

VITACUBE SYSTEMS HOLDINGS INC  
Form 10QSB  
November 14, 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 September 30, 2005**

or

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

Commission file No. 000-50875

## 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

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2). Yes  No

As of November 14, 2005 the Company had 9,618,900 shares of its \$.001 par value common stock issued and outstanding.

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**Part I FINANCIAL INFORMATION****Item 1 CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****VITACUBE SYSTEMS HOLDINGS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

|   | September 30, 2005 | December 31, 2004 |
|---|--------------------|-------------------|
| <b>ASSETS</b>   |                    |                   |
| Current assets:   |                    |                   |
| Cash  | \$ 4,305,813       | \$ 114,794        |
| Accounts receivable, net of allowance for doubtful accounts of \$4,531 and \$237, respectively                            | 10,882             | 4,358             |
| Inventory, net of allowance for obsolescence of \$101,900 and 43,300, respectively  | 305,582            | 478,300           |
| Prepaid expenses and other current assets   | 520,163            | 108,315           |
| Total current assets  | 5,142,440          | 705,767           |
| Intangible assets, net  | 37,053             | 40,015            |
| Property and equipment, net   | 97,192             | 109,275           |
| Deferred offering costs   |                    | 269,106           |
| Total assets  | 5,276,685          | 1,124,163         |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>  |                    |                   |
| Current liabilities:  |                    |                   |
| Accounts payable and accrued expenses   | 437,690            | 611,398           |
| Total current liabilities   | 437,690            | 611,398           |
| <b>SHAREHOLDERS EQUITY (Note 2):</b>  |                    |                   |
| Preferred stock, authorized 5,000,000 shares, \$.001 par value, none issued or outstanding                                |                    |                   |
| Common stock, authorized 50,000,000 shares, \$.001 par value, 9,618,900 and 6,534,043 issued and outstanding respectively | 9,619              | 6,534             |
| Additional paid in capital  | 15,861,672         | 8,071,186         |
| Accumulated (deficit)   | (11,032,296)       | (7,564,955)       |
| Total shareholders equity   | 4,838,995          | 512,765           |
| Total liabilities and shareholders equity   | \$ 5,276,685       | \$ 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

|  | For the Three<br>Months<br>Ended<br>September 30,<br>2005 | For the Three<br>Months<br>Ended<br>September 30,<br>2004 | For the Nine<br>Months<br>Ended<br>September<br>30, 2005 | For the Nine<br>Months<br>Ended<br>September 30,<br>2004 |
|--|---|---|--|--|
| Net sales  | 323,400   | 230,599   | 783,126  | 561,454  |
| Cost of goods sold   | 155,195   | 71,598  | 345,648  | 177,664  |
| Gross profit   | 168,205   | 159,001   | 437,478  | 383,790  |
| Operating expenses:  |   |   |  |  |
| Selling and marketing expenses                                     | 996,736   | 414,278   | 1,901,503  | 823,923  |
| General and administrative expenses                                | 844,241   | 454,626   | 2,006,289  | 1,183,810  |
| Research and development expenses                                  | 24,778  | 964   | 43,733   | 5,511  |
| Depreciation and amortization                                      | 6,428   | 13,022  | 19,229   | 54,272   |
| Total operating expenses   | 1,872,183   | 882,890   | 3,970,754  | 2,067,516  |
| Loss from operations   | (1,703,978)   | (723,889)   | (3,533,276)  | (1,683,726)  |
| Other income (expense)   |   |   |  |  |
| Interest income  | 53,316  | 1,829   | 68,776   | 3,971  |
| Interest (expense)   |   |   | (2,841)  | (300,872)  |
| Total other income (expense)                                       | 53,316  | 1,829   | 65,935   | (296,901)  |
| Net (loss)   | \$ (1,650,662)  | \$ (722,060)  | \$ (3,467,341)   | \$ (1,980,627)   |
| Net (loss) per common share Basic and diluted net (loss) per share | \$ (0.17)   | \$ (0.11)   | \$ (0.41)  | \$ (0.36)  |
| Weighted average common shares outstanding, basic and diluted      | 9,589,400   | 6,518,565   | 8,486,550  | 5,439,205  |

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

## VITACUBE SYSTEMS HOLDINGS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

|   | For the Nine<br>Months Ended<br>September 30, 2005 | For the Nine<br>Months Ended<br>September 30, 2004 |
|---|--|--|
| Cash flows from operating activities:                         |  |  |
| Net Loss  | (3,467,341)  | (1,871,129)  |
| Adjustments to reconcile                                      |  |  |
| Depreciation and amortization                                 | 19,229   | 54,272   |
| Beneficial conversion interest                                |  | 255,000  |
| Stock issued in exchange for satisfaction of accounts payable |  | 100,000  |
| Stock and stock options issued for services                   | 383,998  | 248,014  |
| Change in allowance for doubtful accounts                     | 4,294  | (146)  |
| Change in allowance for inventory obsolescence                | 58,600   | (14,483)   |
| Change in allowance for product returns                       | 15,170   |  |
| Changes in assets and liabilities:                            |  |  |
| Accounts receivable   | (10,818)   | (783)  |
| Inventory   | 114,118  | (249,803)  |
| Other assets  | (475,851)  | (18,336)   |
| Accrued interest  |  | 45,872   |
| Accounts payable and accrued expenses                         | (245,550)  | (336,509)  |
| Accrued employee benefits and payroll                         | 56,672   |  |
| Net cash (used) by operating                                  | (3,547,479)  | (1,788,031)  |
| Cash flows from investing activities:                         |  |  |
| Capital expenditures  | (4,184)  | (4,006)  |
| Proceeds from sale of equipment                               |  |  |
| Net cash used in investing activities                         | (4,184)  | (4,006)  |
| Cash flow from financing:                                     |  |  |
| Proceeds from bridge loan financing                           | 195,000  | 205,000  |
| Repayments of bridge financing                                | (195,000)  | (47,500)   |
| Proceeds from loan to shareholder                             | 170,000  | 12,481   |
| Repayments of loan to shareholder                             | (170,000)  | (132,173)  |
| Issuance of common stock, net of offering costs               | 7,742,682  | 2,416,059  |
| Deferred offering costs                                       |  | (67,079)   |
| Net cash from financing                                       | 7,742,682  | 2,386,788  |
| Net increase in cash  | 4,191,019  | 594,751  |
| Cash at beginning of the period                               | 114,794  | 7,963  |
| Cash at end of period   | \$ 4,305,813                                       | \$ 602,714   |

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 condensed consolidated financial statements include those of VitaCube Systems Holdings, Inc., (VSHI) and its wholly owned subsidiaries, VitaCube Systems, Inc. and XELR8, Inc. (formerly VitaCube Network, Inc.). Collectively, they are referred to herein as the Company .

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

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

During the current quarter, the Company changed the name under which its products were sold to XELR8, and launched two new products and re-branded an existing product under the concept of the Eat-Drink-Snack System . The new products consist of a meal replacement shake and energy drink. The existing product lines consist of a rehydration drink, a protein shake, an appetite suppressant chew (the Snack ), and 12 individual supplements packaged in the VitaCube®. The 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

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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*

The accompanying financial statements include the accounts of the Company and its wholly-owned subsidiaries VitaCube Systems, Inc. and XELR8, Inc. (formerly 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



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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 accounts for its stock-based compensation plans using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ( APB No. 25 ), and related interpretations, and follows the disclosure provisions of SFAS No. 123, Accounting for Stock-Based Compensation ( SFAS No. 123 ) and SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure ( SFAS No. 148 ). Statement of Financial Accounting Standards No. 123 Share-Based Payments ( SFAS No. 123R ) was revised and promulgated in December 2004. The Company intends to adopt this standard when required. On April 14, 2005, the SEC deferred the date of required adoption for SFAS No. 123R for companies in VSHI's position to fiscal years beginning after June 15, 2005.

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<br>September 30 |              | Nine Months Ended<br>September 30 |                |
|--|------------------------------------|--------------|-----------------------------------|----------------|
|  | 2005                               | 2004         | 2005                              | 2004           |
| Net loss, as reported  | \$ (1,650,662)                     | \$ (722,060) | \$ (3,467,341)                    | \$ (1,980,627) |
| Add: Stock-based compensation expense included in reported net loss, net of related tax effects                                    | 226,417                            | 201,048      | 234,417                           | 457,512        |
| Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects | (521,016)                          | (277,727)    | (984,922)                         | (678,422)      |
| Pro forma net loss   | \$ (1,945,201)                     | \$ (798,739) | \$ (4,217,846)                    | \$ (2,201,537) |
| Earnings per share:  |                                    |              |                                   |                |
| Basic and diluted earnings (loss) per common share   |                                    |              |                                   |                |
| As reported  | \$ (0.17)                          | \$ (0.11)    | \$ (0.41)                         | \$ (0.36)      |
| Pro forma  | (0.20)                             | (0.12)       | (0.50)                            | (0.40)         |

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 nine months ended September 30, 2005 and September 30, 2004: risk-free interest rate between 3.85% - 4.01% and 2.79%-3.85%, respectively; no dividend yield; expected life of 5 years; and an expected volatility of 60.64% 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.

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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

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 1/12<sup>th</sup> 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 September 30, 2005, the Company amortized \$24,000 of this prepayment and applied this expense to its operating expenses.

**NOTE 3 - EVENTS SUBSEQUENT TO SEPTEMBER 30, 2005**

On October 11, 2005, the Company entered into a Promissory Note agreement with Colorado Business Bank, to provide a \$250,000 line of credit to the company, secured by deposits held by Colorado Business Bank. The line provides for an annual interest rate of 5.60% and the facility expires on January 19, 2006. The company has not used any of the available credit under this facility.

**Item 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION**

**Cautionary Note Regarding Forward-Looking Statements**

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**

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 hydration drink, a protein shake, an appetite suppressant chew introduced in March 2005, 12 individual supplements packaged in our VitaCube®, and the Eat-Drink-Snack System that was introduced in September 2005, which consist of a meal replacement shake, appetite suppressant chew and energy drink. The VitaCube® is an easy to use, compartmentalized box with instructions for which supplements to take and the proper times to take them. The Eat-Drink-Snack System is sold as a system or the components can be purchased individually. In conjunction with the launch of the new products, the company launched a new website, marketing materials and distributor duplication system.

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.

Our revenue will depend on the number and productivity of our independent distributors, who purchase products from us, for resale to their customers or for personal use. Because we will substantially distribute 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**

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 September 30, 2005, orders shipped that are subject to our 60-day money back guarantee were approximately \$50,040. 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.

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We monitor our estimates on an ongoing basis and may revise allowances to reflect our experience. Our reserve for product returns at ended September 30, 2005 and at December 31, 2004 was \$19,280 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 \$101,900 as of September 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

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

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

*Net sales.* Net sales were \$323,400 an increase of 40% compared to \$230,599. 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<br>September 30, |                    |
|------------------------------------|-------------------------------------|--------------------|
|                                    | 2005<br>% of Sales                  | 2004<br>% of Sales |
| eForce® hydration drink            | 36%                                 | 21%                |
| VitaPro® protein shake             | 11%                                 | 17%                |
| Vitamins and minerals (Vitacubes®) | 31%                                 | 56%                |
| sZone® snack                       | 13%                                 | %                  |
| Eat-Drink-Snack System             | %                                   | %                  |
| Other materials, apparel, etc.     | 9%                                  | 6%                 |

*Gross Profit.* Gross profit increased to \$168,205 compared to \$159,001, an increase of 6%. Gross profit as a percentage of revenue (gross margin) decreased to 52% from 69%. The increase in gross profit reflects the increase in net sales. Gross margin decreased due to an increase in our reserve for obsolete inventory, the decrease of the sales price on selected products as part of a promotion and the inability to pass on all the additional shipping costs to our distributors.



*Sales and marketing expenses.* Sales and marketing expenses increased to \$996,735 from \$414,278, an increase of 141%. The increase in sales and marketing expenses is a result of an increase in our activities associated with our independent distributors. We incurred \$379,241 in costs to attract experienced sales leaders for our distributor network and \$267,020 in evaluating and identifying our brand positioning and holding a September event to launch the new XELR8 brand and the Eat-Drink-Snack System . The Company also incurred \$28,830 of travel related costs associated with Company personnel participating in events sponsored by the independent distributors. We expect to continue to incur higher sales and marketing expenses for the next 12 months as we implement our marketing plan.

*General and administrative expenses.* General and administrative expenses were \$844,241 an increase of 86% compared to \$454,262. The increase is a result of expenses associated with business consultants used in the web development, public company expenses for the annual meeting, stock and stock option compensation that was paid to consultants and higher executive compensation. Executive compensation increased as a result of employment agreements with Earnest Mathis, our Chief Executive Officer effective March 2, 2005, Doug Ridley, our President on June 2, 2005 and John Pougnet, our Chief Financial Officer effective September 12, 2005. The Company issued options to consultants for services rendered for past or current performance with investor relations, accounting services, web development and to independent distributors.

*Research and development expenses.* Research and development expenses increased to \$24,778 from \$964 an increase of 2,470%. We are continuing to research and develop ingredients and manufacturing technologies for our product line.

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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.

*Net Loss.* Our net loss was \$1,650,662 or (\$0.17) per share compared to \$722,060 or (\$0.11) per share, an increase of \$0.06 per share or 129% and 56%, 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 nine months ended September 30, 2005 compared to the nine months ended September 30, 2004.**

*The discussion below first presents the results of the nine months ended September 30, 2005 followed by the results of the nine months ended September 30, 2004.*

*Net sales.* Net sales were \$783,126 an increase of 40% compared to \$561,454. Our sales are generated primarily through our independent distributors, who purchase products 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                   | Nine Months Ended<br>September 30, |                    |
|------------------------------------|------------------------------------|--------------------|
|                                    | 2005<br>% of Sales                 | 2004<br>% of Sales |
| eForce® hydration drink            | 31%                                | 9%                 |
| VitaPro® protein shake             | 12%                                | 20%                |
| Vitamins and minerals (Vitacubes®) | 39%                                | 66%                |
| sZone® snack                       | 10%                                | %                  |
| Eat-Drink-Snack System             | %                                  | %                  |
| Other- materials, apparel, etc.    | 8%                                 | 5%                 |

*Gross Profit.* Gross profit increased to \$437,478 compared to \$383,790 an increase of 14%. Gross profit as a percentage of revenue (gross margin) decreased to 56% 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 and the charges taken for obsolete inventory.

*Sales and marketing expenses.* Sales and marketing expenses increased to \$1,901,503 from \$823,923, an increase of 131%. 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 37% of net sales for the current period compared to 19% for the comparable period. We incurred \$687,522 in costs to attract experienced sales leaders, \$139,951 in training and recruiting events and \$50,358 in associated travel costs for support to our distributors. We also spent \$272,793 in the rebranding of the Company under the Eat-Drink-Snack System concept and XELR8 name, and launching the new marketing materials.

*General and administrative expenses.* General and administrative expenses were \$2,006,289 an increase of 69% compared to \$1,183,810. Our general and administrative expenses consist primarily of employee and executive compensation 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, Doug Ridley, our President on June 2, 2005 and John Pougnet, our new Chief Financial Officer on September 12, 2005. We incurred \$275,331 in costs associated with being a public company and spent \$128,275 in technology improvements. The Company also issued options to consultants for services rendered

for past or current performance with investor relations, accounting services, web development and to independent distributors which resulted in a non-cash charge of \$202,417.

*Research and development expenses.* Research and development expenses increased to \$43,733 from \$5,511 an increase of 694%. We have increased our research and development expenses to broaden our depth of our product line. In March 2005, we introduced sZone®, a chocolate-raspberry chew used as a snack between meals promoting healthy weight management. In September 2005 we introduced two new products in our Eat-Drink-Snack System , a blueberry oatmeal flavored meal replacement drink and a lemon-lime flavored energy antioxidant drink. 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 \$3,467,341 or (\$0.41) per share compared to \$2,201,537 or (\$0.36) per share. Our net loss increased by 57% 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 \$0.05 was due to a the increased loss which is partially offset by the significantly higher number of shares outstanding in 2005 compared to 2004.

#### **Liquidity and Capital Resources**

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 directors 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 left us with net proceeds of \$7.3 million.

We used cash in operating activities of \$3.5 million for the nine months ended September 30, 2005 compared to a use of cash of \$1.8 million in the first nine 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 September 30, 2005, we had \$4.3 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 \$4,704,750 at September 30, 2005.

We believe that our cash resources with the net proceeds of \$7.3 million from the public 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 September 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**

We were a defendant in a lawsuit filed in Denver, Colorado District Court in 2001, entitled Jordan Simons Plaintiff case no 01-CV-4242. On July 29, 2005, we reached a settlement with Mr. Simons for \$11,400. A motion for dismissal with prejudice was 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**

Our 2005 annual meeting of stockholders (the 2005 Annual Meeting ) was held on July 22, 2005 in Denver, Colorado. Two proposals, as described in our Proxy Statement dated June 30, 2005, were voted on at the meeting. Following is a brief description of the matters voted upon and the results of the voting:

1. Election of Directors:

| Nominee:               | Number of Shares |          |
|------------------------|------------------|----------|
|                        | FOR              | WITHHELD |
| Earnest Mathis, Jr.    | 5,513,681        | 14,400   |
| Douglas Ridley         | 5,513,681        | 14,400   |
| John B. McCandless     | 5,513,681        | 14,400   |
| Anthony DiGiandomenico | 5,513,681        | 14,400   |

2. Proposal to increase the number of shares issuable under our Stock Incentive Plan from 1,000,000 shares to 1,800,000 shares.

|           | Against | Abstain |
|-----------|---------|---------|
| For       |         |         |
| 2,729,581 | 136,861 | 1,000   |



**Item 5. OTHER INFORMATION**

None.

**Item 6. EXHIBITS**

| <b>Exhibit No</b> | <b>Description</b>  |
|-------------------|---|
| 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 November 14, 2005.

**VITACUBE SYSTEMS HOLDINGS, INC.**

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

By */s/ John D Pougnet* .  
John D Pougnet  
Chief Financial Officer (Principal Accounting Officer)