WATERS CORP /DE/
Form 10-Q
November 06, 2015
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended October 3, 2015

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 Number: 01-14010

Waters Corporation

(Exact name of registrant as specified in its charter)

Delaware	**13-3668640**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

34 Maple Street

Milford, Massachusetts 01757

(Address, including zip code, of principal executive offices)

(508) 478-2000

(Registrant s telephone number, including area code)

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

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

Indicate the number of shares outstanding of the registrant s common stock as of October 30, 2015: 81,663,790

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WATERS CORPORATION AND SUBSIDIARIES

QUARTERLY REPORT ON FORM 10-Q

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WATERS CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS, EXCEPT PER SHARE DATA)

(unaudited)

	October 3, 2015	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$ 459,518	$ 422,177
Investments	1,851,216	1,633,211
Accounts receivable, less allowances for doubtful accounts and sales returns of $6,651 and $7,179 at October 3, 2015 and December 31, 2014, respectively	416,311	433,616
Inventories	281,786	246,430
Other current assets	85,016	118,302
Total current assets	3,093,847	2,853,736
Property, plant and equipment, net	325,554	321,583
Intangible assets, net	222,806	232,371
Goodwill	352,151	354,838
Other assets	126,886	115,406
Total assets	$ 4,121,244	$ 3,877,934
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Notes payable and debt	$ 175,176	$ 225,243
Accounts payable	61,710	65,704
Accrued employee compensation	39,809	47,198
Deferred revenue and customer advances	157,992	129,706
Accrued income taxes	5,388	15,143
Accrued warranty	13,107	13,266
Other current liabilities	82,772	85,335
Total current liabilities	535,954	581,595
Long-term liabilities:		
Long-term debt	1,455,000	1,240,000
Long-term portion of retirement benefits	77,353	85,230
Long-term income tax liabilities	19,482	20,397
Other long-term liabilities	64,899	56,046
Total long-term liabilities	1,616,734	1,401,673

Total liabilities		2,152,688		1,983,268
Commitments and contingencies (Notes 6, 7 and 10)				
Stockholders equity:				
Preferred stock, par value $0.01 per share, 5,000 shares authorized, none issued at October 3, 2015 and December 31, 2014				
Common stock, par value $0.01 per share, 400,000 shares authorized, 157,252 and 156,716 shares issued, 81,654 and 83,147 shares outstanding at October 3, 2015 and December 31, 2014, respectively		1,573		1,567
Additional paid-in capital		1,451,601		1,392,494
Retained earnings		4,712,512		4,394,513
Treasury stock, at cost, 75,598 and 73,569 shares at October 3, 2015 and December 31, 2014, respectively		(4,070,314)		(3,815,203)
Accumulated other comprehensive loss		(126,816)		(78,705)
Total stockholders equity		1,968,556		1,894,666
Total liabilities and stockholders equity	$	4,121,244	$	3,877,934

The accompanying notes are an integral part of the interim consolidated financial statements.

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WATERS CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(IN THOUSANDS, EXCEPT PER SHARE DATA)

(unaudited)

	Three Months Ended	
	October 3, 2015	September 27, 2014
Product sales	$ 336,933	$ 331,165
Service sales	163,645	162,000
Total net sales	500,578	493,165
Cost of product sales	138,014	133,868
Cost of service sales	68,790	68,354
Total cost of sales	206,804	202,222
Gross profit	293,774	290,943
Selling and administrative expenses	124,655	122,226
Research and development expenses	30,703	27,279
Purchased intangibles amortization	2,573	2,725
Operating income	135,843	138,713
Interest expense	(9,017)	(9,062)
Interest income	2,736	1,762
Income from operations before income taxes	129,562	131,413
Provision for income taxes	13,281	17,916
Net income	$ 116,281	$ 113,497
Net income per basic common share	$ 1.42	$ 1.36
Weighted-average number of basic common shares	82,036	83,663
Net income per diluted common share	$ 1.40	$ 1.34
Weighted-average number of diluted common shares and equivalents	82,784	84,401

The accompanying notes are an integral part of the interim consolidated financial statements.

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WATERS CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(IN THOUSANDS, EXCEPT PER SHARE DATA)

(unaudited)

	Nine Months Ended	
	October 3, 2015	**September 27, 2014**
Product sales	$ 971,842	$ 937,225
Service sales	483,880	468,249
Total net sales	1,455,722	1,405,474
Cost of product sales	398,168	387,646
Cost of service sales	206,589	204,148
Total cost of sales	604,757	591,794
Gross profit	850,965	813,680
Selling and administrative expenses	367,066	380,791
Research and development expenses	90,209	79,002
Purchased intangibles amortization	7,547	8,018
Operating income	386,143	345,869
Interest expense	(27,038)	(24,522)
Interest income	7,576	4,920
Income from operations before income taxes	366,681	326,267
Provision for income taxes	48,682	45,939
Net income	$ 317,999	$ 280,328
Net income per basic common share	$ 3.85	$ 3.32
Weighted-average number of basic common shares	82,552	84,375
Net income per diluted common share	$ 3.82	$ 3.29
Weighted-average number of diluted common shares and equivalents	83,305	85,162

The accompanying notes are an integral part of the interim consolidated financial statements.

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WATERS CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(IN THOUSANDS)

(unaudited)

	Three Months Ended		Nine Months Ended	
	October 3, 2015	September 27, 2014	October 3, 2015	September 27, 2014
Net income	$ 116,281	$ 113,497	$ 317,999	$ 280,328
Other comprehensive loss:				
Foreign currency translation	(10,931)	(48,671)	(53,322)	(16,071)
Unrealized gains (losses) on investments before income taxes	1,814	(645)	2,397	91
Income tax (expense) benefit	(68)	42	(97)	11
Unrealized gains (losses) on investments, net of tax	1,746	(603)	2,300	102
Retirement liability adjustment before reclassifications	(511)		1,070	(931)
Amounts reclassified to selling and administrative expenses	1,478	516	3,320	1,548
Retirement liability adjustment before income taxes	967	516	4,390	617
Income tax expense	(325)	(400)	(1,479)	(603)
Retirement liability adjustment, net of tax	642	116	2,911	14
Other comprehensive loss	(8,543)	(49,158)	(48,111)	(15,955)
Comprehensive income	$ 107,738	$ 64,339	$ 269,888	$ 264,373

The accompanying notes are an integral part of the interim consolidated financial statements.

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WATERS CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)

(unaudited)

	Nine Months Ended	
	October 3, 2015	**September 27, 2014**
Cash flows from operating activities:		
Net income	$ 317,999	$ 280,328
Adjustments to reconcile net income to net cash provided by operating activities:		
Provisions for doubtful accounts on accounts receivable	766	2,051
Provisions on inventory	3,683	3,603
Stock-based compensation	24,957	24,460
Deferred income taxes	1,821	(9,151)
Depreciation	33,202	34,661
Amortization of intangibles	33,693	35,889
Building impairment		4,093
Gain on sale of building	(1,377)	
Change in operating assets and liabilities, net of acquisitions:		
Decrease in accounts receivable	6,121	23,588
Increase in inventories	(39,171)	(36,812)
Decrease (increase) in other current assets	2,183	(9,348)
Increase in other assets	(11,614)	(10,949)
Increase in accounts payable and other current liabilities	4,234	3,887
Increase in deferred revenue and customer advances	31,099	23,737
Decrease in other liabilities	(954)	(20,111)
Net cash provided by operating activities	406,642	349,926
Cash flows from investing activities:		
Additions to property, plant, equipment and software capitalization	(72,250)	(70,437)
Business acquisitions, net of cash acquired	(9,408)	(23,672)
Payments for intellectual property licenses		(1,800)
Purchases of investments	(1,467,078)	(1,731,043)
Maturities and sales of investments	1,249,073	1,504,528
Proceeds from sale of building	5,154	
Net cash used in investing activities	(294,509)	(322,424)
Cash flows from financing activities:		
Proceeds from debt issuances	285,073	336,430
Payments on debt	(120,140)	(229,770)
Payments of debt issuance costs	(2,382)	(1,400)
Proceeds from stock plans	28,948	43,287

Purchases of treasury shares		(255,111)		(261,570)
Excess tax benefit related to stock option plans		5,689		8,605
Proceeds from (payments for) debt swaps and other derivative contracts		5		(366)
Net cash used in financing activities		(57,918)		(104,784)
Effect of exchange rate changes on cash and cash equivalents		(16,874)		(6,546)
Increase (decrease) in cash and cash equivalents		37,341		(83,828)
Cash and cash equivalents at beginning of period		422,177		440,796
Cash and cash equivalents at end of period	$	459,518	$	356,968

The accompanying notes are an integral part of the interim consolidated financial statements.

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WATERS CORPORATION AND SUBSIDIARIES

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudit,000 Convertible promissory note to a company due November 15, 2010 including interest at 12% per annum; unsecured; convertible into common stock at $0.15 per share; accrued interest due monthly commencing December 1, 2008 not paid 51,450 Convertible promissory note to an individual dated October 21, 2008 and due October 21, 2009 including interest at 12% per annum; unsecured; convertible into common stock at $0.15 per share 5,000 ---------- 1,545,450 Current portion of convertible promissory notes 1,268,000 ---------- Convertible promissory notes, less current portion $ 277,450 ========== Substantially all promissory notes are with shareholders. 40 NOTE 8: INCOME TAXES HealthSport has not recorded a deferred tax benefit or expense for the years ended December 31, 2008 and 2007, as all net deferred tax assets have a full valuation allowance. Actual income tax benefit applicable to net loss before income taxes is reconciled with the "normally expected" federal income tax as follows: 2008 2007 ----------- ----------- Normally expected income tax benefit $ 3,044,100 $ 3,348,000 Increase (decrease) in taxes resulting from: State income taxes net of federal benefit 295,500 325,000 Non-deductible meals and entertainment (2,200) (8,400) Valuation allowance (3,337,400) (3,664,600) ----------- ----------- $ -- $ -- =========== =========== The net deferred taxes at December 31, 2008 and 2007 are comprised of the following: 2008 2007 ----------- ----------- Net operating loss carryforward $17,659,300 $14,321,900 Start-up cost carryforward 827,600 827,600 ----------- ----------- 18,486,900 15,149,500 Valuation allowance (18,486,900) (15,149,500) ----------- ----------- Net deferred tax asset $ -- $ -- =========== =========== HealthSport has available unused net operating loss carryforwards and capitalized start-up costs of approximately $45,950,000 which will expire in various periods from 2009 to 2028, some of which may be limited as to the amount available on an annual basis. NOTE 9: COMMON STOCK OPTIONS AND WARRANTS In April 2000, HealthSport adopted its 2000 Stock Option Plan (the "2000 Plan"), and the Company's Board of Directors approved the same. HealthSport shareholders approved the 2000 Plan in April 2001. The 2000 Plan was established to advance the interests of HealthSport and its stockholders by attracting, retaining and motivating key personnel. The Board of Directors, or a committee that it appoints, is authorized to grant options to purchase the common stock of HealthSport, not to exceed an aggregate of 15,000 shares. The Board of Directors, or a committee that it appoints, is also authorized to establish the exercise price and vesting terms of individual grants under the 2000 Plan. The 2000 Plan terminates in April 2010. 41 On October 18, 2006, HealthSport adopted its 2006 Stock Option Plan (the "2006 Plan"), and the Company's Board of Directors and shareholders approved the 2006 Plan. The 2006 Plan was also established to advance the interests of HealthSport and its stockholders by attracting, retaining and motivating key personnel. The Board of Directors, or a committee that it appoints, is authorized to grant options to purchase the common stock of HealthSport, not to exceed an aggregate of 5,000,000 shares. The Board of Directors, or a committee that it appoints, is also authorized to establish the exercise price and vesting terms of individual grants under the 2006 Plan. The 2006 Plan terminates on October 18, 2011. Options granted under the 2000 Plan or the 2006 Plan (collectively the "Plans") may be either "incentive stock options" intended to qualify as such under the Internal Revenue Code, or "non-qualified stock options." HealthSport expects that most options granted pursuant to the Plans will be subject to vesting over a three or four-year period, such as 25% increments on each annual grant date anniversary, during which the optionee must continue to be an employee of HealthSport. The Board or the committee, if applicable, may choose to impose different vesting requirements or none at all. Options outstanding under the Plans have a maximum term of up to ten years. The Plans also provide that all options that are not vested will become vested upon a change in control, unless the options are either assumed or substituted with equivalent options. In addition, unvested options become vested, after a change in control, if an optionee is subject to involuntary termination other than for cause during that optionee's remaining vesting period after a change in control. The Plan further provides that all options will be forfeited 30 days after employment terminates or six months in the case of death or

disability. A summary of stock option activity during the years ended December 31, 2008 and 2007 is as follows. 2008 2007 ---------------------------------- ---------------------------------- Weighted Weighted average Initial average Initial exercise Intrinsic exercise Intrinsic Shares price Value Shares price Value ---------- ---------- ---------- ---------- ---------- ---------- Outstanding, beginning of year 4,115,390 $ 1.60 $4,442,298 425,000 $ 1.95 $ 502,836 Granted 5,226,700 0.66 451,791 3,690,390 1.56 3,939,462 Exercised -- -- -- -- -- Forfeited/expired (2,995,000) 1.29 (1,010,695) -- -- -- ---------- ---------- ---------- ---------- Outstanding, end of year 6,347,090 $ 0.97 $3,883,394 4,115,390 $ 1.60 $4,442,298 ========== ========== ========== ========== Options exercisable at year end 5,873,761 $ 1.03 4,095,390 $ 1.59 Plan shares available for grant 14,610 1,409,610 The table above includes options for 4,985,390 shares and 3,605,390 shares from the Plans discussed above at December 31, 2008 and 2007, respectively. The outstanding options have a weighted-average remaining contract term of 2.29 years. 42 A summary of unvested stock option activity during the years ended December 31, 2008 and 2007 is as follows: 2008 2007 --------------------------------------- --------------------------------------- Weighted Weighted average Initial average Initial exercise Intrinsic exercise Intrinsic Shares price Value Shares price Value ----------- ----------- ----------- ----------- ----------- ----------- Outstanding, beginning of year 20,000 $ 2.70 $ 42,035 -- $ -- $ -- Granted 473,329 0.23 240,799 20,000 2.70 42,035 Vested (5,000) 2.70 (10,509) -- -- -- Forfeited/expired (15,000) 2.70 (31,526) -- -- -- ----------- ----------- ----------- ----------- Outstanding, end of year 473,329 $ 0.23 $ 240,799 20,000 $ 2.70 $ 42,035 =========== =========== =========== =========== As of December 31, 2008, there are warrants outstanding for 1,000,000 shares with an average exercise price of $0.35 which have vested. These options and warrants were granted to consultants and former employees and are not issued pursuant to the Plans. Data concerning all stock options at December 31, 2008 and 2007 follows: Options and Warrants Outstanding ------------------------------- Weighted- Average Number Number Remaining of of Contractual Options Exercise Price Options Life (years) Exercisable ------------- ------------- ------------- ------------- Year ended December 31, 2008 --- $0-1.10 2,896,700 3.52 2,423,371 $1.20-1.50 2,825,390 1.34 2,825,390 $1.60-2.41 625,000 0.87 625,000 Year ended December 31, 2007 --- $0-1.10 100,000 1.70 100,000 $1.36-1.50 2,980,390 2.37 2,980,390 $2.20-2.41 975,000 1.91 975,000 $2.50-2.70 60,000 3.33 40,000 43 The fair value of each option on the date of grant is estimated using the Black Scholes option valuation model. The following weighted-average assumptions were used for options granted during the year ended December 31, 2008 and 2007: 2008 2007 -------- Expected term 3-5 years 1-5 years Expected average volatility 98.61% 103.77% Expected dividend yield 0% 0% Risk-free interest rate 4.75% 4.75% Expected annual forfeiture rate 0% 0% NOTE 10: STOCKHOLDERS' EQUITY PREFERRED STOCK - The Company is authorized to issue up to 2,000,000 shares of Series A non-voting, cumulative preferred stock with a par value of $2.75. At December 31, 2008 and 2007, no preferred stock was issued or outstanding. A 6% cumulative dividend would be payable quarterly to stockholders of record on the last day of the month prior to the dividend date. The Series A preferred stock has a liquidation preference over HealthSport's common stock as well as any other classes of stock established by HealthSport. COMMON STOCK - The Company is authorized to issue up to 500,000,000 shares of common stock with a par value of $.0001. At December 31, 2008 and 2007, 49,366,120 and 42,898,397 shares were issued and outstanding, respectively. INTRINSIC VALUE OF COMMON STOCK OPTIONS - Intrinsic value of common stock options includes the computed fair value of the compensation element of common stock options for employees, consultants and directors. This cost is being amortized over the average expected exercise period. WARRANTS - The Company issued warrants to acquire 300,000 shares at $0.40 as a part of a convertible secured promissory note transaction. The exercise price was later converted to $0.15 pursuant to subsequent financing. The warrants were valued using Black Scholes and have a cash-less exercise provision. Warrants to acquire 100,000 shares were exercised, and 79,729 net shares were issued in 2008. COMMON STOCK TRANSACTIONS - 2008 o 2,276,000 shares of common stock were issued for net cash proceeds of $816,500; o 1,585,000 shares of common stock were issued for services rendered in the amount of $325,250; o 1,000,327 shares of common stock were issued for accounts payable in the amount of $243,698; o 693,334 shares of common stock were issued for a convertible note payable in the amount of $100,000 and accrued interest of $4,000; 44 o 300,000 shares of common stock were issued for preparation of operational guidelines and procedures for certain of the Company's equipment which was valued at $75,000; o 533,333 shares of common stock were issued for loan fees in the amount of $80,000; and o 79,729 shares were issued for a cash-less

warrant exercise. COMMON STOCK TRANSACTIONS - 2007 o 18,249,952 shares of common stock were issued to acquire 100% of InnoZen, which was valued at $27,374,928; o 4,951,500 shares of common stock were issued for net cash proceeds of $6,543,045; o 15,000 shares of common stock were issued for a stock subscription receivable of $22,500 which was collected in January 2008; o 115,000 shares of common stock were issued to employees and consultants as stock awards valued at $317,000; o 136,000 shares of common stock were issued for royalty agreements valued at $204,000; o 50,000 shares of common stock were issued for the Fix website and tradenames, valued at $74,000; o 49,000 shares of common stock were issued for accounts payable in the amount of $54,000. NOTE 11: RELATED PARTY TRANSACTIONS At December 31, 2008, the Company's total convertible promissory notes payable of $1,545,450 were primarily owed to non-affiliated stockholders. InnoZen repaid a loan in 2007 to a principal shareholder and affiliate in the amount of $108,285 after the acquisition of InnoZen was completed. NOTE 12: COMMITMENTS AND CONTINGENCIES The Company maintains its corporate office at 10130 Mallard Creek Road, Suite 331, Charlotte, NC 28262. The Company maintained its corporate office in the office of its accountant at no cost to the Company in 2008 and 2007. In January 2007, the Company executed a three-year lease agreement for 2,182 square feet of office space in Amherst, New York for the Enlyten office. The Company closed this office during 2008 and is attempting to sub-lease the space for the remainder of the lease term. InnoZen leases its office and current manufacturing facility in Woodland Hills, California. The lease expires on January 1, 2010 and has a one-year renewal option. InnoZen believes it has found a qualified party to assume the lease and plans to consolidate all operations in the Oxnard location. The Company leased a manufacturing facility in Oxnard, California which contains approximately 25,000 square feet. The lease term is from December 1, 2007 through January 31, 2015. The Company began manufacturing at this location in January 2009 and plans to consolidate all of InnoZen's operations by mid-year 2009. 45 Total rent expense was $338,912 and $163,300 in 2008 and 2007, respectively. Future minimum lease payments for operating leases are: 2009 - $381,000; 2010 - $199,000; 2011 - $202,000; 2012 - $206,000; 2013 - $212,000; and thereafter - $235,000. The Company has the following royalty agreements: 1. Royalty agreement for an indefinite period covering all strip products except FIX STRIPS and ENLYTEN(TM) ENERGY STRIPS of 1.0% of the first $100,000,000 in sales and 0.5% of the next $150,000,000 in sales. 2. Royalty agreement for an indefinite period of 1.0% of the first $20,000,000 in sales of the FIX STRIPS and ENLYTEN(TM) ENERGY strips and 0.5% of the next $80,000,000 in sales of the FIX STRIPS and ENLYTEN(TM) ENERGY strips. On March 11, 2008, we entered into a five-year distribution agreement with Unico Holdings, Inc. ("Unico"). Unico markets its products through numerous sales channels, including large retail merchandisers, drug store chains, grocery stores and pharmaceutical distributors. Unico's customers include most of the largest retailers and distributors in the U.S. in each of these sales channels. The agreement calls for a minimum of $22 million of product purchases over a five-year term in order for Unico to maintain its exclusive distribution right. On September 11, 2008, the Company entered into an exclusive distributor agreement with T. Lynn Mitchell Companies, LLC ("T Lynn"). Pursuant to the agreement, T Lynn, for a period of ten years, was granted the exclusive worldwide rights for the four initial products which use the Company's patent pending bi-layered strip technology. In addition, the agreement contemplates that the Company can formulate other bi-layered products which T Lynn may market in the future, subject to pricing or other constraints. The Company began sales of Antioxidant Strips, Electrolytes Plus, Energy Strips and Melatonin & Theanine Strips during the fourth quarter of 2008 which will be nationally marketed beginning in the first quarter of 2009. The Company has a license agreement and two distribution agreements which cover the majority of Asia and South and Central America. The agreements cover the Company's cough products, provide for minimum purchases and require the distributor to obtain product approval in each country before sales can commence in those countries. No sales have been made pursuant to these agreements as of December 31, 2008. In the normal course of business, the Company may become a party in a legal proceeding. The only significant matter of which the Company is aware is the Gatorade case discussed below. The Company has settled several contracts through verbal agreements and the Company believes all of these contracts have been terminated without any remaining liability to the Company. 46 NOTE 13: GOING CONCERN At December 31, 2008 and 2007, the Company had current assets of $1,799,604 and $2,411,410; current liabilities of $4,527,706 and $2,066,125; and a working capital deficit of $2,728,102 and working capital of $345,285, respectively. The Company incurred a loss of $8,953,121 during

2008, which included depreciation and amortization of $1,366,451 and amortization of non-cash stock compensation of $2,823,530. In 2007, the Company projected sales to be as high as $10 million, based on forecasts for SPORTSTRIPS, PediaStrips and FIX STRIPS. The alleged tortious interference by Gatorade in our agreement with the Buffalo Bills, other NFL teams and NFL players substantially hindered our ability to market and sell our SPORTSTRIPS product, which was our first product to market. FIX STRIPS sales did not commence until the fourth quarter and were substantially below initial forecasts from consultants. At the end of the fourth quarter of 2007, the Company changed its sales direction and reduced staff with the goal of selling product through distributors rather than making all sales directly to our customers. On March 11, 2008, we entered into a five-year distribution agreement with Unico. Unico markets its products through numerous sales channels, including large retail merchandisers, drug store chains, grocery stores and pharmaceutical distributors. Unico's customers include most of the largest retailers and distributors in the U.S. in each of these sales channels. The agreement calls for a minimum of $22 million of product purchases over a five-year term in order for Unico to maintain its exclusive distribution right. The Unico distribution agreement is initially for PEDIASTRIPS and commenced during the third quarter of 2008. We are attempting to establish similar arrangements for our SPORTSTRIPS and other products. The Company has established other film strip products for a number of products which were previously only delivered in a different manner, such as liquids and pills. The Company expects this to develop into a large part of its business in the future. On September 11, 2008, the Company entered into an exclusive distributor agreement with T. Lynn Mitchell Companies, LLC ("T Lynn"). Pursuant to the agreement, T Lynn, for a period of ten years, was granted the exclusive worldwide rights for the four initial products which use the Company's patent pending bi-layered strip technology. In addition, the agreement contemplates that the Company can formulate other bi-layered products which T Lynn may market in the future, subject to pricing or other constraints. The Company began sales of Energy Strips, Antioxidant Strips, Electrolytes Plus and Melatonin & Theanine Strips during the fourth quarter of 2008 and has several other products which are expected to begin shipping in 2009. The Company will continue to require substantial working capital until sales develop to the level required to support operations. The current level of overhead is approximately $175,000 per month and manufacturing costs total approximately $240,000 per month. The Company is continually analyzing its current costs and is attempting to make additional cost reductions where possible. Sales amounted to approximately $1,600,000 during the first quarter of 2009. This sales level represents a substantial improvement from prior periods but will require additional increases to support the current level of operations. We estimate that sales will develop to the level necessary to be at or near cash flow break-even by the beginning of the third quarter of 2009. Based on this time-frame, the Company would need from $500,000 to $1,500,000 to meet its minimum requirements, including operating cash short-falls and completing a globally compliant manufacturing plant. The Company expects to continue to make private placements of its common stock or to borrow additional funds as needed. These conditions raise substantial doubt about the Company's ability to continue as a going concern. The consolidated financial statements do not include any adjustments that may result from the outcome of these uncertainties. 47 ITEM 9: CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE None. ITEM 9A(T): CONTROLS AND PROCEDURES EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES -- We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) that are designed to provide reasonable assurance that the information required to be disclosed by us in reports filed under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Annual Report. Based on that evaluation, our Chief Executive Officer concluded that our disclosure controls and procedures as of December 31, 2008 were effective. MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING --- The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting and for the assessment of the effectiveness of internal control over financial reporting. Internal control over financial reporting is defined in

Rule 13a-15(f) or 15d-15(f) promulgated under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and effected by the Company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company's internal control over financial reporting is supported by written policies and procedures that: (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the Company's assets; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles and that receipts and expenditures of the Company are being made only in accordance with authorizations of the Company's management and directors; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements. The Company's internal control system was designed to provide reasonable assurance to the Company's management and board of directors regarding the preparation and fair presentation of published financial statements. All internal control systems, no matter how well designed, have inherent limitations which may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. 48 Management conducted an evaluation of the effectiveness of the Company's internal control over financial reporting as of December 31, 2008. In making this assessment, management used the framework set forth in the report entitled "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission, or ("COSO"). The COSO framework summarizes each of the components of a company's internal control system, including (i) the control environment, (ii) risk assessment, (iii) control activities, (iv) information and communication, and (v) monitoring. The matters involving internal controls and procedures that our management considered to be material weaknesses under the standards of the Public Company Accounting Oversight Board were: (1) lack of a functioning audit committee due to a lack of a majority of independent members and a lack of a majority of outside directors on our board of directors, resulting in ineffective oversight in the establishment and monitoring of required internal controls and procedures; (2) the Company has not maintained perpetual inventory records at its subsidiary location in California and has not maintained adequate control of inventory stored off-site at a third-party warehouse and (3) inadequate segregation of duties consistent with control objectives. The aforementioned material weaknesses were identified by our Chief Executive Officer in connection with the review of our financial statements as of December 31, 2008. Management believes the second material weakness did not have more than a nominal effect on our financial results due to the complete count of the inventory on hand at December 31, 2008 and the pricing of the extended inventory. These are the procedures normally used to test perpetual inventory records. Accordingly, the inventory is accurate at December 31, 2008, although there exists a degree of risk that interim inventory results may have been inaccurate. In addition, the aforementioned procedure, while accurate causes delays in obtaining the current information. Management believes that the third material weakness did not have an effect on our financial results due primarily to using a third-party to review its financial information and prepare its financial statements in addition to the audit performed by the auditor. However, management believes that the lack of a functioning audit committee and the lack of a majority of outside directors on our board of directors results in ineffective oversight in the establishment and monitoring of required internal controls and procedures, which could result in a material misstatement in our financial statements in future periods. This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permits us to provide only management's report in this annual report. MANAGEMENT'S REMEDIATION INITIATIVES ---------------------------------- In an effort to remediate the identified material weaknesses and other deficiencies and enhance our internal controls, we have initiated, or plan to initiate, the following measures: We are implementing a fully functioning

perpetual inventory system for our inventory in California, which is expected to be operating in the second quarter of 2009. 49 Management believes that the appointment of two or more outside directors, who shall be appointed to the audit committee, will remedy the lack of a functioning audit committee and a lack of a majority of outside directors on our Board. We expect to expand our board of directors during 2009. CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING -- There was no change in our internal controls over financial reporting that occurred during the period covered by this report, that has materially affected, or is reasonable likely to materially affect, our internal controls over financial reporting. ITEM 9B: OTHER INFORMATION Pursuant to General Instruction B of Form 8-K, any reports previously or in the future submitted under Item 2.02 (Results of Operations and Financial Condition) are not deemed to be "filed" for the purpose of Section 18 of the Securities Exchange Act of 1934 and the Company is not subject to the liabilities of that section, unless the Company specifically states that the information is to be considered "filed" under the Exchange Act or incorporates it by reference into a filing under the Securities Act or Exchange Act. If a report on Form 8-K contains disclosures under Item 2.02, whether or not the report contains disclosures regarding other items, all exhibits to such report relating to Item 2.02 will be deemed furnished, and not filed, unless the registrant specifies, under Item 9.01 (Financial Statements and Exhibits), which exhibits, or portions of exhibits, are intended to be deemed filed rather than furnished pursuant to this instruction. The Company is not incorporating, and will not incorporate, by reference these reports into a filing under the Securities Act of 1933, as amended, or the Exchange Act of 1934, as amended. 50 PART III ITEM 10: DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE EXECUTIVE OFFICERS AND DIRECTORS The following section sets forth as of December 31, 2008, the names, ages and current positions with the Company held by the Directors, Executive Officers and Significant Employees; together with the year such positions were assumed. There is no immediate family relationship between or among any of the Directors, Executive Officers or Significant Employees, and we are not aware of any arrangement or understanding between any Director or Executive Officer and any other person pursuant to which he was elected to his current position. Each Executive Officer will serve until he or she resigns or is removed or otherwise disqualified to serve, or until his or her successor is elected and qualified. We currently have four Directors. Name Age Position and Term ---- --- ----------------- Hank Durschlag 45 Director since September 11, 2006; acting CEO from December 11, 2007 until March 1, 2008; CEO and President since August 15, 2008; Acting CFO since December 11, 2007 Daniel J. Kelly 47 CEO and President starting January 1, 2007; became a Director on May 2, 2007; resigned as CEO on December 11, 2007 and as President on March 1, 2008 Robert S. Davidson 42 Director since May 4, 2007; CEO of InnoZen, Inc. Matthew Burns 39 Director since May 4, 2007; COO of HealthSport from May 4, 2007 until May 2008 Thomas A. Beckett 41 Chief Operating Officer of InnoZen, Inc. since May 2008 and manufacturing manager from January 2007 until May 2008 Mark Udell 32 Controller of InnoZen, Inc. since October 16, 2007 51 HANK DURSCHLAG - Was appointed a Director of the Company on September 11, 2006; was acting CEO from December 11, 2007 until March 1, 2008; became CEO and President on August 15, 2008; and has been Acting CFO since December 11, 2007. Mr. Durschlag is the co-developer of the electrolyte sports strips and co-authored the patent, "Edible Film for Transmucosal Delivery of Nutritional Supplements". Mr. Durschlag has extensive experience in the fields of healthcare and sports medicine, with specific emphasis on novel drug delivery systems. In addition, Mr. Durschlag is a partner in Greenville, South Carolina based GlucoTec, Inc., a developer and manufacturer of an FDA Class II Medical Device designed to regulate blood glucose levels in an acute care setting via both intravenous and subcutaneous delivery of insulin and other fluids. Mr. Durschlag has also co-authored patents in this area. Previously, Mr. Durschlag served as Vice President of Sales and Marketing for Diabetes Management Services, Inc., a durable medical equipment distributor with specific treatment modules in women's health and pregnancy. Mr. Durschlag holds a bachelors degree from California University of Pennsylvania and an MBA from Clemson University. Mr. Durschlag is also CEO and a director of Double Eagle Holdings, Ltd. (DEGH.OB). DANIEL J. KELLY - Became CEO and President on January 1, 2007. Mr. Kelly resigned as Acting CEO on December 11, 2007 and resigned as President on March 1, 2008. Mr. Kelly began his business career approximately 20 years ago managing and advising Jim Kelly, his brother and Pro Football Hall of Fame Quarterback. Mr. Kelly also owns and serves as the President of Jim Kelly Enterprises, Inc., a company started over 15 years ago. In 1988,

Mr. Kelly negotiated the most lucrative player contract in NFL history (at that time) for Jim. Mr. Kelly has 20 years experience in marketing, promotions and celebrity endorsements and continues to work with such companies as Coors, Miller Lite, LA Weightloss and Ameriquest. Mr. Kelly received his bachelor's degree from the University of Houston and was a prominent member of the NFL Quarterback Club, serving on the Sponsorship and Marketing Committees that negotiated comprehensive, multi-year deals with major US companies such as McDonalds, VISA, Footlocker and MBNA Bank. He is the vice chairman of the Kelly for Kids Foundation. ROBERT STEVEN DAVIDSON - Mr. Davidson has been the Company's Chairman of the Board since May 4, 2007. Since May 2002, Mr. Davidson has also served as the President, Chief Executive Officer and a director of InnoZen. From January 2002 through July 2005, Mr. Davidson was President and Chief Executive Officer of Zengen, Inc. Mr. Davidson has approximately ten years of experience in the biopharmaceutical industry. From September 1998 to December 2001, Mr. Davidson was the chief executive officer of Gel Tech, L.L.C., where he raised capital for the market launch and distribution of the Zicam product line. He led the marketing team that took Zicam from an unknown entity to one of the top medications in its class. He also implemented and launched line extensions to strengthen the brand name and increase company value. From October 1994 to August 1998, Mr. Davidson was the chief executive officer of Biotem Cytotechnologies, Inc., a biopharmaceutical research and development company. Mr. Davidson received his B.S. degree with a concentration in Biological Life Sciences from The University of the State of New York, (Excelsior College). He has a Masters Certificate in Applied Project Management from Villanova University and received his Masters of Public Health (Homeland Security) from American Military University, Virginia. Mr. Davidson is a certified Performance Enhancement Specialist through the National Academy of Sports Medicine. 52 MATTHEW BURNS - Mr. Burns has served as the Chief Operating Officer and a Director of the Company since May 4, 2007 and was Chief Operating Officer of the Company until he left on April 30, 2008 to pursue other business interests. Mr. Burns has also been an officer and director of InnoZen since April 2004. Prior to joining InnoZen and its parent Zengen, from July 2001 to February 2002, Mr. Burns was an associate attorney at Morgan Lewis & Bockius, LLP, where he worked in the firm's business and finance practice group in the Los Angeles office. Prior to joining Morgan Lewis, Mr. Burns worked as an associate attorney in the corporate finance group at Morrison & Foerster's San Francisco office. Prior to joining Morrison & Foerster, Mr. Burns worked as an associate attorney in the corporate practice at Holland & Knight in Tampa, Florida. His law practice concentrated on mergers and acquisitions and corporate finance for companies in a variety of industries, including life sciences and technology. Mr. Burns has also provided counsel to public and private companies on general corporate law, corporate governance and securities matters. Mr. Burns received his J.D. from Stetson University of College of Law in 1995 and his B.A. in Finance from the University of South Florida in 1992. THOMAS A. BECKETT - Mr. Beckett is the Chief Operating Officer of InnoZen which includes the Company's R&D and manufacturing operations. He has been with InnoZen since 2003, as a consultant until January 1, 2007, and has served in a variety of operational roles. Prior to his work at InnoZen, Mr. Beckett had careers in both law and business. He was an attorney for the Atlanta based law firm of King & Spalding, and before this, practiced at Holland & Knight in Tampa, Florida. Mr. Beckett also worked in the Los Angeles area as a producer and actor, working on a variety of projects in film and TV. Mr. Beckett began his career in business as a commercial banking officer with First Union National Bank. Mr. Beckett received a B.A. degree from the University of Virginia and a law degree (J.D.) from the University of Florida College of Law. MARK UDELL - is a Certified Public Accountant who has served as InnoZen's controller since October 2007. Prior to joining InnoZen, Mr. Udell was an accounting manager at Green Hasson & Jenks, LLP in Los Angeles, California, where he worked in the firm's auditing practice group for over six years. Mr. Udell became a CPA in 2001 and received his B.A. in Business Economics with concentration in accounting from the University of California, Santa Barbara in 1999. AUDIT COMMITTEE The Board of Directors currently serves as the audit committee since there are currently no independent directors. COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT Section 16(a) of the Securities Exchange Act of 1934, as amended, requires the Company's executive officers, directors and persons who own more than ten percent of the Company's common stock to file initial reports of ownership and changes in ownership with the SEC. Additionally, SEC regulations require that the Company identify any individuals for whom one of the referenced reports was not filed on a timely basis during the most recent fiscal year or prior fiscal years. To the Company's knowledge,

based solely on a review of reports furnished to it, the Directors all timely filed Form 5s in February 2009 to report Form 4 obligations which were not timely filed in 2008. 53 CODE OF ETHICS The Company expects to include the adoption of a code of ethics on its agenda during 2009 upon expanding its board of directors. NOMINATING COMMITTEE The Company does not currently have a standing nominating committee or committee performing similar functions. The full Board of Directors participates in the consideration of director nominees. ITEM 11: EXECUTIVE COMPENSATION The Compensation Committee of the Board of Directors deliberates executive compensation matters to the extent they are not delegated to the Chief Executive Officer. The following table shows the compensation of the Company's Chief Executive Officer and each executive officer whose total cash compensation exceeded $100,000 for the three years ended December 31, 2008. 54 SUMMARY COMPENSATION TABLE -- Stock Option All other Name and principal Salary awards awards compensation Total position Year ($) ($) ($)(a) ($) ($) -- M.E. "Hank" Durschlag (d) 2008 $100,000 $ - $ 648 $ 1,168 $ 101,816 (Interim CEO from 12/11/07 to 2007 $100,000 $ - $ - $ 2,810 $ 102,810 3/1/08; Acting CFO since 2006 72,000 - - - 72,000 12/11/07; CEO since 8/15/08) Daniel J. Kelly (CEO 2008 $115,625 $ - $289,449 $ - $ 405,074 from January 1, 2007 until 2007 $203,646 $ 27,500 $289,200 $ - $ 520,346 December 11, 2007)(b) 2006 N/A $ 5,500 $ 5,910 $ 32,500 $ 43,910 Robert S. Davidson (CEO of 2008 $203,000 $ - $166,623 $ - $ 369,623 InnoZen from May 4, 2007) (c) 2007 $120,250 $ - $110,650 $ - $ 230,900 2006 N/A N/A N/A N/A N/A Matthew Burns (COO of 2008 $ 49,333 $ - $165,975 $ - $ 215,308 HealthSport from May 4 2007 $120,250 $ - $110,650 $ - $ 230,900 2007 until April 30, 2008) (c) 2006 N/A N/A N/A N/A N/A Robert Kusher (CEO from 2008 $ 30,000 $ - $201,155 $ - $ 231,155 March 1, 2008 until August 31, 2007 N/A N/A N/A N/A N/A 2008) (e) 2006 N/A N/A N/A N/A N/A Thomas A. Beckett (COO of 2008 $134,417 $ - $ 30,648 $ - $ 165,065 InnoZen since May 2008) 2007 $ 90,790 $ - $ 20,000 $ - $ 110,790 2006 N/A N/A N/A N/A N/A Mark Udell (Controller of InnoZen 2008 $100,000 $ - $ 42,990 $ - $ 142,990 since October 2007) 2007 $ 25,833 N/A $ 8,534 N/A $ 34,367 2006 N/A N/A N/A N/A N/A (a) The option award represents the amortization of the options granted to the named individuals. (b) In 2007 and 2006, the amount for the stock award represents the amortization of Mr. Kelly's 10% share of the stock granted to Jim Kelly for his appearance fees. All other compensation in 2006 represents the amount paid to Jim Kelly Enterprises, Inc. Mr. Kelly is owner and President of Jim Kelly Enterprises, Inc. and was acting as a consultant to the Company during 2006. At December 31, 2008 and 2007, Mr. Kelly had $10,000 and $8,854, respectively, in accrued salary not included in the table above. (c) At December 31, 2007, Mr. Davidson and Mr. Burns each had $3,083 in accrued salary not included in the table above. (d) Mr. Durschlag earned $1,168 and $2,810 in royalties on sales of the Enlyten products in 2008 and 2007, respectively. (e) At December 31, 2008, Mr. Kusher had $86,120 in accrued salary not included in the table above. 55 Columns for bonus, non-equity incentive plan compensation and nonqualified deferred compensation earnings have been omitted from the table above as all amounts are zero. NARRATIVE DISCLOSURE TO SUMMARY COMPENSATION TABLE Compensation levels and amounts are determined by the Board of Directors based on amounts paid to executives in similar sized companies with similar responsibilities. Stock options are valued utilizing the Black-Scholes valuation method. M.E. "Hank" Durschlag became Interim CEO and Acting CFO on December 11, 2007. Mr. Durschlag was Interim CEO until March 1, 2008, when Mr. Kusher assumed the duty and then became CEO and President on August 15, 2008, when Mr. Kusher left the Company. Mr. Durschlag's compensation of $100,000 per annum did not change when he assumed the temporary positions, while he assisted the Company in finding a full-time CEO. On November 4, 2008, Mr. Durschlag received an option which is currently exercisable for 250,000 shares of the Company's common stock, exercisable at $0.23. Mr. Kelly became President and Chief Executive Officer of the Company on January 1, 2007. Mr. Kelly's compensation for 2007 was $212,500 and he received $1,000 per month insurance reimbursement until health insurance was available for employees. Mr. Kelly's compensation increased to $262,500 in 2008. In addition, Mr. Kelly was granted a stock option for 400,000 shares exercisable at $2.25 per share in January 2007, which expires in three years. On November 4, 2008, Mr. Kelly received an option which is currently exercisable for 100,000 shares of the Company's common stock, exercisable at $0.23. Mr. Kusher became Chief Executive Officer of the Company on March 1, 2008. Mr. Kusher's compensation was scheduled to be $240,000 per year for two years with benefits to include health insurance, four weeks

vacation and reimbursement of all reasonable out-of-pocket expenses. Mr. Kusher was to be awarded 500,000 shares of our common stock that would vest when we obtained $750,000 in debt or equity financing for the Company. Mr. Kusher was granted an option to purchase 1,000,000 shares of our common stock at an exercise price of $1.00 per share which was exercisable on March 1, 2009 and an option to purchase 1,000,000 shares of our common stock at an exercise price of $1.50 per share which was exercisable on March 1, 2010. The options did not vest since Mr. Kusher left the Company on August 15, 2008, when it was determined he would be unable to secure the new equity or debt financing needed by the Company to continue its operations. Mr. Beckett has an agreement which provides for annual compensation of $138,000 and other normal benefits. Mr. Udell's annual compensation is $100,000. 56 GRANTS OF PLAN BASED AWARDS TABLE AS OF DECEMBER 31, 2008 --- All other stock awards: All other option awards: Exercise or Grant date fair number of shares number of securities Base price of value of stock and Name/Date of stock or units (#) underlying options (#) Option awards option awards -- M.E. Durschlag -- 250,000 $ 0.23 $ 19,425 November 4, 2008 Robert S. Davidson -- 250,000 $ 0.23 $ 19,425 November 4, 2008 Robert S. Davidson's wife -- 50,000 $ 0.23 $ 3,885 November 4, 2008 Dan Kelly -- 100,000 $ 0.23 $ 7,770 November 4, 2008 Thomas A. Beckett -- 250,000 $ 0.23 $ 19,425 November 4, 2008 Mark Udell -- 150,000 $ 0.23 $ 11,655 Other required columns: estimated future payouts under non-equity incentive plan awards and estimated future payouts under equity incentive plan awards are omitted from the table as they are all zero. NARRATIVE DISCLOSURE TO GRANTS OF PLAN BASED AWARDS TABLE The Board of Directors awarded options to the active board members and to the majority of the Company's employees. OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END TABLE -- Number of securities underlying unexercised options (#) Option Option ------------------------------ exercise expiration Name Exercisable Unexercisable price ($) date -- Daniel J. Kelly 100,000 -- $ 1.10 September 12, 2009 Daniel J. Kelly 400,000 -- $ 2.25 January 1, 2010 Daniel J. Kelly 100,000 -- $ 0.23 November 4, 2013 Robert S. Davidson 495,000 -- $ 1.36 May 4, 2010 Robert S. Davidson 250,000 -- $ 0.23 November 4, 2013 Robert S. Davidson's wife 50,000 -- $ 1.36 May 4, 2010 Robert S. Davidson's wife 16,666 33,334 $ 0.23 November 4, 2013 M.E. Durschlag 250,000 -- $ 0.23 November 4, 2013 Matthew Burns 495,000 -- $ 1.36 May 4, 2010 Thomas A. Beckett 90,000 -- $ 1.36 May 4, 2010 Thomas A. Beckett 250,000 -- $ 0.23 November 4, 2013 Mark Udell 50,000 100,000 $ 0.23 November 4, 2013 The columns for option awards - equity incentive plan awards: number of securities underlying unexercised unearned options and all four stock award columns are omitted from the table as these amounts were zero. 57 ADDITIONAL NARRATIVE DISCLOSURE Mr. Kelly's option for 100,000 shares was granted while he was a consultant and before he became President and CEO on January 1, 2007. Mr. Kelly's second option for 400,000 shares was granted when he became President and CEO. Mr. Davidson and Mr. Burns received options on May 4, 2007 to replace options they had at InnoZen. On November 4, 2008, the Board of Directors granted options to themselves and the majority of the employees of the Company as detailed above. Options exercised and stock vested table, pension benefits table and nonqualified deferred compensation table and all omitted as there would have been no information to include. COMPENSATION OF DIRECTORS TABLE - ADDITIONAL NARRATIVE DISCLOSURE Directors did not receive any additional compensation for the meetings they attended in 2008. It is anticipated that a formal plan for compensation of Directors will be instituted when outside Directors are added. ITEM 12: SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS There are no known persons who, as of February 28, 2009, the most recent practicable date, are known by us to own beneficially more than 5% of any class of our outstanding voting securities. SECURITY OWNERSHIP OF MANAGEMENT The following table indicates the beneficial ownership of the Company's voting securities of all Directors of the Company and all Executive Officers who are not Directors of the Company, and all officers and directors as a group, as of February 28, 2009, the most recent practicable date. As of February 28, 2009, there were 49,859,082 shares of the Company's common stock outstanding. Except as otherwise indicated below, to the best of the Company's knowledge, each person named in the table has sole voting and investment power with respect to the securities beneficially owned by them as set forth opposite their name. All options are currently exercisable, unless otherwise indicated. 58 Name and Address of Amount and Nature of % of Title of Class Beneficial Owner Beneficial Owner Class -------------- --------------- --------------- ----- Common M.E. "Hank" Durschlag a 825,000 1.65% 5403 McChesney Dr. Charlotte, NC 28269 Common Robert S. Davidson b 1,422,142 2.81% 6429 Independence Ave Woodland Hills, CA 91367 Common Daniel J. Kelly c 732,050 1.45% 495 Commerce Drive, Suite 1 Amherst, New York Common Matthew Burns d 841,711 1.67% 6429 Independence Ave Woodland Hills, CA 91367 Common Thomas A. Beckett e 347,960 0.69% 6429 Independence Ave Woodland Hills, CA 91367 Common Mark Udell f 50,000 0.10% 6429 Independence Ave Woodland Hills, CA 91367 Common All current officers and directors as a Group (6 persons) 4,218,863 8.05% a. Includes option granted November 4, 2008 for 250,000 shares exercisable at $0.23 per share for five years. b. Includes 461,831 shares owned jointly by Mr. Davidson and his wife; includes 9,456 shares owned by Mr. Davidson's wife; includes three-year option granted May 4, 2007, to replace InnoZen option, to acquire 495,000 shares at $1.36 per share held by Mr. Davidson; includes five-year option granted November 4, 2008 for 250,000 shares exercisable at $0.23 per share held by Mr. Davidson; includes three-year option granted May 4, 2007, to replace InnoZen option, to acquire 50,000 shares at $1.36 per share held by Mr. Davidson's wife; and includes five-year option granted November 4, 2008 to acquire 16,666 shares exercisable at $0.23 per share held by Mr. Davidson's wife. Does not include options granted November 4, 2008 to Mr. Davidson's wife for 16,667 shares exercisable November 4, 2009 and 16,667 shares exercisable November 4, 2010. c. Includes option granted in September 2006 for 100,000 shares exercisable at $1.10 per share; option granted January 1, 2007 for 400,000 shares exercisable at $2.25 per share; and option granted November 4, 2008 for 100,000 shares exercisable at $0.23 for five years. d. Includes three-year option for 495,000 shares, exercisable at $1.36 per share; granted May 4, 2007 to replace InnoZen options. e. Includes three-year option granted May 4, 2007, to replace InnoZen option, to acquire 90,000 shares at $1.36 per share held by Mr. Beckett; and includes five-year option granted November 4, 2008 for 250,000 shares exercisable at $0.23 per share. f. Includes five-year option granted November 4, 2008 for 150,000 shares exercisable at $0.23 per share. At December 31, 2008, 50,000 shares are exercisable, 50,000 shares become exercisable November 4, 2009 and the remaining 50,000 shares become exercisable on November 4, 2010. 59 EQUITY COMPENSATION PLANS Approved by Not approved by Security Holders Security Holders Total --------------- --------------- ----- Number of securities to be issued upon exercise of outstanding options, warrants and rights 4,985,390 -- 4,985,390 Weighted-average exercise price of outstanding options, warrants and rights $ 1.11 $ -- $ 1.11 Number of securities remaining available for future issuance under equity compensation plans (excluding securities above) 14,610 -- 14,610 ITEM 13: CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE At December 31, 2008, the Company's total convertible promissory notes payable of $1,545,450 was primarily owed to non-affiliated stockholders. InnoZen repaid a loan to a principal shareholder and affiliate in the amount of $108,285 after it was acquired by HealthSport in 2007. ITEM 14: PRINCIPAL ACCOUNTANT FEES AND SERVICES Audit Fees - The aggregate fees billed as of April 3, 2009 for professional services rendered by the Company's accountant was $52,200 and $81,950 for the audit of the Company's annual financial statements and quarterly reviews for the fiscal years ended December 31, 2008 and 2007, respectively. Audit-Related Fees - None. Tax Fees - None for 2008 or 2007. All Other Fees - Other than the services described above, no other fees were billed for services rendered by the principal accountant during fiscal 2008 or fiscal 2007. Audit Committee Policies and Procedures - The Board of Directors pre-approves audit and review services. If greater than 50 percent, disclose the percentage of hours expended on the principal accountant's engagement to audit the registrant's financial statements for the most recent fiscal year that were attributed to work performed by persons other than the principal accountant's full-time, permanent employees - Not applicable. 60 PART IV ITEM 15: EXHIBITS AND FINANCIAL STATEMENT SCHEDULES (a) The following documents are filed as part of this report: 1. Financial Statements - The following consolidated financial statements of HealthSport, Inc. and Subsidiaries are contained in Item 8 of this Form 10-K: o Report of Independent Registered Public Accountant o Consolidated Balance Sheets at December 31, 2008 and 2007 o Consolidated Statements of Operations - For the years ended December 31, 2008 and 2007 o Consolidated Statements of Stockholders' Equity - For the years ended December 31, 2008 and 2007 o Statements of Cash Flows - For the years ended December 31, 2008 and

2007 o Notes to the Consolidated Financial Statements 2. Financial Statement Schedules were omitted, as they are not required or are not applicable, or the required information is included in the Financial Statements. 3. Exhibits - The following exhibits are filed with this report or are incorporated herein by reference to a prior filing, in accordance with Rule 12b-32 under the Securities Exchange Act of 1934. EXHIBIT DESCRIPTION ------- ----------- 31.1 Certification of the Chief Executive Officer pursuant to Rule 13a-14 of the Securities Exchange Act of 1934 32.1 Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350 61 SIGNATURES In accordance with the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized. HEALTHSPORT, INC. April 22, 2009 /S/ M.E. "HANK" DURSCHLAG --- M.E. "Hank" Durschlag, President, CEO and Acting CFO (Principal executive and accounting officer) In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated. April 22, 2009 /S/ ROBERT S. DAVIDSON ------------------------------------ Robert S. Davidson, Director April 22, 2009 /S/ M.E. "HANK" DURSCHLAG ------------------------------------ M.E. "Hank" Durschlag, Director, President, CEO and Acting CFO April 22, 2009 /S/ DANIEL J. KELLY ------------------------------------ Daniel J. Kelly, Director April 22, 2009 ------------------------------------ Matthew Burns, Director 62