

CAPSALUS CORP  
Form 10-Q  
November 21, 2011

SECURITIES AND EXCHANGE COMMISSION  
Washington D.C. 20549

FORM 10-Q

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

For the Quarterly period ended September 30, 2011

- 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: 333-146744

CAPSALUS CORP.

(Exact name of small business issuer as specified in its charter)

Nevada  
(State or other jurisdiction of  
Incorporation or organization)

88-0338837  
(I.R.S. Employer Identification No.)

618 S. Northwest Highway #139, Barrington, IL 60010  
(Address of principal executive offices)

(888) 400-7179  
(Issuer's telephone number)

Capsalus Corp. , 2675 PACES FERRY ROAD, SUITE 100, ATLANTA, GA 30339

(Former name, former address and former fiscal year, if applicable)

Check whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

|                         |                          |                           |                                     |
|-------------------------|--------------------------|---------------------------|-------------------------------------|
| Large accelerated filer | <input type="checkbox"/> | Accelerated filer         | <input type="checkbox"/>            |
| Non-accelerated filer   | <input type="checkbox"/> | Smaller reporting company | <input checked="" type="checkbox"/> |

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

As of November 17, 2011, 424,978,781 shares of common stock were outstanding.

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## CAPSALUS CORP.

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CAPSALUS CORP.  
CONSOLIDATED BALANCE SHEETS (Unaudited)

| ASSETS  | September 30,<br>2011 | December 31,<br>2010 |
|---|-----------------------|----------------------|
| <b>CURRENT ASSETS</b>   |                       |                      |
| Cash  | \$ 4,040              | \$ 36,662            |
| Current assets of discontinued operations   | 9,879                 | 65,983               |
| Other current assets  | -                     | 54,064               |
| <b>Total Current Assets</b>   | <b>13,919</b>         | <b>156,709</b>       |
| Property and equipment, net   | 15,098                | 23,585               |
| Goodwill  | 2,014,752             | 2,014,752            |
| Intangible assets, net  | 1,953,700             | 1,743,700            |
| Investments   | 607,500               | 590,000              |
| <b>TOTAL ASSETS</b>   | <b>\$ 4,604,969</b>   | <b>\$ 4,528,746</b>  |
| <b>CURRENT LIABILITIES</b>  |                       |                      |
| Accounts payable  | \$ 569,559            | \$ 287,663           |
| Accrued compensation  | 286,891               | 186,888              |
| Accrued interest  | 388,352               | 180,697              |
| Preferred unit subscription payable   | -                     | 200,000              |
| Current liabilities of discontinued operations  | 736,140               | 776,245              |
| Embedded derivatives and share liability  | 206,680               | -                    |
| Short-term notes payable and other debt   | 2,466,379             | 1,651,986            |
| Current portion of long-term debt obligations   | 425,000               | 80,000               |
| <b>Total Current Liabilities</b>  | <b>5,079,001</b>      | <b>3,363,479</b>     |
| Liabilities for warrants to purchase common stock   | 150,889               | -                    |
| Long-term debt obligations, net of current portion  | 1,540,886             | 1,452,690            |
| <b>STOCKHOLDERS' DEFICIT</b>  |                       |                      |
| Common stock, \$.001 par value, 500,000,000 shares authorized,<br>424,628,781 and<br>388,620,388 shares issued and outstanding at September 30, 2011<br>and December 31, 2010, respectively | 424,629               | 388,620              |
| Treasury stock  | (105,000)             | (105,000)            |
| Additional paid-in capital  | 30,277,811            | 30,093,091           |
| Accumulated deficit   | (32,763,247)          | (30,664,134)         |
| <b>Total Stockholders' Deficit</b>  | <b>(2,165,807)</b>    | <b>(287,423)</b>     |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT</b>  | <b>\$ 4,604,969</b>   | <b>\$ 4,528,746</b>  |

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

CAPSALUS CORP.  
CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

|  | Three months ended September 30, |                | Nine months ended September 30, |                |
|--|----------------------------------|----------------|---------------------------------|----------------|
|  | 2011                             | 2010           | 2011                            | 2010           |
| Sales, net   | \$ -                             | \$ -           | \$ -                            | \$ -           |
| Operating expenses   | 607,200                          | 516,952        | 1,955,287                       | 1,377,347      |
| Loss from continuing operations  | (607,200)                        | (516,952)      | (1,955,287)                     | (1,377,347)    |
| Other income (expense):  |                                  |                |                                 |                |
| Realized loss on sale of marketable securities   | -                                | -              | -                               | (12,844)       |
| Gain on warrants, derivatives and share liability  | 690,807                          | -              | 690,807                         | -              |
| Interest expense   | (368,744)                        | (1,039,654)    | (828,787)                       | (1,395,150)    |
| Total other income (expense)   | 322,063                          | (1,039,654)    | (137,980)                       | (1,407,994)    |
| Loss from continuing operations before provision for income taxes                                      | (285,137)                        | (1,556,606)    | (2,093,267)                     | (2,785,341)    |
| Income tax provision   | -                                | -              | -                               | -              |
| Net loss from continuing operations  | (285,137)                        | (1,556,606)    | (2,093,267)                     | (2,785,341)    |
| Net income (loss) from discontinued operations, net of income tax benefit of \$0 and \$0, respectively | (2,331)                          | 191,476        | (5,846)                         | (1,215,941)    |
| Net loss   | \$ (287,468)                     | \$ (1,365,130) | \$ (2,099,113)                  | \$ (4,001,282) |
| Net loss from continuing operations per common share (basic and diluted)                               | \$ -                             | \$ -           | \$ (0.01)                       | \$ (0.01)      |
| Net loss from discontinued operations per common share (basic and diluted)                             | \$ -                             | \$ -           | \$ -                            | \$ -           |
| Net loss per common share (basic and diluted)  | \$ -                             | \$ -           | \$ (0.01)                       | \$ (0.01)      |
| Weighted average shares outstanding:   |                                  |                |                                 |                |
| Basic and diluted  | 414,009,216                      | 383,364,985    | 406,852,859                     | 297,090,592    |

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

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|   |             |                |
|---|-------------|----------------|
| Net cash used in operating activities                           | -           | (36,913)       |
| Net cash provided by investing activities                       | -           | 31,000         |
| Net cash provided by (used in) financing activities             | 13,153      | (50,118)       |
| Net cash provided by (used in) discontinued operations          | \$ 13,153   | \$ (56,031)    |
| Net increase (decrease) in cash                                 | \$ (32,622) | \$ 523,876     |
| Cash, beginning of period                                       | 36,662      | 60,144         |
| Cash, end of period   | \$ 4,040    | \$ 584,020     |
| Supplemental cash and non-cash flow information                 |             |                |
| Beneficial conversion feature related to short-term debt        | \$ -        | \$ (2,413,158) |
| Liabilities for warrants to purchase common stock               | \$ 347,490  | \$ -           |
| Embedded derivatives and share liability                        | \$ 700,886  | \$ -           |
| Common stock issued to pay accounts payable                     | \$ 23,000   | \$ 41,875      |
| Common stock issued for conversion of short-term debt           | \$ 19,000   | \$ 1,106,037   |
| Common stock issued for accrued interest                        | \$ 27,293   | \$ -           |
| Common stock issued in connection with the acquisition of Guava | \$ 210,000  | \$ -           |
| Common stock issued for prepaid marketing fees                  | \$ -        | \$ 56,000      |
| Conversion of preferred stock into common stock                 | \$ -        | \$ 88,000      |
| Cash paid for interest  | \$ 7,120    | \$ 9,308       |
| Loss on sale of treasury stock                                  | \$ -        | \$ (173,668)   |
| Unrealized gain (loss) on marketable securities                 | \$ -        | \$ (12,065)    |

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

#### Note 1. Basis of Presentation and Nature of Operations

**Basis of Presentation:** The interim Consolidated Financial Statements of Capsalus Corp. (Capsalus, the Company, we, us or our) are unaudited but, in the opinion of management, reflect all adjustments necessary for a fair statement of financial position, results of operations and cash flows for the periods presented. Except as otherwise disclosed herein, these adjustments consist of normal, recurring items. The results of operations for any interim period are not necessarily indicative of full year results. The Consolidated Financial Statements and Notes are presented in accordance with the requirements for Quarterly Reports on Form 10-Q and do not contain certain information included in our annual Consolidated Financial Statements and Notes.

The preparation of the interim Consolidated Financial Statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the interim Consolidated Financial Statements and the reported amounts of revenue and expenses for the reporting periods. Despite our intention to establish accurate estimates and use reasonable assumptions, actual results may differ from our estimates.

The December 31, 2010 Consolidated Balance Sheet data was derived from the audited Consolidated Financial Statements but does not include all disclosures required by accounting principles generally accepted in the United States of America. This Form 10-Q should be read in conjunction with our Consolidated Financial Statements and Notes included in our Annual Report on Form 10-K/A for the year ended December 31, 2010.

**Nature of Operations:** Capsalus is a global wellness solutions company with operations in Nutritional Products and Healthcare Services. The Nutritional Products division is a consumer-driven business unit focused on healthy food and beverages. Healthcare Services specializes in providing a scalable suite of in-home non-medical and medical staffing and services, including light housekeeping and transportation, nurse and doctor visits, occupational and physical therapy and other clinical services. Neither our Nutritional Products nor our Healthcare Services divisions have generated revenues as of the date of this report.

#### Note 2. Summary of Significant Accounting Policies

**Principles of Consolidation:** The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, as of the dates of their acquisitions. The wholly-owned subsidiaries include ongoing operations in White Hat Holdings, Inc. (White Hat) and Guava Senior Home & Healthcare Services, Inc. (Guava), and our discontinued operations in Ceres Organic Harvest, Inc. (Ceres), Pacific Rim Foods, Ltd. (Pacific Rim), and Modular Process Constructors, LLC (MPS). All inter-company transactions and balances have been eliminated in the consolidation.

**Property and Equipment:** Property and equipment is reported at cost less accumulated depreciation. Maintenance and repairs are charged to expense as incurred. The cost of property and equipment is depreciated over the following estimated useful lives of the related assets:

|                    |         |
|--------------------|---------|
| Computer Equipment | 3 years |
|--------------------|---------|

**Segment Reporting:** The Company operates and manages the business under one reporting segment.

**Long-Lived and Amortizable Intangible Assets:** The Company periodically evaluates the carrying value of long-lived and amortizable intangible assets to be held and used, including but not limited to, property and equipment and

intangible assets, when events and circumstances warrant such a review. The carrying value of a long-lived or amortizable intangible asset is considered impaired when the anticipated undiscounted cash flow from such asset is less than its carrying value. In that event, a loss is recognized based on the amount by which the carrying value exceeds the fair value of the long-lived asset. Fair value is determined primarily using the anticipated cash flows discounted at a rate commensurate with the risk involved. Losses on long-lived assets to be disposed of are determined in a similar manner, except that fair values are reduced for the cost to dispose. The Company has reviewed long-lived and amortizable intangible assets with estimable useful lives and determined that the remaining net carrying value is recoverable in future periods.

**Intangible Assets:** Identified intangible assets (excluding goodwill), consisting primarily of developed formulations, customer relationships, licensed assets and trademarks, are being amortized using a method that reflects the pattern in which the related assets are expected to be consumed.

**Investments:** Investments in businesses that are not controlled, and over which we do not have the ability to exercise significant influence, are accounted for under the cost method.

**Goodwill:** Goodwill is the excess of cost of an acquired entity over the amounts assigned to assets acquired and liabilities assumed in a business combination. Goodwill is not amortized. We evaluate the carrying value of goodwill for our reporting units annually during the quarter ending December 31, and between such annual evaluations if events occur or circumstances change that would indicate a possible impairment. We use a discounted cash flow model based on management's judgment and assumptions to determine the estimated fair value of a reporting unit. An impairment loss generally would be recognized when the carrying amount of a reporting unit's net assets exceeds the estimated fair value of the reporting unit.

**Fair Value of Financial Instruments:** The respective carrying value of certain on-balance sheet financial instruments approximates their fair values. These financial instruments include cash, accounts payable and accrued liabilities, and notes payable. Fair values were assumed to approximate cost or carrying values as most of the debt was incurred recently and the assets were acquired within one year. Management is of the opinion that the Company is not exposed to significant interest, credit or currency risks arising from these financial instruments.

**Accounting for Convertible Debentures, Warrants and Derivative Instruments:** The Company does not enter into derivative contracts for purposes of risk management or speculation. However, from time to time, the Company enters into contracts that are not considered derivative financial instruments in their entirety but that include embedded derivative features.

Warrants to purchase common stock and embedded conversion options which are accounted for as liabilities are recorded in the consolidated balance sheets at fair value with unrealized changes in the fair values of these derivatives being recorded in the consolidated statements of operations as "gain or loss on warrants, derivatives and share liability". The recognition of the fair value of derivative liabilities (i.e., warrants and embedded conversion options) at the date of issuance is applied first to the proceeds. The excess fair value, if any, over the proceeds from units-type offerings (i.e., preferred stock with freestanding warrants) or from a debt instrument, is recognized immediately in the consolidated statements of operations as "gain or loss on warrants, derivatives and share liability" or "interest expense," respectively. The value of warrants or derivatives associated with a debt instrument is recognized at inception as a discount to the debt instrument. This discount is amortized over the life of the debt instrument using the effective interest method. The value of the warrants and derivatives associated with the units-type offerings is credited to additional paid-in-capital upon conversion to common stock.

The Company uses the Black-Scholes pricing model to determine fair values of its derivative liabilities. Valuations derived from this model are subject to ongoing internal verification and review. The model uses market-sourced inputs such as interest rates and option volatilities. Selection of these inputs involves management's judgment and may impact net income. The fair value of the derivative liabilities are subject to the changes in the trading value of the Company's common stock. As a result, the Company's financial statements may fluctuate from quarter-to-quarter based on factors, such as the price of the Company's stock at the balance sheet date, the amount of shares converted by note holders and/or exercised by warrant holders, and changes in the determination of market-sourced inputs. Consequently, the Company's financial position and results of operations may vary materially from quarter-to-quarter based on conditions other than its operating revenues and expenses.

The Company accounts for debt issued with common stock, equity-classified detachable stock purchase warrants, and/or other equity-classified incentives by allocating the proceeds of the debt between the debt and incentives based on the relative estimated fair values of the debt security without incentives and the incentives themselves. The amount allocated to the incentives would then be reflected as both an increase to stock and/or additional paid-in capital and as a debt discount that would be amortized over the term of the debt



In the case of convertible debt instruments, the proceeds from the issuance of convertible notes are first allocated between the convertible notes and any incentives. If the amount allocated to convertible notes results in an effective per share conversion price less than the fair market price of the Company's common stock, the intrinsic value of this beneficial conversion feature is recorded as a further discount to the convertible notes. The beneficial conversion feature discount is equal to the difference between the effective conversion ratio and the fair market price of the Company's common stock, with a corresponding increase to additional paid-in capital.

**Income Taxes:** The Company provides for income taxes using an asset and liability approach. Deferred tax assets and liabilities are recorded based on the differences between the financial statement and tax bases of assets and liabilities and the tax rates in effect when these differences are expected to reverse. Deferred tax assets are reduced by a valuation allowance if, based on the weight of the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. For all periods presented, the Company has recorded a full valuation allowance against its deferred tax assets.

The Company recognizes a financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement with the relevant tax authority.

**Reclassifications:** Certain reclassifications have been made to the 2010 financial statement presentation to correspond to the current year's format. Total 2010 equity, cash flows and net loss were unchanged due to these reclassifications.

**Recent Accounting Developments:** In May 2011, the FASB issued Accounting Standards Update (ASU) ASU No. 2011-04, "Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs". The amendments in this ASU are to be applied prospectively and are effective during interim and annual periods beginning after December 15, 2011. This ASU is not expected to have a material impact on the consolidated financial statements upon adoption.

In June 2011, the FASB issued ASU No. 2011-05, "Presentation of Comprehensive Income". Under the amendments in this ASU, an entity has two options for presenting its total comprehensive income: to present total comprehensive income and its components along with the components of net income in a single continuous statement, or in two separate but consecutive statements. The amendments in this ASU are required to be applied retrospectively and are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, with early adoption permitted. The Company intends to conform to the new presentation required in this ASU beginning with its Form 10-Q for the three months ended March 31, 2012. This ASU is not expected to have a material impact on the consolidated financial statements upon adoption.

Management does not believe that any other recently issued, but not yet effective, accounting standards if currently adopted would have a material effect on the consolidated financial statements.

### Note 3. Going Concern Uncertainty

The accompanying financial statements have been prepared on the basis that the Company will continue as a going concern, which assumes the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has accumulated losses totaling \$32,763,247 from inception through September 30, 2011, and a net working capital deficit of \$5,065,082 as of September 30, 2011. The uncertainty related to these conditions raises substantial doubt about the Company's ability to continue as a going concern. The accompanying consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Over the next 18 months, in order to have the capability of achieving our business plan, we believe that we will require at least \$5,000,000 in additional funding to pay down certain payables and accruals and to provide working capital. Should we be unable to obtain additional funding in the next 3 months, we would be required to further cut expenses until such funding is obtained. We are currently attempting to raise these funds by means of one or more private offerings of debt or equity securities or both. However, at this point, we have not specifically identified the type or sources of this funding. We also are exploring commercial and joint venture financing opportunities. If we are unsuccessful in raising funds, we may have to reduce expenses and/or cease operations altogether.

### Note 4. Discontinued Operations

On March 31, 2010, Ceres adopted a plan to close the business of Organic Grain and Milling, Inc. (OGM). As of March 31, 2010, substantially all operational activities of OGM were discontinued. As a result, effective in its first quarter of fiscal 2010, the Company classified OGM as discontinued operations separate from the continuing operations of the Company for all the periods presented in the consolidated financial statements.

On July 1, 2010, the Company adopted a plan to close the business of Ceres Organic Harvest, Inc. (Ceres). As of July 1, 2010, substantially all operational activities of Ceres were discontinued. As a result, effective in the quarter ended September 30, 2010, the Company classified Ceres as discontinued operations separate from the continuing operations of the Company for all the periods presented in the consolidated financial statements.

On August 6, 2010, the Company entered into an agreement to sell the Animal Wellness Group business. As a result, effective in the quarter ended September 30, 2010, the Company classified the Animal Wellness Group as discontinued operations separate from the continuing operations of the Company for all the periods presented in the consolidated financial statements.

On December 31, 2010, the Company adopted a plan to close the business of Modular Process Systems, LLC (MPS). As of December 31, 2010, substantially all operational activities of MPS were discontinued. As a result, effective in the quarter ended December 31, 2010, the Company classified MPS as discontinued operations separate from the continuing operations of the Company for all the periods presented in the consolidated financial statements.

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The following table summarizes results of OGM, Ceres, MPS and the Animal Wellness Group classified as discontinued operations in the Company's consolidated statements of operations for the three and nine month periods ended September 30, 2011 and 2010:

|   | Three months ended    |                       | Nine months ended     |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September 30,<br>2011 | September 30,<br>2010 | September 30,<br>2011 | September 30,<br>2010 |
| Sales, net  | \$ -                  | \$ 13,437             | \$ -                  | \$ 591,389            |
| Cost of goods sold  | -                     | 20,142                | -                     | 557,658               |
| Gross profit  | -                     | (6,705)               | -                     | 33,731                |
| Operating expenses  | 2,032                 | 35,571                | 3,764                 | 584,809               |
| Goodwill and intangible asset impairment                  | -                     | -                     | -                     | 853,548               |
| Loss from discontinued operations                         | (2,032)               | (42,276)              | (3,764)               | (1,404,626)           |
| Other income (expense)                                    | (299)                 | 233,752               | (2,082)               | 188,685               |
| Income (loss) from discontinued operations before taxes   | (2,331)               | 191,476               | (5,846)               | (1,215,941)           |
| Income tax expense (benefit) from discontinued operations | -                     | -                     | -                     | -                     |
| Net income (loss) from discontinued operations            | \$ (2,331)            | \$ 191,476            | \$ (5,846)            | \$ (1,215,941)        |

The following table summarizes the major classes of remaining assets and liabilities in OGM's, Ceres', MPS's and the Animal Wellness group's balance sheets as of September 30, 2011 and December 31, 2010:

|  | September 30,<br>2011 | December 31,<br>2010 |
|--|-----------------------|----------------------|
| Cash   | \$ -                  | \$ 24,037            |
| Accounts receivable                            | 9,879                 | 41,946               |
| Current assets of discontinued operations      | \$ 9,879              | \$ 65,983            |
| Accounts payable                               | \$ 614,610            | \$ 654,715           |
| Accrued liabilities and deferred revenue       | 73,215                | 73,215               |
| Notes payable                                  | 48,315                | 48,315               |
| Current liabilities of discontinued operations | \$ 736,140            | \$ 776,245           |

Note 5. Product License and Asset Purchase

On August 11, 2009, the Company entered into an exclusive license and distribution agreement to acquire the formulations and worldwide marketing rights to a suite of products that promote joint and bone health in horses, dogs and humans. These formulas and related rights are being acquired from Platte Valley State Bank (Platte Valley), who currently owns all rights pertaining to these products. The products were previously developed, manufactured and distributed by Clark Biotechnology, Inc. (CBI). CBI discontinued operations in 2008 due to the death of its founder.

The agreement calls for minimum royalties totaling \$350,000 to be paid as follows:

|          |                        |
|----------|------------------------|
| \$30,000 | September 11, 2010 (1) |
| \$80,000 |                        |



|          |                           |
|----------|---------------------------|
|          | September<br>11, 2011 (2) |
| \$80,000 | September<br>11, 2012     |
| \$80,000 | September<br>11, 2013     |
| \$80,000 | September<br>11, 2014     |

- (1) The Company made this payment by the due date referenced above.
- (2) The Company paid \$10,000 of this amount during the quarter ended March 31, 2011. As of the date of this report, the remainder of this amount is unpaid. Platte Valley has verbally agreed to extend the due date of this payment until the Company can procure funding.

The Company has imputed interest on these installments at a rate of 12%, which is equivalent to the Company's estimated borrowing rate as of the date of the agreement. The discounted value of the licensed asset totals \$243,700 and has been included in intangible assets on our consolidated balance sheet and a corresponding liability included in current portion of long-term debt obligations (refer to Note 10. Long-term debt) as of September 30, 2011.

The Company is treating these minimum royalty payments as a purchase of the related formulations and marketing rights as once these minimum royalty payments are made, the Company will have sole title to the formulations and marketing rights.

In addition, the Company is required to pay additional royalties of 4% of net sales of the products that exceed \$2,000,000 in each year of the agreement. These royalties will be recorded as incurred. There were no sales of this product during the period from August 11, 2009 to September 30, 2011.

#### Note 6. Acquisition

On January 26, 2011, the Company acquired all of the issued and outstanding capital stock of Guava Senior Home & Healthcare Services, Inc., a Delaware corporation, and Guava Franchising, Inc. a Delaware corporation specializing in providing a scalable suite of in-home non-medical and medical staffing services (collectively referred to herein as "Guava"), pursuant to a Stock Purchase Agreement by and between the Company and Mary S. Schreiber, PhD. ("Schreiber"), the sole owner of Guava (the "Purchase Agreement"). In accordance with the Purchase Agreement, the Company issued to Schreiber 7,000,000 shares of restricted common stock valued at \$0.03 per share, the trading value of the Company's common stock on January 26, 2011.

In addition, the Company executed an Earn-Out Agreement with Schreiber, providing for Schreiber to earn, over a period ending December 31, 2013, an additional 5,000,000 shares of common stock for each \$5,000,000 of gross revenue achieved by Guava, up to an aggregate of an additional 20,000,000 shares of its common stock over such period of time. Issuance of additional shares of common stock is contingent on Schreiber's continuous employment with the Company through December 31, 2013.

The Company also entered into a three-year employment agreement with Schreiber, whereby she will be paid \$180,000 annually plus annual cash performance bonuses in return for her continued employment during the term of the arrangement and her agreement not to compete in a similar business of the Company during the term of the arrangement and for a period of one year, thereafter. In accordance with the terms of the employment agreement, the Company cannot terminate Schreiber's employment for anything other than for cause.

Due to the nature and timing of this transaction, as of September 30, 2011, the Company has made a good-faith estimate as to the value of the consideration paid for Guava and the fair value of acquired assets, including identifiable intangibles, and recorded a preliminary purchase price allocation. The Company intends to finalize these estimates and the purchase price allocation prior to the end of fiscal 2011.

The preliminary allocation of the purchase price is based on the best information available to management. This allocation is provisional, as the Company is required to recognize additional assets or liabilities if new information is obtained about facts and circumstances that existed as of January 26, 2011 that, if known, would have resulted in the recognition of those assets or liabilities as of that date. The Company may adjust the preliminary purchase price allocation after obtaining additional information regarding asset valuation, liabilities assumed and revisions of previous estimates. The following table summarizes the preliminary allocation of the purchase price based on the estimated fair value of the acquired assets and assumed liabilities of Guava.

|  |            |
|--|------------|
| Issuance of 7,000,000 shares of common stock with an estimated fair value of \$.03 per share (closing price on January 26, 2011) | \$ 210,000 |
| Total purchase consideration   | \$ 210,000 |
| Identifiable intangible assets   | \$ 210,000 |
| Total assets acquired  | \$ 210,000 |

The acquired intangible assets have an estimated weighted average useful life of five years and will be amortized using a method that reflects the pattern in which the assets are expected to be consumed.

#### Note 7. Intangible Assets

##### Intangible Assets

Intangible assets, net consisted of the following at September 30, 2011 and December 31, 2010:

|                              | September 30,<br>2011 | December 31,<br>2010 |
|------------------------------|-----------------------|----------------------|
| Formulas                     | \$ 1,000,000          | \$ 1,000,000         |
| Customer relationships       | 400,000               | 400,000              |
| Trademarks                   | 100,000               | 100,000              |
| Licensed assets (See Note 5) | 243,700               | 243,700              |
| Other (See Note 6)           | 210,000               | -                    |
|                              | \$ 1,953,700          | \$ 1,743,700         |

The Company does not anticipate sales from employing these intangible assets until 2012. As such, estimated aggregate amortization expense based on current intangibles for the next five years is expected to be as follows: none in the remainder of 2011, \$81,293 in 2012, \$166,349 in 2013, \$351,171 in 2014, \$476,024 in 2015, and \$878,863 thereafter.

#### Note 8. Investments

Investments (recorded at cost) at September 30, 2011 and December 31, 2010 consisted of the following:

|                       | September 30,<br>2011 | December 31,<br>2010 |
|-----------------------|-----------------------|----------------------|
| PanTheryx, Inc.       | \$ 90,000             | \$ 90,000            |
| Wish Upon a Hero, LLC | 517,500               | 500,000              |
| Total investments     | \$ 607,500            | \$ 590,000           |



## PanTheryx

During fiscal 2009, the Company made an initial \$25,000 investment in PanTheryx, Inc. PanTheryx is developing innovative US-originated products for introduction to the Indian healthcare market; ranging from new drug delivery systems, to immunotherapeutic agents, to field appropriate diagnostics. In 2010, the Company made an additional \$65,000 investment in PanTheryx. Currently, the Company owns 5% of the outstanding common stock of PanTheryx.

## Wish Upon A Hero

On October 20, 2010, the Company executed an irrevocable Subscription Agreement for the purchase of 200,000 Class B Preferred Units (the "Units") of Wish Upon A Hero, LLC, a Delaware limited liability company ("WISH"), for an aggregate consideration of \$400,000. WISH is an online community that focuses on the distribution of goodwill and human kindness. WISH connects people in need (Wishers) with people who can help (Heroes). During the quarter ended September 30, 2011, the Company purchased additional Units for \$17,500. The Company currently owns 22.875% of WISH.

In connection with the purchase of the WISH Units, the Company granted Non-Qualified Stock Options to the President of WISH, to purchase up to 8,000,000 shares of the Company's common stock at an exercise price of \$.05 per share. Options to acquire 2,000,000 shares vested immediately with an additional 3,000,000 options vesting if WISH accumulates gross revenues of \$5,000,000 on or before October 20, 2012 and an additional 3,000,000 options vesting if WISH accumulates \$10,000,000 in gross revenues on or before October 20, 2012. All vested options will expire on October 20, 2020.

The Company determined the fair value of the initial 2,000,000 options to be \$100,000 using the Black-Scholes option pricing model. The Company used the following assumptions in calculating the option's fair value; risk-free interest rate of 0.3%, expected dividend yield of 0%, expected volatility of 142% and expected term of 5 years. The fair value of these vested options increased the Company's investment in WISH with a corresponding increase to additional paid in capital. Should WISH reach the revenue targets for the remaining 6,000,000 options, the respective additional vested options will be recorded to the Company's investment in WISH and additional paid in capital at the options then calculated fair value using the Black-Scholes option pricing model.

These investments are accounted for under the cost method as the Company does not have the ability to exercise significant control or influence.

## Note 9. Short-term Notes Payable and Other Debt

Short-term notes payable and other debt at September 30, 2011 and December 31, 2010 consisted of the following:

|                                      | September 30,<br>2011 | December 31,<br>2010 |
|--------------------------------------|-----------------------|----------------------|
| Short-term convertible notes payable | \$ 2,375,579          | \$ 1,507,686         |
| Short-term loans                     | 90,800                | 144,300              |
|                                      | \$ 2,446,379          | \$ 1,651,986         |

## Short-term Convertible Notes Payable

A summary table of short-term convertible notes payable as of September 30, 2011 and December 31, 2010 follows:

|  | September 30,<br>2011 | December 31,<br>2010 |
|--|-----------------------|----------------------|
| Commonwealth One   | \$ -                  | \$ 50,000            |
| Plant Notes  | 77,996                | 89,867               |
| Blake Note   | 100,000               | 100,000              |
| CMS Notes, net of remaining debt discount of \$7,292 at December 31, 2010  | 100,000               | 92,708               |
| 2010 Tranche I Notes, net of remaining debt discount of \$227,417 and \$28,889 at September 30, 2011 and December 31, 2010, respectively | 2,097,583             | 1,175,111            |
| Total  | \$ 2,375,579          | \$ 1,507,686         |

## Commonwealth One

The Commonwealth One round of financing was closed in the quarter ended December 31, 2008. Proceeds from the notes were \$550,000. Interest at 12.0% was due with the principal on various dates through June 2009. The notes were unsecured and are convertible into shares of the Company's common stock at \$0.045 per share at any time during the term of the notes.

During the quarter ended March 31, 2011, the remaining principal balance of \$50,000 was paid in cash and \$25,888 of related accrued interest was converted into 1,295,646 shares of the Company's common stock at \$0.02 per share.

## Plant Notes

The Company also entered into loan agreements with an unrelated individual (Plant Notes) during the quarters ended December 31, 2008 and March 31, 2009. Proceeds from the agreements totaled \$105,000 with interest at 5.0% due with the principal on June 30, 2010. The notes are unsecured and are convertible into shares of the Company's common stock at \$0.50 per share at any time during the term of the notes. During the year ended December 31, 2010, the Company paid \$20,000 in principal and accrued interest on the Plant Notes. During the nine months ended September 30, 2011, the Company paid an additional \$15,000 in principal and accrued interest. The note holder has verbally extended the remaining balance of this note until further notice.

## Blake Note

In connection with the acquisition of Pacific Rim Foods on December 31, 2008, the Company acquired a note payable for \$100,000 to an unrelated individual (Blake Note). Interest at 10.0% is payable annually. All outstanding interest and principal was due January 13, 2011. The note is unsecured and is convertible into shares of the Company's common stock at \$0.125 per share at any time during the term of the note. The note holder has verbally extended the remaining balance of this note until a replacement note is able to be executed.

## CMS Notes

In December 2009, the Company entered into a round of financing with Charles Morgan Securities, Inc. During the quarter ended March 31, 2010, proceeds from additional CMS notes were \$100,000. Interest at 12.0% is due with the principal on February 11, 2011. The notes are unsecured and are convertible into shares of the Company's common stock at \$0.04 per share at any time during the term of the notes. As the conversion price of the CMS notes issued during the quarter ended March 31, 2010 was below the then current market price of the Company's common stock, a beneficial conversion feature discount was recorded, in the form of a debt discount, in the amount of \$100,000. The discount recorded has been fully amortized to interest expense as of March 31, 2011. Amortization of \$7,292 was recorded for the quarter ended March 31, 2011. The note holders have verbally extended the remaining balance of these notes until a replacement note is able to be executed.

2010 Tranche I Notes

During the quarter ended June 30, 2010, the Company entered into a round of financing with a group of individual lenders. Proceeds from the notes (2010 Tranche I Notes) were \$60,000 as of June 30, 2010. The notes are unsecured, bear interest at 10%, are due at various dates from April through May 2011, and are convertible into shares of the Company's common stock at prices ranging from \$0.03 to \$0.04 per share at any time during the term of the notes. As the conversion price of the notes was below the then current market price of the Company's common stock, a beneficial conversion feature discount was recorded, in the form of a debt discount, in the amount of \$60,000. The discount recorded has been fully amortized to interest expense as of September 30, 2011. Amortization of \$16,667 and \$28,889 was recorded for the three and nine month periods ended September 30, 2011, respectively.

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During the quarter ended September 30, 2010, additional proceeds from 2010 Tranche I Notes were \$1,144,000. These notes are unsecured, bear interest ranging from 10% to 12%, are due at various dates from July through September 2011, and are convertible into shares of the Company's common stock at \$0.04 per share at any time during the term of the notes.

During the quarter ended March 31, 2011, additional proceeds from 2010 Tranche I Notes were \$335,000. These notes are unsecured, bear interest ranging from 10% to 13%, are due at various dates from January through March 2012, and are convertible into shares of the Company's common stock at \$0.04 per share at any time during the term of the notes.

On April 1, 2011, additional proceeds from a 2010 Tranche I Note were \$500,000. The related note is unsecured, bears interest of 13%, is due on March 31, 2012, and is convertible into shares of the Company's common stock at \$0.04 per share at any time during the term of the note.

During the quarter ended June 30, 2011, \$19,000 of the 2010 Tranche 1 Notes plus accrued interest of \$1,405 was converted into 510,137 shares of the Company's common stock.

During the quarter ended September 30, 2011, additional proceeds from 2010 Tranche I Notes were \$305,000. The related notes are unsecured, bear interest of 12%, are due on various dates from July through September 2012, and are convertible into shares of the Company's common stock at \$0.02 per share any time during the term of the notes. In addition, the Company issued common stock warrants to each note holder, for an aggregate total of 15,250,000 shares. The warrants expire on various dates from July through September 2014, and are exercisable at \$0.08 per share at any time during the term of the agreements. As a result of the Company no longer having any authorized unissued shares of common stock (see Note 12), the warrants issued with these notes and the embedded conversion features were recorded as liabilities and as a discount to the notes at their estimated fair value. The estimated fair value of the warrants and conversion features totaled \$333,800. The excess fair value over the face value of the notes was recorded immediately to interest expense, while the remaining \$299,000 of discounts are being amortized to interest expense over the term of the notes. Amortization of \$71,583 was recorded for the three and nine month periods ended September 30, 2011.

Except as noted herein, the conversion prices of all other convertible notes were established at, or above, the then current market price of the Company's common stock and therefore, no beneficial conversion feature discount has been recorded.

#### Short Term Loans

In connection with the acquisition of WhiteHat on April 14, 2010, the Company assumed notes payable totaling \$309,300. The outstanding balance of the notes as of September 30, 2011 and December 31, 2010 is \$90,800 and \$144,300, respectively. Interest is at 10%, principal and interest payments are due upon demand, and the notes are unsecured.



## Note 10. Long-term Debt

Long-term debt at September 30, 2011 and December 31, 2010 consisted of the following:

|  | September 30,<br>2011 | December 31, 2010   |
|--|-----------------------|---------------------|
| Zero Coupon Convertible Subordinated Notes Payable, interest at 5.0%, principal and interest due December 12, 2013, convertible into shares of common stock of the Company at \$0.076 per share at any time, unsecured (total maturity value of \$2,545,073) | \$ 1,424,344          | \$ 1,153,404        |
| Liability for license agreement (total maturity value of \$310,000 at September 30, 2011) (See Note 5)   | 266,542               | 254,286             |
| Convertible Note Payable, interest at 12.0%, principal and interest due April 1, 2012, convertible into shares of common stock of the Company at \$0.02 per share at any time, unsecured, net of debt discount (face value of \$100,000)                     | 75,000                | 37,500              |
| Convertible Note Payable, interest at 12.0%, principal and interest due June 2, 2012, convertible into shares of common stock of the Company at \$0.02 per share at any time, unsecured, net of debt discount (face value of \$300,000)                      | 200,000               | 87,500              |
|  | 1,965,886             | 1,532,690           |
| Less current portion:  | (425,000)             | (80,000)            |
| <b>Total long-term debt</b>  | <b>\$ 1,540,886</b>   | <b>\$ 1,452,690</b> |

## Zero Coupon Notes

In December 2008, the Company issued Zero Coupon Convertible Subordinated notes payable with a maturity date of December 12, 2013 for proceeds of \$3,035,000. No payments are required on the notes until maturity at which time the principal amount of \$3,808,298 was due. Original interest discount (OID) accrues at a rate of 5% per year on the accreted value of the note. The holder may at any time during the term of the note convert the accreted value of the notes into shares of common stock of the Company. If either an event of default occurs under the note, as defined in the note agreement, or a change of control occurs with respect to the Company, the holder of the note may put the note to the Company at its accreted value.

The original conversion price of the Zero Coupon Convertible Subordinated notes (\$0.125 per share) was established at, or above, the then current market price of the Company's common stock and therefore, no beneficial conversion feature discount has been recorded. The conversion price is subject to weighted-average anti-dilution adjustments in the event we issue common stock at a price below the then-applicable conversion price other than common stock issuances or option grants to the Company's employees, directors or officers.

The Company does not consider these anti-dilution features to be an embedded derivative and therefore subject to variable accounting due to the embedded instrument not meeting the net settlement characteristic as noted in Accounting Standards Codification (ASC) 815-10-15-83(c) and ASC 815-10-15-99. More specifically, to meet the net settlement characteristics, an embedded instrument must be able to be either (1) net settled under contract terms, (2) net settled through a market mechanism or (3) net settled by delivery of derivative instrument or asset readily convertible to cash. The Company believes the embedded instrument cannot be net settled via contract terms or a market mechanism and although settlement of the embedded instrument could be made with the delivery of the

Company's common stock (i.e. an asset), due to the Company's stock being lightly traded as per ASC 815-10-15-130 and as illustrated at ASC 815-10-55-87, 88 and 89 (Cases B through D), to be considered "readily convertible to cash", the number of shares of stock to be exchanged must be small relative to the stock's daily transaction volume. Currently, the Company's daily transaction volume of their common stock is very low. However, moving forward, as required in ASC 815-10-15-139, the Company will continually evaluate whether or not the common stock is considered to be readily convertible to cash. In the event the Company's daily trading volume of their common stock were to increase significantly to the point where the shares to be exchanged in connection with the convertible notes would be relatively small in relation to the daily trading volume, the contract would then satisfy the net settlement characteristic and likely may need to be accounted for as a derivative.

Under current accounting guidance, if the terms of a contingent conversion option does not permit an issuer to compute the number of shares that the holder would receive if the contingent event occurs and the conversion price is adjusted, an issuer shall wait until the contingent event occurs and then compute the resulting number of shares that would be received pursuant to the new conversion price. The number of shares that would be received upon conversion based on the adjusted conversion price would then be compared with the number that would have been received before the occurrence of the contingent event. The excess number of shares multiplied by the commitment date stock price equals the incremental intrinsic value that results from the resolution of the contingency and the corresponding adjustment to the conversion price. That incremental amount shall be recognized when the triggering event occurs.

On April 14, 2010, the acquisition of WhiteHat Holdings, LLC qualified as a triggering event for the weighted-average anti-dilution adjustments. The Company evaluated the event based upon the note agreement and determined that the conversion price of the notes should be adjusted down to \$0.076 per share. Since this new conversion price is lower than the original conversion price, the Company recognized and recorded a beneficial conversion feature discount, in the form of a debt discount, in the amount of \$1,812,180. The discount recorded is being amortized to interest expense over the remaining life of the notes using the effective interest method. Amortization of \$94,249 and \$270,940 was recorded for three and nine month periods ended September 30, 2011, respectively.

On July 8, 2010, approximately \$1.1 million of the Company's zero-coupon convertible notes payable were converted to 17,550,610 million shares of the Company's common stock at \$0.06 per share. The notes converted had a revised conversion rate of \$0.076 per share. Since the actual conversion rate was lower, the Company recognized and recorded an additional beneficial conversion feature charge in its consolidated statement of operations of approximately \$280,000 during the quarter ending September 30, 2010. In addition, the conversion resulted in the recognition of the portion of the previously recorded debt discount that related to the converted notes. This resulted in a charge to interest expense of \$571,105 for the year ended December 31, 2010.

#### Convertible Notes Payable

During the quarter ended June 30, 2010, the Company entered into a financing agreement with an individual lender. Proceeds from the notes were \$100,000 on April 1, 2010 and \$300,000 on June 2, 2010. The notes are unsecured and are convertible into shares of the Company's common stock at \$0.02 per share at any time during the term of the notes. As the conversion price of the notes was below the then current market price of the Company's common stock, a beneficial conversion feature discount was recorded, in the form of a debt discount, in the amount of \$100,000 and \$300,000, respectively. The discount recorded is being amortized to interest expense over the life of the notes. Amortization of \$50,000 and \$150,000 was recorded for the three and nine month periods ended September 30, 2011, respectively.

Future minimum payments on long-term debt at September 30, 2011 are as follows:

| Years ending<br>December 31, |              |
|------------------------------|--------------|
| Remaining 2011               | \$ 70,000    |
| 2012                         | 480,000      |
| 2013                         | 2,625,073    |
| 2014                         | 80,000       |
|                              | \$ 3,255,073 |



## Note 11. Basic and Diluted Earnings (Loss) Per Share

The Company computes earnings (loss) per share under two different methods, basic and diluted, and presents per share data for all periods in which statements of operations are presented. Basic earnings (loss) per share is computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding. Diluted earnings (loss) per share is computed by dividing net income (loss) by the weighted average number of common stock and common stock equivalents outstanding. The table below shows the calculation of basic and diluted loss per share for the three and nine month periods ended September 30, 2011 and 2010, respectively:

|  | Three months ended<br>September |                       | Nine months ended     |                       |
|--|---------------------------------|-----------------------|-----------------------|-----------------------|
|  | 30,<br>2011                     | September<br>30, 2010 | September<br>30, 2011 | September<br>30, 2010 |
| Loss:  |                                 |                       |                       |                       |
| Net loss from continuing operations  | \$ (285,137)                    | \$ (1,556,606)        | \$ (2,093,267)        | \$ (2,785,341)        |
| Net (loss) income from discontinued operations                             | (2,331)                         | 191,476               | (5,846)               | (1,215,941)           |
| Net loss   | \$ (287,468)                    | \$ (1,365,130)        | \$ (2,099,113)        | \$ (4,001,282)        |
| Number of shares:  |                                 |                       |                       |                       |
| Weighted-average shares outstanding  | 414,009,216                     | 383,364,985           | 406,852,859           | 297,090,592           |
| Loss per share:  |                                 |                       |                       |                       |
| Net loss from continuing operations per common share (basic and diluted)   | \$ -                            | \$ -                  | \$ (0.01)             | \$ (0.01)             |
| Net loss from discontinued operations per common share (basic and diluted) | \$ -                            | \$ -                  | \$ -                  | \$ -                  |
| Net loss per common share (basic and diluted)                              | \$ -                            | \$ -                  | \$ (0.01)             | \$ (0.01)             |

As of September 30, 2011, the Company had (i) 200,000 shares of common stock issuable upon the exercise of outstanding warrants, (ii) 56,057,247 shares of common stock issuable under convertible financing arrangements and (iii) 19,113,972 shares of common stock issuable as contingent consideration. As of September 30, 2010, the Company had (i) 1,240,000 shares of common stock issuable under convertible preferred stock arrangements, (ii) 200,000 shares of common stock issuable upon the exercise of outstanding warrants and (iii) 86,284,218 shares of common stock issuable under convertible financing arrangements. These 75,371,219 and 87,724,218 shares as of September 30, 2011 and 2010, respectively, which would be reduced by applying the treasury stock method, were excluded from diluted weighted average outstanding shares amount for computing the net loss per common share, because the net effect would be antidilutive for each of the periods presented.

## Note 12. Stockholders' Equity

## Common Stock

The Company is authorized to issue 500,000,000 shares of \$.001 par value common stock. The Company has 424,628,781 shares of its common stock issued and outstanding at September 30, 2011. Dividends may be paid on outstanding shares as declared by the Board of Directors. Each share of common stock is entitled to one vote.

## Preferred Stock

The Company is authorized to issue 10,500,000 shares of \$0.05 par value preferred stock. No shares are outstanding at September 30, 2011 and December 31, 2010.



## Stock Issuances

During the quarter ended March 31, 2011, the Company issued:

- 2,500,000 shares of common stock valued at \$50,000 (\$0.02 per share) for cash.
- 1,150,000 shares of common stock valued at \$26,000 (approximately \$0.02 per share) to satisfy certain accounts payable of the Company.
- 5,600,000 shares of common stock valued at \$224,000 (\$0.04 per share) for professional services. This amount is included in the Company's consolidated statements of operations for the quarter ended March 31, 2011.
- 2,510,750 shares of common stock valued at \$100,430 (\$0.04 per share) for employee bonuses. This amount is included in the Company's consolidated statements of operations for the quarter ended March 31, 2011.
  - 7,000,000 shares of common stock valued at \$210,000 (\$0.03 per share) for the acquisition of Guava.
- 1,762,805 shares of common stock related to contingent consideration in connection with the acquisition of WhiteHat Holdings, LLC.
- 1,295,646 shares of common stock valued at \$25,888 (\$0.02 per share) to satisfy accrued interest payable of the Company.

During the quarter ended June 30, 2011, the Company issued:

- 510,137 shares of common stock valued at \$20,405 (\$0.04 per share) for the conversion of a \$19,000 short-term note payable and \$1,405 of related accrued interest payable.
- 179,085 shares of common stock valued at \$3,582 (\$0.02 per share) for professional services. This amount is included in the Company's consolidated statements of operations for the quarter ended June 30, 2011.
- 500,000 shares of common stock valued at \$15,000 (\$0.03 per share) for professional services. This amount is included in the Company's consolidated statements of operations for the quarter ended June 30, 2011.

During the quarter ended September 30, 2011, the Company issued:

- 1,500,000 shares of common stock, valued at \$30,000 (\$0.02 per share) were issued to a financial services company related to a release and settlement agreement. This amount is included in the Company's consolidated statements of operations for the quarter ended September 30, 2011.
- 830,000 shares of common stock valued at \$16,600 (\$0.02 per share) for professional services. This amount is included in the Company's consolidated statements of operations for the quarter ended September 30, 2011.
- 670,000 shares of common stock valued at \$13,400 (\$0.02 per share) for a retention bonus to an officer of the Company. This amount is included in the Company's consolidated statements of operations for the quarter ended September 30, 2011.
- 10,000,000 shares of common stock and a warrant to purchase 7,500,000 shares of the Company's common stock for \$200,000 in cash. The warrant is exercisable at \$0.02 per share and expires on September 1, 2016.

## Stock Warrants

During the quarter ended September 30, 2011, warrants to purchase shares of the Company's common stock of 15,250,000 and 7,500,000, respectively, were issued related to notes payable and to a stock purchase. The warrants are exercisable at prices ranging from \$0.02 to \$0.08 per share and expire on various dates through September 1, 2016.

The Company had a total of 22,950,000 and 200,000 warrants to purchase shares of the Company's common stock outstanding as of September 30, 2011 and December 31, 2010, respectively. The warrants are exercisable at prices ranging from \$0.02 to \$0.125 per share and expire on various dates through September 1, 2016.





### Treasury Stock

As of September 30, 2011, the Company held 1,002,835 shares of its common stock in treasury with a total cost basis of \$105,000.

### Liability for Warrants and Embedded Derivatives and Share Liability

As of July 1, 2011, the Company did not have sufficient authorized shares of common stock required to settle the outstanding convertible debt, warrants and contingent shares related to the acquisition of WhiteHat Brands, LLC (see Note 13), if converted. As such, the conversion features of the 2010 Tranche I Notes are considered embedded derivatives requiring bifurcation from the debt host and were recorded on the consolidated balance sheet as an embedded derivative liability at fair value with a corresponding debit to additional paid-in capital. The embedded derivative is revalued at each balance sheet date and marked to fair value with the corresponding adjustment recognized as "gain or loss on warrants, derivatives and share liability" in the consolidated statements of operations. As of September 30, 2011 and December 31, 2010, the fair value of derivatives embedded in convertible debt was \$115,150 and zero, respectively.

As a result of not having sufficient authorized shares, a portion of the contingent shares related to the acquisition of WhiteHat Brands, LLC are also considered a liability and thus were recorded on the consolidated balance sheet as a share liability at fair value with a corresponding debit to additional paid-in capital as of July 1, 2011. This share liability is revalued at each balance sheet date and marked to fair value with the corresponding adjustment recognized as "gain or loss on warrants, derivatives and share liability" in the consolidated statements of operations. As of September 30, 2011 and December 31, 2010, the fair value of the share liability was \$91,530 and zero, respectively.

The Company's outstanding warrants also meet the definition of a liability based on the assessment above. The warrants were recorded at fair value and classified as a warrant liability in the consolidated balance sheet with a corresponding debit to additional paid-in capital. The warrant liability is revalued at each balance sheet date and marked to fair value with the corresponding adjustment recognized as "gain or loss on warrants, derivatives and share liability" in the consolidated statements of operations. As of September 30, 2011 and December 31, 2010, the fair value of the warrants was \$150,889 and zero, respectively.

The embedded derivatives, share liability and warrants are measured at fair value generally using the Black-Scholes option valuation technique. In selecting the appropriate fair value technique, the Company considers the nature of the instrument, the market risks that it embodies and the expected means of settlement.

### Note 13. Commitments and Contingencies

#### Common Stock Shares Commitment

The Company failed to meet certain capital requirements related to the acquisition of WhiteHat in 2010. As a result, the Company was committed to issue 33,691,592 additional shares of its common stock (Additional Shares) to former WhiteHat shareholders. The Company recorded the fair value of the Additional Shares of \$2,358,411 as additional purchase consideration and as a credit to additional paid-in capital in 2010. As of September 30, 2011, the Company has issued 1,762,805 of the Additional Shares. During the quarter ended September 30, 2011, the Company entered into settlement agreements with two former WhiteHat shareholders, and former employees of the Company, whereby these individuals agreed to forgo the issuance of Additional Shares related to them totaling 3,661,770 shares. Though the Company remains committed to issue the remaining 28,267,017 shares, the Company is currently in negotiations with other former WhiteHat shareholders to reduce the shares issuable to them under this commitment.

#### Litigation Matters

The Company periodically is subject to claims and lawsuits that arise in the ordinary course of business. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the financial position of the Company.

Note 14. Income Taxes

Realization of our net operating loss carryforwards and other deferred tax temporary differences are contingent upon future taxable earnings. Our net deferred tax assets have been reduced fully by a valuation allowance, as realization is not considered to be more likely than not based on an assessment of the history of losses and the likelihood of sufficient future taxable income.

We are subject to income taxes in the U.S. federal jurisdiction and various state jurisdictions. As of September 30, 2011, we are no longer subject to U.S. federal tax examinations for tax years before 2007. We are subject to state tax audits until the applicable statutes of limitations expire.

We recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of September 30, 2011, there were no such items accrued and we had no unrecognized tax benefits. We do not expect any material changes in our unrecognized tax positions over the next 12 months.

Note 15. Subsequent Events

On November 16, 2011, the Company issued 350,000 shares of common stock valued at \$7,000 (\$0.02 per share) for professional services.

On October 13, 2011, the Company entered into a Stock Purchase Agreement (the "Stock Purchase Agreement") with GeneLink, Inc. ("GeneLink"), pursuant to which GeneLink has agreed to sell 100% of the stock of GeneWize Life Sciences, Inc. ("GeneWize"). The Stock Purchase Agreement provides for a purchase price of \$500,000 payable at the closing of the transactions contemplated thereby, plus an earnout of between \$1.5 million and \$4.5 million, subject to the performance of GeneWize after the closing. The closing is conditioned upon, among other things, the approval of the shareholders of GeneLink.

GeneLink, GeneWize and the Company also entered into an Interim Management Agreement dated October 13, 2011, pursuant to which the Company will manage the operation of GeneWize until the closing or termination of the Stock Purchase Agreement. Pursuant to the Interim Management Agreement, the Company will be responsible for all expenses and shall receive all revenues of GeneWize from October 1, 2011 through the closing or termination of the transactions contemplated by the Stock Purchase Agreement.

Item 2. Management's Discussion and Analysis or Plan of Operation

NOTE REGARDING FORWARD-LOOKING STATEMENTS

Sections of this Form 10-Q, including the Management's Discussion and Analysis or Plan of Operation, contain "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), Section 21E of the Securities and Exchange Act of 1934, as amended (the "Exchange Act"), and the Private Securities Litigation Reform Act of 1995, as amended. These forward-looking statements are subject to risks and uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from the results, performance or achievements expressed or implied by the forward-looking statements. You should not unduly rely on these statements. Forward-looking statements involve assumptions and describe our plans, strategies, and expectations. You can generally identify a forward-looking statement by words such as "may," "will," "should," "would," "could," "plan," "goal," "potential," "expect," "anticipate," "estimate," "believe," "intend," "project," and variations thereof. This Quarterly Report on Form 10-Q contains forward-looking statements that address, among other things,

CRITICAL ACCOUNTING POLICIES AND ESTIMATES:

The preparation of the financial information contained in this 10-Q requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We evaluate these estimates on an ongoing basis, including those related to allowances for doubtful accounts and returns, inventory valuation, the carrying value and any impairment of goodwill and intangible assets, and income taxes. These critical accounting policies are discussed in more detail in the Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K/A for the year ended December 31, 2010.

RECENT ACCOUNTING DEVELOPMENTS

See Note 2 to the accompanying interim consolidated financial statements for a summary of recent accounting developments.

Plan of Operation

Overview

WhiteHat Holdings, LLC (WhiteHat) was acquired on April 14, 2010. In combining with WhiteHat, the Company is creating a new, consumer-driven business unit, the Nutritional Products Division, focused on healthy food and beverages. WhiteHat is committed to promoting the health and wellness of children by providing healthy and nutritious products and related services to support healthy eating habits and regular physical activity, especially during the pre-teen years. WhiteHat intends to produce a variety of great-tasting, fortified juice beverages for kids under the brand Dog On It! TM that are made with all-natural ingredients and loaded with calcium and vitamins A, B, C, D & E – without adding excess sugar or high fructose corn syrup. WhiteHat is headquartered in Atlanta, GA.

Acquired in January 2011, Guava Senior Home & Healthcare Services, Inc. (Guava) is a wholly-owned division that specializes in providing a scalable suite of in-home non-medical and medical staffing and services, including light housekeeping and transportation, nurse and doctor visits, occupational and physical therapy and other clinical services. Care is not limited to seniors; it is available to clients ranging from pediatric to geriatric including new mothers, persons with disabilities and patients following same-day surgery.



Guava is unique in various ways. Guava will provide the broadest range of in-home non-medical and medical staffing services to individual clients, corporations and medical institutions. No previous medical or care giving experience is necessary to buy a healthcare franchise, and the Guava opportunity gives you the ready-made framework within which to build a successful business.

Today Capsalus and its two Operating Groups—Nutritional Products and Healthcare Services—offer a broad range of solutions to global health problems. Currently, neither Nutritional Products nor Healthcare Services has generated any revenues or has acquired significant assets. As such, the Company operates and manages the business under one reporting segment.

WhiteHat is focused on the functional powdered beverages market. Until now, powdered beverages have accounted for only a very small percentage of overall beverage consumption in the US. However, demand in this segment of the market is rising, driven by packaging innovation, which has seen powdered beverage mixes, historically sold in tubs or canisters, being made available in single-shot sleeves or sticks, to take advantage of the growth in popularity of bottled water.

WhiteHat has identified significant opportunity in two largely untapped segments of the powdered beverage market. White Hat has developed a low-cost, innovative alternative in the pre-natal vitamins market, which is currently only being serviced in pill format. White Hat believes its lower cost and more desirable product format will remove major obstacles to the development of this niche market. White Hat plans to soft launch its new line of pre-natal powdered beverage mixes as a branded product when adequate funding is in place, initially via online channeling and through large retailers.

WhiteHat plans to tap the private label market for its more mainstream electrolyte powdered beverage mixes, offering a lower cost approach than a branded product to penetrate the market than a branded product. White Hat is exploring private label opportunities for its product line with several large retail companies. The Company is also targeting to license its formulated powdered mixes among specialty sports-related enterprises.

We believe that we will require at least \$1.5 million in funding in order for WhiteHat to affect this plan.

Guava is finalizing the development of a differentiated franchise model, built around a unique “back of the house” support for its franchisees, which takes care of all the administrative aspects. This will allow Guava the benefit of maintaining financial control and transparency across its entire franchise network. Guava will initially focus on three state markets, Delaware, Pennsylvania and Georgia, and ultimately intends to market franchises in all fifty States, as well as in the European Union.

We believe that we will require at least \$2.0 million in funding in order for Guava to finalize its franchise model, and execute its initial franchise agreement.

We have not generated any operating revenues from our current ongoing businesses, and as of September 30, 2011 we had incurred a cumulative consolidated net loss from inception of \$32,763,247.

For the three and nine month periods ended September 30, 2011, our consolidated net losses were \$287,468 and \$2,099,113, respectively. For the three and nine month periods ended September 30, 2010 our consolidated net losses were \$1,365,130 and \$4,001,282, respectively. Our current liabilities as of September 30, 2011 exceeded current assets by \$5,065,082.

Over the next 18 months, in order to have the capability of achieving our business plan, we believe that we will require at least \$5,000,000 in additional funding to pay down certain payables and accruals and to provide working capital. Should we be unable to obtain additional funding in the next 3 months, we would be required to further cut

expenses until such funding is obtained. We are currently attempting to raise these funds by means of one or more private offerings of debt or equity securities or both. However, at this point, we have not specifically identified the type or sources of this funding. We also are exploring commercial and joint venture financing opportunities. If we are unsuccessful in raising funds, we may have to reduce expenses and/or cease operations altogether.

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## Results of Operations

Three months ended September 30, 2011 compared to three months ended September 30, 2010

Operating expenses increased to \$607,200 in the quarter ended September 30, 2011 from \$516,952 in the same quarter in 2010. Operating expenses increased primarily due to costs associated with the further development of Guava's franchise model, expenses to build the back office technology for use by future franchisees and salaries for staff of approximately \$407,000. These expense increases were partially offset by decreased operating expenses of approximately \$130,000 at WhiteHat due to a lack of funding available during the quarter.

Interest expense decreased to \$368,744 in the quarter ended September 30, 2011 from \$1,039,654 in the same quarter in 2010. This decrease was primarily due to the Company recording approximately \$671,000 less amortization of debt discounts in the quarter ended September 30, 2011 versus the same period one year ago.

Nine months ended September 30, 2011 compared to the nine months ended September 30, 2010

Operating expenses increased to \$1,955,287 in the nine months ended September 30, 2011 from \$1,377,347 in the same period in 2010. Operating expenses increased primarily due to costs associated with the further development of Guava's franchise model, expenses to build the back office technology for use by future franchisees and salaries for staff of approximately \$946,000. This increase was partially offset by cost containment measures at the Company's corporate office and at White Hat due to the lack of funding available.

Interest expense decreased to \$828,787 in the nine months ended September 30, 2011 from \$1,395,150 in the same period in 2010 due primarily to the Company recording approximately \$607,000 less amortization of debt discounts in the nine month period ended September 30, 2011 versus the same period one year ago.

## Liquidity and Capital Resources

We had a cash balance of \$4,040 as of September 30, 2011 and a cash balance of \$36,662 as of December 31, 2010.

Intangible assets increased to \$1,953,700 as of September 30, 2011 compared to \$1,743,700 at December 31, 2010. The increase was due to the recording of intangible assets related to the acquisition of Guava during the nine month period ended September 30, 2011.

Total assets at September 30, 2011 are \$4,604,969 compared to \$4,528,746 at December 31, 2010. This increase can be primarily attributed to assets recorded related to the acquisition of Guava during the nine month period ended September 30, 2011.

As of September 30, 2011, we have current liabilities totaling \$5,079,001 compared to \$3,363,479 at December 31, 2010. Changes are due to normal operations, to accrual increases for interest and payroll, certain long-term debt obligations becoming due within one year, new borrowings under short-term notes payable and the recording of embedded derivatives and share liability.

Long term debt as of September 30, 2011 is \$1,540,886 compared to \$1,452,690 at December 31, 2010. The increase can be attributed to the amortization of a debt discount related to the beneficial conversion feature originally recorded in 2010 partially offset by certain long-term debt obligations becoming due within one year and thus being reported as a current liability.





### Operating Activities

Net cash used in operations increased to \$1,092,903 during the nine months ended September 30, 2011 from \$951,045 during the nine months ended September 30, 2010. The increase in cash used in operations is due mainly to the use of cash for operations of Guava, which was acquired in 2011.

### Investing Activities

Net cash used in investing activities increased to \$217,500 during the nine months ended September 30, 2011 from \$100,056 during the nine months September 30, 2010. In 2011, we invested \$217,500 in WISH. In 2010, the use of cash was mainly attributable to the use of \$103,500 for the acquisition of WhiteHat Holdings, LLC., which was offset slightly by proceeds from the sale of marketable securities of \$3,444.

### Financing Activities

Net cash provided by financing activities during the nine months ended September 30, 2011 was \$1,264,628, compared to \$1,631,008 during the nine months September 30, 2010. The primary reason for the decrease in cash provided by financing activities was higher borrowings under short-term notes payable and reduced payments on short term debt in 2010. More specifically, during the nine months ended September 30, 2011, cash provided by the issuance of debt and stock was \$1,390,000 compared to \$1,870,618 for the same period in 2010. Payments on short and long term debt were \$125,372 during the nine months ended September 30, 2011, compared to \$288,117 during the same period in 2010. Proceeds from the sale of treasury stock were \$48,507 during the nine months ended September 30, 2010. There were no treasury stock sales in 2011.

### Going Forward

Our longer-term working capital and capital requirements will depend upon numerous factors, including revenue and profit generation, the cost of filing, prosecuting, defending, and enforcing patent claims and other intellectual property rights, competing technological and market developments, collaborative arrangements. Additional capital will be required in order to attain our goals. We cannot assure you that funds from our future operations or funds provided by our current financing activities will meet the requirements of our operations, and in that event, we will continue to seek additional sources of financing to maintain liquidity. We are actively pursuing all potential financing options as we look to secure additional funds both to stabilize and to grow our business operations. Our management will review any financing options at their disposal, and will judge each potential source of funds on its individual merits. We cannot assure you that we will be able to secure additional funds from debt or equity financing, as and when we need to, or if we can, that the terms of this financing will be favorable to us or our stockholders.

### Item 3. Qualitative and Quantitative Disclosures About Market Risk.

None.

### Item 4. Controls and Procedures.

#### Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures designed to provide reasonable assurance that information required to be disclosed in our reports filed pursuant to the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer/Chief Financial Officer as appropriate, to allow timely decisions regarding required disclosures. A control system, no matter how well conceived and

operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

As of September 30, 2011, our Chief Executive Officer/Chief Financial Officer carried out an evaluation of the effectiveness of our disclosure controls and procedures as such term is defined in Rules 13a-15(e) under the Securities and Exchange Act of 1934 (The "Exchange Act"). Based on that evaluation, the Chief Executive Officer/Chief Financial Officer concluded that our disclosure controls and procedures were not effective as of September 30, 2011 in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in applicable rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, in a manner that allows timely decisions regarding required disclosure because of those material weaknesses relating to internal controls that are described in Item 9A(T). of the Company's Form 10-K/A for the year ended December 31, 2010, filed May 17, 2011.

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Notwithstanding the material weaknesses that existed as of September 30, 2011, our Chief Executive Officer/Chief Financial Officer has concluded that the financial statements included in this report present fairly, in all material respects, the financial position, results of operations and cash flows of the Company in conformity with accounting principles generally accepted in the United States of America.

#### Changes in Internal Controls

During the fiscal quarter ended September 30, 2011, there were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Management has concluded that the material weaknesses in internal control, as described in Item 9A(T) of our Form 10-K/A for the year ended December 31, 2010, have not been fully remediated. We are committed to finalizing our remediation action plan and implementing the necessary enhancements to our policies and procedures to fully remediate the material weaknesses discussed above. Due to our lack of sufficient capital, we expect these material weaknesses to continue until our capital needs are met.

## PART II—OTHER INFORMATION

### Item 1. Legal Proceedings.

Not Applicable.

### Item 1A. Risk Factors.

The Company is a smaller reporting company as defined by Rule 12b-2 of the Exchange Act and is not required to provide the information required under this item.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

During the quarter ended March 31, 2011, the Company issued:

- 2,500,000 shares of common stock valued at \$50,000 (\$0.02 per share) for cash.
- 1,150,000 shares of common stock valued at \$26,000 (approximately \$0.02 per share) to satisfy certain accounts payable of the Company.
  - 5,600,000 shares of common stock valued at \$224,000 (\$0.04 per share) for professional services.
  - 2,510,750 shares of common stock valued at \$100,430 (\$0.04 per share) for employee bonuses.
  - 7,000,000 shares of common stock valued at \$210,000 (\$0.03 per share) for the acquisition of Guava.
- 1,762,805 shares of common stock related to contingent consideration in connection with the acquisition of WhiteHat Holdings, LLC.
- 1,295,646 shares of common stock valued at \$25,888 (\$0.02 per share) to satisfy accrued interest payable of the Company.

During the quarter ended June 30, 2011, the Company issued:

- 510,137 shares of common stock valued at \$20,405 (\$0.04 per share) for the conversion of a \$19,000 short-term note payable and \$1,405 of related accrued interest payable.
  - 179,085 shares of common stock valued at \$3,582 (\$0.02 per share) for professional services.
  - 500,000 shares of common stock valued at \$15,000 (\$0.03 per share) for professional services.



During the quarter ended September 30, 2011, the Company issued:

- 1,500,000 shares of common stock, valued at \$30,000 (\$0.02 per share) related to a release and settlement agreement.
- 830,000 shares of common stock valued at \$16,600 (\$0.02 per share) for professional services.
- 670,000 shares of common stock valued at \$13,400 (\$0.02 per share) for a retention bonus to an officer of the Company.
- 10,000,000 shares of common stock and a warrant to purchase 7,500,000 shares of the Company's common stock for \$200,000 in cash valued at \$200,000 (\$0.02 per share) for cash.

All of the investors above are sophisticated individuals who had the opportunity to review all of the Company's SEC filings and to discuss with the officers and directors of the Company the business and financial activities of the Company. All of the investors acquired their common stock (the "Securities") for investment and not with a view toward distribution. All of the stock certificates issued have been affixed with an appropriate legend restricting sales and transfers. Therefore, based on the foregoing, the Company issued the Securities in reliance upon the exemptions from registration provided by Section 4(2) of the Securities Act of 1933 and/or Regulation D, there under.

Item 3. Defaults Upon Senior Securities.

Not Applicable.

Item 4. Submission of Matters of a Vote of Security Holders

None.

Item 5. Other Information

Not Applicable.

Item 6. Exhibits

(a) Exhibits: The following exhibits are filed with this report:

31.1 Certification pursuant to Rule 13a-14(a) or 15d-14(a) under The Securities Exchange Act of 1934 as amended. \*

32. Certifications pursuant to 18 U.S.C section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. \*

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\* The Exhibit attached to this Form 10-Q shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934 (the "Exchange Act") or otherwise subject to liability under that section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933, as amended, or the Exchange Act, except as expressly set forth by specific reference in such filing.



SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, as amended, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Capsalus Corp.

Date: November 21, 2011

By:

/s/ Steven M. Grubner  
Steven M. Grubner,  
Chief Executive Officer/Chief Financial  
Officer



