent distributors are encouraged to build a sales organization consisting of customers and other independent distributors that they recruit and enroll with us. The new independent distributors and customers are classified as part of the recruiting independent distributor s sales network in that distributor s downline organization. Our independent distributors are compensated with commissions and bonuses on sales generated through their downline organization.

Our product lines consist of a sports energy drink, a protein shake, an appetite suppressant chew and 12 individual supplements packaged in our VitaCube®, and four supplements sold separately. Our VitaCube® is an easy to use, compartmentalized box with instructions for which supplements to take and the proper times to take them.

Basis of Presentation

The condensed interim financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures made are adequate to make the information presented not misleading. The condensed interim financial statements and notes thereto should be read in conjunction with the financial statements and the notes thereto, included in the Company s Annual Report to the Securities and Exchange Commission for the fiscal year ended December 31, 2004, filed on Form 10-KSB on March 4, 2005.

The accompanying condensed interim financial statements have been prepared, in all material respects, in conformity with the standards of accounting measurements set forth in Accounting Principles Board Opinion No. 28 and reflect, in the opinion of management, all adjustments necessary to summarize fairly the financial position and results of operations for such periods in accordance with accounting principles generally accepted in the United States of America. All adjustments are of a normal recurring nature. The results of operations for the most recent interim period are not necessarily indicative of the results to be expected for the full year.

Principals of Consolidation

Edgar Filing: VITACUBE SYSTEMS HOLDINGS INC - Form 10QSB

The accompanying financial statements include the accounts of the Company and its wholly owned subsidiaries VitaCube Systems, Inc. and VitaCube Network, Inc. All inter-company accounts and transactions have been eliminated in the preparation of these consolidated statements.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Management believes that the estimates utilized in the preparation of the financial statements are prudent and reasonable. Actual results could differ from these estimates.

Stock-Based Compensation

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

If the Company measured compensation cost based on the fair value of the options at the grant date consistent with the method prescribed by SFAS 123, the Company's net loss and loss per common share would have been increased to the pro forma amounts indicated below:

	Three Months Ended		Six Months Ended	
	June 30, 2005	June 30, 2004	June 30, 2005	June 30, 2004
Net loss, as reported	\$ (1,043,488)	\$ (446,718)	\$ (1,816,680)	\$ (1,258,567)
Add: Stock-based compensation expense included in reported net income, net of related tax effects		18,000		256,464
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	(627,636)	(96,507)	(627,636)	(400,695)
Pro forma net loss	\$ (1,671,124)	\$ (545,225)	\$ (2,444,316)	\$ (1,402,798)
Earnings per share:				
Basic and diluted earnings (loss) per common share				
As reported	\$ (.11)	\$ (.07)	\$ (.23)	\$ (.26)
Pro forma	\$ (.18)	\$ (.08)	\$ (.31)	\$ (.29)

The fair value of each option grant was estimated at the date of the grant using the Black-Scholes option pricing model with the following assumptions for the three and six months ended June 30, 2005 and June 30, 2004: risk-free interest rate between 3.85% - 4.00% and 2.79%-3.85%, respectively; no dividend yield; expected life of 5 years; and volatility of 116.01% and 86.97%, respectively.

During the initial phase-in period of applying SFAS 123 for pro forma disclosure purposes, the results may not be representative of the effects on reported net income (loss) for future years because options vest over several years and additional grants generally are made each year.

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

Net Loss Per Share

Edgar Filing: VITACUBE SYSTEMS HOLDINGS INC - Form 10QSB

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

NOTE 2 - SHAREHOLDERS EQUITY

On April 5, 2005, the Company completed an offering of its securities to the public raising \$9,225,000 before expenses and listed its common stock and units on the American Stock Exchange. The offering was for 1.5 million units at \$6.15 per unit, each unit consisting of two shares of our common stock, one redeemable Class A public warrant and one redeemable Class B public warrant. The net proceeds to the Company, after deducting the underwriter's discount of 7% (\$.43 per unit), direct offering costs and expenses were approximately \$7.3 million.

On May 20, 2005 the units were separated and the components began trading on the AMEX under the common stock symbol PRH, Class A public warrant symbol PRH.WS.A and Class B public warrant symbol PRH.WS.B. As of December 31, 2004, deferred offering costs totaling \$269,106 were recorded as long-term assets and during the quarter ended June 30, 2005 were applied against the proceeds of the offering.

On May 20, 2005, the Company entered into a one-year strategic alliance agreement with UTEK Corporation, a technology transfer company. In accordance with the terms of the agreement, the Company issued to UTEK 54,857 unregistered shares of common stock as compensation, with 1/12th of the shares (4,571) vesting each month during the term of the agreement. The agreement is terminable by either party upon 30 days notice. In the event of termination before the completion of the agreement; all unvested shares of common stock shall be returned to the Company. The Company recorded a prepaid expense of \$96,000 related to this issuance of the 54,857 shares of unregistered common stock of the Company. The value of this transaction was based upon the Company's trading price of \$1.75 per share on the day the agreement was reached. During the quarter ended June 30, 2005, the Company amortized \$8,000 of this prepayment and applied this expense to its operating expenses.

NOTE 3 SUBSEQUENT EVENTS

Effective July 1, 2003 the shareholders of the Company adopted the 2003 Stock Incentive Plan (the Plan). The Plan includes incentive and non-qualified stock options and restricted stock grants. On July 22, 2005, the shareholders approved an amendment to the Plan to increase the number of shares available under the Plan to 1,800,000 shares of common stock.

Item 2 MANAGEMENT S DISCUSSION AND ANAYLSIS OR PLAN OF OPERATION

Cautionary Note Regarding Forward-Looking Statements

Edgar Filing: VITACUBE SYSTEMS HOLDINGS INC - Form 10QSB

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 and is subject to the safe harbor created by those sections. We intend to identify forward-looking statements in this report by using words such as believes, intends, expects, may, will, should, plan, projected, contemplates, anticipates, potential, continue, or similar terminology. These statements are based on our beliefs as well as assumptions we made using information currently available to us. We undertake 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 our 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. These risks include changes in demand for our products, changes in the level of operating expenses, our ability to expand our network of distributors, changes in general economic conditions that impact consumer behavior and spending, product supply, the availability, amount, and cost of capital to us and our use of such capital, and other risks discussed in this report. Additional risks that may affect our performance are discussed under Risk Factors Associated with Our Business in our Registration Statement Form SB-2 declared effective April 5, 2005. Readers are cautioned not to place undue reliance on the forward-looking statements contained in this report.

Overview

Edgar Filing: VITACUBE SYSTEMS HOLDINGS INC - Form 10QSB

We are in the business of developing, selling, marketing and distributing nutritional supplement products. We market our products primarily through direct selling or network marketing, in which independent distributors sell our products. In addition, we sell our products directly to professional athletes, Olympic athletes and professional sports teams.

Our product lines consist of a sports energy drink, a protein shake, an appetite suppressant chew introduced in March 2005, 12 individual supplements packaged in our VitaCube®, and four supplements sold separately. Our VitaCube® is an easy to use, compartmentalized box with instructions for which supplements to take and the proper times to take them.

We completed a public offering of our securities in April 2005. We raised approximately \$7.3 million after offering costs and expenses.

We have not yet experienced the kind of growth in the number of independent distributors and revenues as forecasted in our operating plan for 2005.

In June 2005, we hired as our president, one of our board of directors who brings us an extensive experience in network marketing both from a corporate management and independent distributor perspective. We have identified the need to develop a more concise, simple message that allows for greater duplication in our distributor network. To that end, we have created a brand positioning statement that will drive the development of our future marketing efforts including products, packaging, web designs and printed materials. The results of this effort will start to be revealed to the public and our distributors late in the third quarter of 2005.

Our revenue will depend on the number and productivity of our independent distributors, who purchase products and sales materials from us for resale to their customers or for personal use. Because we will distribute substantially all of our products through our independent distributors, our failure to retain our existing distributors and recruit additional distributors could have an adverse effect on our revenue.

Due to the recent start-up of our direct sales program we believe we need to gain more operating experience in order to discern and discuss key indicators of our performance. To date, however, we believe that the number of our distributors is an important indicator to monitor. In addition, we will monitor the sales generated per independent distributor as well as the success of our independent distributors in recruiting new independent distributors. At this time it is too early to determine what indicators will be necessary for us to be profitable.

With respect to industry and market factors that may affect us directly, we believe that industry credibility in both direct selling and nutritional supplements will be critical elements in whether we can increase revenues and become profitable. Any adverse developments in either of these two areas, to us or in our industry, could lead to a lower number

of our independent distributors and reduced sales and recruiting efforts by existing distributors, as well as a loss or no increase in the number of sports celebrity endorsers of our products. We do not know what industry growth was for 2004 or will be for 2005 nor do we have enough experience in the direct sales channel to determine whether a slower industry growth rate, which occurred for several years leading up to 2003, will adversely affect us.

We cannot predict our revenue, gross profit, net income or loss or use of cash and cash equivalents; however, we expect net losses will continue for at least the next 12 months.

Critical Accounting Policies and Estimates

Edgar Filing: VITACUBE SYSTEMS HOLDINGS INC - Form 10QSB

Discussion and analysis of our financial condition and results of operations are based upon financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to the collection of receivables, inventory obsolescence, sales returns and non-monetary transactions such as stock and stock options issued for services and beneficial conversion features of notes payable. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our financial statements.

Revenue Recognition. In accordance with Staff Accounting Bulletin No. 104 Revenue Recognition, revenue is recognized at the point of shipment to customers, at which time title is passed. Net sales include sales of products, sales of marketing tools to independent distributors and freight and handling charges. With the exception of approved professional sports teams, we receive the net sales price from all of our orders in the form of cash or credit card payment prior to shipment. Professional sports teams with approved credit have been extended payment terms of net 30 days.

Allowances for Product Returns. Allowances for product returns are recorded at the time product is shipped. These accruals are based upon the historical return rate since the inception of our network marketing program in the third quarter of 2003, and the specific historical return patterns by product.

We offer a 60-day, 100% money back unconditional guarantee to all customers and independent distributors who have never before purchased products from us. As of June 30, 2005, orders shipped that are subject to our 60-day money back guarantee were approximately \$50,000. All other product may be returned to us by any customer or independent distributor if it is unopened and undamaged for a 100% sales price refund, less a 10% restocking fee, provided the product is returned within 12 months of purchase and is being sold by us at the time of return. We are not able to estimate the amount of revenue we have recognized that is held by these buyers of product and which is returnable, because it is not possible to determine the amount of product would be unopened and undamaged. Returned product damaged during shipment is replaced wholly at our cost, which historically has been negligible.

We monitor our estimates on an ongoing basis and may revise allowances to reflect our experience. Our reserve for product returns at the six months ended June 30, 2005 and at the year ended December 31, 2004 was \$15,749 and \$4,110, respectively.

Inventory Valuation. Inventories are stated at the lower of cost or market on a first-in-first-out basis. A reserve for inventory obsolescence is maintained and is based upon current and future product demands, inventory whose shelf life has expired and market conditions. A change in any of these variables may require additional reserves to be taken. As a result of simplifying our marketing efforts and re-evaluating our brand, we have increased our reserve for obsolete inventory to \$81,500 as of June 30, 2005 from \$43,300 as of December 31, 2004.

Beneficial Conversion Feature of Debt. In accordance with Emerging Issues Task Force No. 98-5, Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios, and No. 00-27, Application of Issue No. 98-5 to Certain Convertible Instruments, we recognize the value of conversion rights attached to convertible debt. These rights give the debt holder the ability to convert his debt into common stock

at a price per share that is less than the trading price to the public on the day the loan is made to us. The beneficial value is calculated based on the market price of the stock at the commitment date in excess of the conversion rate of the debt and

related accruing interest and is recorded as a discount to the related debt and addition to additional paid in capital. The discount is amortized and recorded as interest expense over the remaining outstanding period of related debt.

Stock Based Compensation. We account for our stock-based compensation using Accounting Principles Board's Opinion No. 25 (APB No. 25). Under APB No. 25, compensation expense is recognized for stock options with an exercise price that is less than the market value of the stock on grant. We have adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123 Accounting for Stock-Based Compensation (SFAS 123) for the stock options granted to our employees and directors. Accordingly, no compensation cost has been recognized for these options. Many equity instrument transactions are valued based on pricing models such as Black-Scholes, which require judgments by us. Values for such transactions can vary widely and are often material to the financial statements.

Results of Operations

Edgar Filing: VITACUBE SYSTEMS HOLDINGS INC - Form 10QSB

For the three months ended June 30, 2005 compared to the three months ended June 30, 2004.

The discussion below first presents the results of the quarter ended June 30, 2005 followed by the results of the quarter ended June 30, 2004

Net sales. Net sales were \$222,670 an increase of 42% compared to \$156,483. We are experiencing an increase in net sales as we continue to execute our sales and marketing plan of increasing our distributor and customer base along with creating greater brand recognition. However, our revenues are still behind our forecast for 2005.

The percentage that each product category represented of our net sales is as follows:

Product Category	Three Months Ended June 30,	
	2005 % of Sales	2004 % of Sales
eForce® sports drink	26%	%
VitaPro® nutrition shake	14%	23%
Vitamins and minerals	41%	72%
sZone® snack	12%	%
Other-educational materials, apparel	7%	5%

Gross Profit. Gross profit increased to \$116,777 compared to \$99,013, an increase of 18%. Gross profit as a percentage of revenue (gross margin) decreased to 52% from 63%. The increase in gross profit reflects the increase in net sales. Gross margin decreased due to an increase in our reserve for obsolete inventory and the increase of sales in lower margin items.

Sales and marketing expenses. Sales and marketing expenses increased to \$477,920 from \$251,158, an increase of 90%. The increase in sales and marketing expenses is a result of an increase in our activities associated with our independent distributors. We incurred \$ 230,890 in costs to attract experienced sales leaders for our distributor network and \$12,650 in evaluating and identifying our brand positioning. We also incurred \$18,077 of travel related costs associated with company personnel participating in events sponsored by our independent distributors. We expect to continue to incur higher sales and marketing expenses for the next 12 months as we continue to implement our plan.

General and administrative expenses. General and administrative expenses were \$680,007 an increase of 150% compared to \$271,544. The increase is a result of expenses associated with being a public company and higher executive compensation. We incurred \$138,576 in costs associated with listing on the American Stock Exchange, investor relations, transfer agent fees and filing fees. Executive compensation increased as a result of employment agreements with Earnest Mathis, our Chief Executive Officer effective March 2, 2005 and Doug Ridley, our President on June 2, 2005.

Research and development expenses. Research and development expenses increased to \$10,294 from \$4,547 an increase of 126%. We are continuing to research and develop ingredients and manufacturing technologies for our product line. We have engaged in a strategic alliance agreement with UTEK Corporation, a technology transfer company to assist

us with introductions to university research ingredients and processes. We incurred \$8,000 of costs associated with the UTEK agreement in related stock expenses.

Interest Expense. There was \$1,200 of interest expense incurred in the three months ended June 30, 2005 for short-term financing. The short-term financing of \$365,000 was paid in full with accrued interest of \$2,841 during the quarter. There was no short-term or long-term financing during the three months ended June 30, 2004.

Net Loss. Our net loss was \$1,043,488 or (\$0.11) per share compared to \$466,718 or (\$0.07) per share, an increase of \$.04 per share or 134% and 57%, respectively. The increase in net loss is associated with the increase in both our sales and marketing expenses and general and administrative expenses.

For the six months ended June 30, 2005 compared to the six months ended June 30, 2004.

The discussion below first presents the results of the six months ended June 30, 2005 followed by the results of the six months ended June 30, 2004

Net sales. Net sales were \$459,726 an increase of 39% compared to \$331,017. Our sales are generated primarily through our independent distributors, who purchase products and sales materials from us for resale to their customers or for personal use. We also sell our products directly to professional and Olympic athletes and to professional sports teams. We have re-occurring revenues generated through monthly standing orders by our distributors and customers. Our sales will continue to grow over the comparable period if we continue to increase the number of distributors and customers.

The percentage that each product category represented of our net sales is as follows:

PRODUCT CATEGORY	Six Months Ended June 30,	
	2005 % of Sales	2004 % of Sales
eForce® sports drink	28%	%
VitaPro® nutrition shake	14%	23%
Vitamins and minerals	43%	73%
sZone® snack	8%	%
Other-educational materials, apparel	7%	4%

Gross Profit. Gross profit increased to \$269,272 compared to \$227,962 an increase of 18%. Gross profit as a percentage of revenue (gross margin) decreased to 59% from 69%. The increase in gross profit reflects the increase in net sales.

Gross margin decreased due to an increase in sales of lower margin items.

Sales and marketing expenses. Sales and marketing expenses increased to \$904,767 from \$414,288, an increase of 118%. Sales and marketing expenses consist primarily of distributor commissions, costs associated with attracting experienced field leaders for our distributor network, events and training for the distributors, and sales associated costs such as employee compensation for customer service and warehouse personnel, credit card fees and order fulfillment costs. The independent distributor compensation increased to 30% of net sales for the current period compared to 16% for the comparable period. We incurred \$308,282 in costs to attract experienced sales leaders, \$133,074 in training and recruiting events and \$21,529 in associated travel costs for support to our distributors.

General and administrative expenses. General and administrative expenses were \$1,162,048 an increase of 60% compared to \$727,714. Our general and administrative expenses consist primarily of employee and executive compensation for executives and administrative personnel, legal and accounting fees, business consultants, rent and associated building costs, costs associated with being a public company, business insurance and office costs such as telephone, supplies, computer hardware and software and hosting fees. The increase is the result of higher executive compensation, public company costs and computer associated costs. We entered into employment contracts with Sanford Greenberg, our founder effective April 1, 2004. Prior to that time, Mr. Greenberg drew a nominal salary. We also entered into an employment agreements with David Litt, our Vice President of Sales and Marketing on October 1, 2004, Earnest Mathis, our Chief Executive Officer on March 2, 2005 and Doug Ridley, our President on June 2, 2005. We incurred \$171,034 in costs associated with being a public company and spent \$73,131 in technology improvements.

Research and development expenses. Research and development expenses increased to \$18,956 from \$4,547 an increase of 317%. We have increased our research and development expenses to broaden our depth of functional foods in our product line. In March 2005, we introduced sZone®, a chocolate-raspberry chew used as a snack between meals promotes healthy weight management. We have two additional items under development that we plan to introduce during the third quarter of 2005 and the other in the first quarter of 2006. We estimate the cost for completion of development and testing of these products to be approximately \$15,000. Also on May 20, 2005, we entered into a strategic alliance agreement with UTEK Corporation, a technology transfer company. We will incur a total of \$96,000 in related stock costs amortized over the one-year term of the agreement.

Interest Expense. Interest expense decreased to \$2,841 from \$300,872, a decrease of 99%. During the quarter ended March 31, 2004, there was \$255,000 of beneficial conversion features on bridge loans and \$45,872 in interest on short-term and long-term financing that was either converted into equity or paid in full compared to \$2,841 of interest on short-term financing in 2005.

Net Loss. Our net loss was \$1,816,680 or (\$0.23) per share compared to \$1,258,567 or (\$0.26) per share. Our net loss increased by 44% was the result of higher expenses in 2005 offset slightly by a decrease in interest expense from 2004. The decrease in the net loss per share of \$.03 was due to a significantly higher number of shares outstanding in 2005 compared to 2004.

Liquidity and Capital Resources

Edgar Filing: VITACUBE SYSTEMS HOLDINGS INC - Form 10QSB

Through 2004, operating funds have been provided primarily by loans from our founder, our Chief Executive Officer, and by various shareholders of our Company, and from sales of our common stock and to a lesser degree, funds provided by sales of our product.

On January 31, 2004 we closed a private offering of our common stock issuing 207,999 shares for gross proceeds of \$1,039,980. On April 15, 2004, we closed a second private offering of our common stock issuing 1,665,290 shares for gross proceeds of \$2,497,925. In conjunction with the second offering both our founder and one of our former director converted outstanding loans plus accrued interest into 1,391,087 shares of our common stock at March 31, 2004. On April 5, 2005 we completed a public offering of our common stock issuing 1,500,000 units for gross proceeds of \$9,225,000. Underwriters deducted 7% of proceeds for their discount, 3% in allowable expenses and a financial advisory agreement of \$96,000. We incurred \$821,000 in other expenses related to the public offering. This leaves us with net proceeds of \$7.3 million.

We used cash from operations of \$2.1 million for the six months ended June 30, 2005 compared to a use of cash of \$1.1 million in the first six months of 2004. The use of cash in our operations results from incurring and accruing expenses to suppliers, necessary to generate business and service our customers at a time when revenues did not keep pace with expenses. As of June 30, 2005, we had \$5.8 million in cash and cash equivalents available to pay current creditors and fund future operations. Our net working capital increased after the completion of the public offering from \$94,369 at December 31, 2004 to 6,041,170 at June 30, 2005.

We believe that our cash resources with the net proceeds of \$7.3 million from the offering will be sufficient to fund our operations for the next 12 months, depending upon our sales levels. If our business operations do not result in increased product sales, our business viability, financial position, results of operations and cash flows would likely be adversely affected. Further, if we are not successful in achieving profitability, additional capital will be required to conduct on-going operations. We cannot predict the terms upon which we could raise such capital or if any capital would be available at all.

Customer Concentrations

We had no single customer that accounted for any substantial portion of our revenues.

Off-Balance Sheet Items

We have no off-balance sheet items as of June 30, 2005.

Item 3 CONTROLS AND PROCEDURES

Prior to the filing of this report, the Company's management carried out an evaluation, under the supervision and with the participation of its Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's controls and procedures were effective to ensure that information required to be disclosed by the Company in the reports filed by it under the Securities and Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by the Company in such reports is accumulated and communicated to the Company's management, including the Chief Executive Officer and the Chief Financial Officer of the Company, as appropriate to allow timely decisions regarding required disclosure.

There has been no change in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that has materially affected or is reasonably likely to materially affect its internal control over financial reporting.

Part II OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

Edgar Filing: VITACUBE SYSTEMS HOLDINGS INC - Form 10QSB

We are a defendant in a lawsuit filed in Denver, Colorado District Court in 2001, entitled Jordan Simons Plaintiff case no 01-CV-4242. Mr. Simons claims that we hired him to create a website and breached our contract by terminating him after he had performed some work for us but had not completed the project. Mr. Simons lawsuit was dismissed with prejudice on January 15, 2004, for his failure to prosecute the case and participate in discovery, however on November 22, 2004, the Denver District Court reinstated Mr. Simons lawsuit. On July 29, 2005, we reached a settlement with Mr. Simons for \$11,400. A motion for dismissal with prejudice is in the process of being filed.

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

None.

Item 3. DEFAULTS UPON SENIOR SECURITIES

None.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

Item 5. OTHER INFORMATION

None.

Item 6. EXHIBITS

Edgar Filing: VITACUBE SYSTEMS HOLDINGS INC - Form 10QSB

Exhibit No	Description
31.1	Certification of CEO as Required by Rule 13a-14(a)/15d-14
31.2	Certification of CFO as Required by Rule 13a-14(a)/15d-14
32.1	Certification of CEO as Required by Rule 13a-14(a) and Rule 15d-14(b) (17 CFR 240.15d-14(b)) and Section 1350 of Chapter 63 of Title 18 of the United States Code
32.2	Certification of CFO as Required by Rule 13a-14(a) and Rule 15d-14(b) (17 CFR 240.15d-14(b)) and Section 1350 of Chapter 63 of Title 18 of the United States Code

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City and County of Denver, State of Colorado, on August 12, 2005.

VITACUBE SYSTEMS HOLDINGS, INC.

By */s/ Earnest Mathis* .
Earnest Mathis
Chief Executive Officer

By */s/ Mary Pat O Halloran* .
Mary Pat O Halloran
Chief Financial Officer (Principal Accounting Officer)