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BRAVO FOODS INTERNATIONAL CORP  
Form 10KSB/A  
October 03, 2006

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

AMENDMENT NO. 1 TO  
FORM 10-KSB

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

Report for Period January 1, 2005 to December 31, 2005

BRAVO! FOODS INTERNATIONAL CORP.

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(Name of Small Business Issuer in its Amended Charter)

Commission File Number 0-25039

Delaware

62-1681831

-----  
(State or other jurisdiction of  
incorporation or organization)

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

11300 US Highway 1, Suite 202, North Palm Beach, Florida 33408 USA

-----  
(Address of principal executive offices) (Zip Code)

Telephone number: (561) 625-1411  
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Securities registered under Section 12(b) of the Exchange Act:  
None

Securities registered under Section 12(g) of the Exchange Act  
Common Stock, \$.001 par value  
(Title of class)

=====  
Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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 [X] No [ ]

Check if disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. [ ]

The issuer's revenues for its most recent fiscal year were \$11,948,921.

The aggregate market value of the voting stock held by non-affiliates of the issuer on September 25, 2006, based upon the \$0.56 per share close price of

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such stock on that date, was \$91,688,225 based upon 163,728,971 shares held by non-affiliates of the issuer. The total number of issuer's shares of common stock outstanding held by affiliates and non-affiliates as of September 25, 2006 was 195,018,001.

Transitional Small Business Disclosure Format (check one): Yes [ ] No [X]

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DOCUMENTS INCORPORATED BY REFERENCE: See Exhibits

### EXPLANATORY NOTE

We are filing this Amendment No. 1 to our Annual Report on Form 10-KSB for our year ended December 31, 2005 to reflect the restatement of our consolidated financial statements for the years ended December 31, 2005 and 2004 and the quarterly periods therein. As more fully described in Note 13 to the consolidated financial statements, included herein, we have restated our consolidated financial statements to (i) properly account for certain derivative financial instruments embedded in our notes payable, convertible notes payable and redeemable preferred stock, (ii) properly account for other derivative financial instruments (principally warrants) that were issued in connection with our financing and other business arrangements, (iii) reclassify and properly account for redeemable preferred stock and (iv) address certain other matters more fully described in Note 13. We have also restated Management's Discussion and Analysis and our Evaluation of Disclosure Controls and Procedures, to give effect to the restated financial information.

### FORWARD-LOOKING STATEMENTS

Statements that are not historical facts, including statements about our prospects and strategies and our expectations about growth contained in this report are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements represent our present expectations or beliefs concerning future events. We caution that such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among other things, the uncertainty as to our future profitability; the uncertainty as to whether our new business model can be implemented successfully; the accuracy of our performance projections; and our ability to obtain financing on acceptable terms to finance our operations until profitability.

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## PART I

### ITEM 1 - DESCRIPTION OF BUSINESS

#### The Company

Bravo! Foods International Corp. is a Delaware corporation, which was formed on April 26, 1996. We formerly owned the majority interest in two Sino-American joint ventures in China, known as Green Food Peregrine Children's Food Co. Ltd. and Hangzhou Meilijian Dairy Products Co., Ltd. These two joint ventures processed milk products for local consumption in the areas of Shanghai and Hangzhou, China, respectively. We closed Green Food Peregrine in December 1999 and sold our interest in Hangzhou Meilijian Dairy in December 2000.

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In December 1999, we obtained Chinese government approval for the registration of a new wholly owned subsidiary in the Wai Gao Qiao "free trade zone" in Shanghai, China. We formed this import-export company to import, export and distribute food products on a wholesale level in China. In addition, China Premium (Shanghai) was our legal presence in China with respect to contractual arrangements for the development, marketing and distribution of branded food products. We ceased all activities of this Chinese subsidiary in April 2004, owing to low sales volume and insufficient financial or logistic resources to market our products profitably in mainland China.

In December 1999, we formed Bravo! Foods, Inc., a wholly owned Delaware subsidiary, which we utilized to advance the promotion and distribution of branded Looney Tunes(TM) products in the United States, through production agreements with local dairy processors. At the end of 2001, we assumed this business, and our U.S. subsidiary ceased functioning as an operating company at that time.

On February 1, 2000, we changed our name from China Peregrine Food Corporation to China Premium Food Corporation, and on March 16, 2001 we changed our name to Bravo! Foods International Corp.

In January 2005, we formed Bravo! Brands (UK) Ltd., a United Kingdom registered company that is wholly owned by Bravo! Brands International Ltd. We will utilize Bravo! Brands (UK) Ltd. to advance the production, promotion and distribution of licensed branded products in the United Kingdom through production and sales agent agreements with local entities. Currently, we are evaluating our distribution and product mix in the UK in order to develop and implement a more effective business plan going forward. During this period of re-evaluation, we have ceased production of our products in the United Kingdom.

### The Business

Our business involves the development and marketing of our own Slammers(R) and Bravo!(TM) trademarked brands, the obtaining of license rights from third party holders of intellectual property rights to other trademarked brands, logos and characters and, in certain international markets, the granting of production and marketing rights to processor dairies to produce branded flavored milk utilizing our intellectual property. In addition, we anticipate the commencement of exporting our products to Mexico and Canada in the fourth quarter 2006 and first quarter 2007, respectively.

In the United States, we generate revenue from the sales of finished branded flavored milks to retail consumer outlets or distributors for resale to retail consumer outlets. Currently, we use a single third-party processor in the United States to produce all of our single serve milk based beverages. We anticipate the expanded production of our products with the addition of HP Hood, LLC as a second processor, with production commencing in the fourth quarter 2006. We recognize revenue in the United

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States at the gross amount of our invoices for the sale of finished product to wholesale buyers or distributors. We take title to our branded flavored milks when they are shipped by our third party processors and recognize as revenue the gross wholesale price charged to our wholesale customers or distributors. Our gross margin is determined by the reported wholesale price less (i) the cost charged by our third party processor, to produce our branded milk products and (ii) shipping costs.

Internationally, we generate revenue primarily through our sale to

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processors of flavor ingredients utilized for our products, which are developed and refined by us, and the grant of production rights to processors to produce our flavored milks. The consideration paid to us under these production contracts consists of fees charged for our grant of production rights for our branded flavored milks plus a charge for flavor ingredients.

All of our third party licensing agreements recognize that we will use third party production agreements for the processing of flavored milk products and that the milk products will be produced and may be sold directly by those processors. Our responsibilities under our third party production agreements are to design and provide approved packaging artwork, to help determine the best tasting flavors for the particular market and to assist in the administration, promotion and expansion of the respective branded milk programs. Ingredients for the flavored milks are formulated to our specifications and supplied on an exclusive basis by either Givaudan Flavors Group or Mastertaste, both of which are flavor development and production companies. In the United States, we are the vendor of record for our direct wholesale business and assume the responsibility for sales and marketing of our flavored milks.

### Master Distribution Agreement - Coca-Cola Enterprises

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On August 31, 2005, we entered into a ten-year Master Distribution Agreement with Coca-Cola Enterprises Inc that we believe will significantly expand the distribution and sales of our products. The agreement provides for the distribution of our products in Coca-Cola Enterprises in the United States, all U.S. possessions, Canada, Belgium, continental France, Great Britain, Luxembourg, Monaco and the Netherlands, as well as any other geographic territory to which, during the term of the agreement, Coca-Cola Enterprises obtains the license to distribute beverages of The Coca-Cola Company. The appointment of Coca-Cola Enterprises as the exclusive distributor for our products was effective August 30, 2005, has an effective distribution date of October 31, 2005 and an expiration date of August 15, 2015. Coca-Cola Enterprises has the option to renew the Master Agreement for two subsequent periods of ten additional years. Attendant to the execution of the agreements we issued three-year warrants to Coca-Cola Enterprises for the right to purchase 30 million shares of our common stock at an exercise price of \$0.36 per share.

Under the terms of the agreement, Coca-Cola Enterprises is obligated to use all commercially reasonable efforts to solicit, procure and obtain orders for our products and merchandise and actively promote the sale of such products in the Territory, as defined in the agreement. The agreement establishes a comprehensive process for the phased transition from our existing system of distributors to Coca-Cola Enterprises, dependent upon distribution territory, product and sales channels. Under the agreement, Coca-Cola Enterprises implemented its distribution on a ramp-up basis, commencing , October 31, 2005. Coca-Cola Enterprises' distribution in other Territory areas will be dependent upon, among other things, third-party licensing considerations and compliance with the regulatory requirements for the products in foreign countries.

We have agreed to provide the following:

- o strategic direction of our products;
- o maintain sales force education and support;

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- o actively market and advertise our products and design and develop point of sale materials and advertising.

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We are also responsible for handling:

- o consumer inquiries;
- o product development; and
- o the manufacture and adequate supply of our products for distribution by Coca-Cola Enterprises.

The terms of the agreement require our company to maintain the intellectual property rights necessary for our company to produce, market and/or distribute and for Coca-Cola Enterprises to sell our products in the Territory. We are obligated to spend a fixed dollar amount through 2006 on national and local advertising, including actively marketing the Slammers trademark, based on a plan as mutually agreed each year. Beginning in 2007, the Company shall allocate an amount per year for such activities in each country in the defined Territory equal or greater than an agreed upon percentage of our total revenue in such country.

Under the agreement, Coca-Cola Enterprises has the right of first refusal to distribute any new products developed by our company, and the agreement establishes a process for the potential expansion of Coca-Cola Enterprises' distribution of the Company's products to new territories. Either party may terminate the agreement for a material breach, insolvency or bankruptcy. Coca-Cola Enterprises may terminate (i) for change of control by our company, (ii) upon a material governmental regulatory enforcement action or threatened governmental action having a material adverse consumer or sales impact on our products and (iii) upon twelve months notice after August 15, 2006.

### Third Party Intellectual Property Licenses

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Marvel Enterprises, Inc. (Super Heroes(R) and Marvel Heroes(R))

On February 4, 2005, we entered into a two-year license agreement for the utilization of Marvel Heroes characters on our flavored milks in the United Kingdom and Ireland. We agreed to a royalty rate of 4% of net wholesale sales in the territory against the prepayment of a guaranteed minimum royalty amount. We have adopted the unit sales model currently used in the United States. We have outsourced the infrastructure required for the production, promotion, marketing, distribution and sale of our products through a production agreement with Waterfront Corporation in the UK and through an exclusive sales agency agreement with Drinks Brokers, Ltd. a UK registered company responsible for the launch and growth of several major beverage brands in the licensed territory. Currently, we are evaluating our distribution and product mix in the UK in order to develop and implement a more effective business plan going forward. During this period of re-evaluation, we have ceased production of our Marvel co-branded products in the United Kingdom.

In March 2005, we entered into a new one-year license agreement with Marvel Enterprises, Inc. to use its Super Heroes(R) properties to promote our branded milk products in the United States, Canada and Mexico. Under the terms of the license agreement, we agreed to a royalty rate of 5% of net wholesale sales in the United States, 4% for school lunch channels and 2.5% for school hot lunch programs. We also agreed to a 11% royalty on the amount invoiced to dairy processors for production in Canada and Mexico. We have not renewed this license agreement owing to the failure of our Marvel co-branded products to achieve expected market penetration.

On February 4, 2005, we entered into an eighteen month license agreement for the utilization of Marvel Heroes characters on our flavored milks in nine Middle East Countries. We agreed to a 11% royalty on the amount invoiced to third party dairy processors for "kits" in the territory against the

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prepayment of a guaranteed minimum royalty amount. We have not renewed this license agreement owing to the failure of our Marvel co-branded products to achieve expected market penetration.

Chattanooga Bakery, Inc.( Moon Pie(R) )

In October 2003, we assigned a two-year license with MD Enterprises, Inc., under which, we have the exclusive right to manufacture, distribute, market and sell Moon Pie(R) flavored milk products in the United States, subject to a variable royalty rate of 2% to 3% of net wholesale sales, depending upon volume. This license has been extended verbally.

Masterfoods USA (Starburst(R), Milky Way(R), 3 Musketeers(R))

On September 21, 2004, we entered into a licensing agreement with Masterfoods USA, a division of Mars, Incorporated, for the use of Masterfood's Milky Way(R), Starburst(R) and 3 Musketeers(R) trademarks in connection with the manufacture, marketing and sale of single serve flavored milk drinks in the United States, its Possessions and Territories and US Military installations worldwide. The license limits the relationship of the parties to separate independent entities. The initial term of the license agreement expires December 31, 2007. We have agreed to pay a royalty based upon the total net sales value of the licensed products sold and advance payments of certain agreed upon guaranteed royalties. Ownership of the licensed marks and the specific milk flavors to be utilized with the marks remains with Masterfoods. We have a right of first refusal for other milk beverage products utilizing the Masterfoods marks within the licensed territory. This license has amended to include additional Masterfoods brands and to extend the term to December 31,2012.

In March 2006, we signed two new seven year licensing agreements for Canada and Mexico with Masterfoods, effective January 1, 2006. The licensing agreement for Canada covers single servings of the Mars(R) Brand flavored milk drink, Starburst(R) brand flavored milk drink and the 3 Musketeers(R) brand flavored milk. In Mexico the licensing agreement is for single serve Milky Way(R) brand flavored milk, Starburst(R) brand flavored milk Drink and the 3 Musketeers(R) Brand Flavored Milk. These licensing agreements cover most trade channels including grocery, food service, Club Stores as well as schools with children over the age of 13, colleges and universities, vending machines, amusement parks and movie theaters.

Diabetes Research Institute

In June 2005, we extended our licensing agreement with Diabetes Research Institute to June 30, 2007. We agreed to a variable royalty rate of 0.25% of net sales. We use this intellectual property, which consists of a logo plus design on the labels of our Slim Slammers(TM) product line.

In House Intellectual Property  
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In addition to our third-party licenses, we have developed and sell flavored milks bearing trademarks developed by us, including "Slammers(R)" "Pro Slammers(TM)", "Slim Slammers(R)", Bravo!(TM) and "Breakfast Blenders(TM)".

Production Contracts/Administration  
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Our operations in the United States, the Middle East, Mexico and Canada are run directly by Bravo! Foods International Corp. Our United Kingdom

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business is managed through our wholly owned subsidiary Bravo! Brands International Ltd., which is a UK registered company.

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### United States

Since 2003, our milk products have been produced by Jasper Products, located in Joplin, Missouri. In addition to the production of our products, Jasper has provided the infra-structure necessary for our invoicing, shipping and collection activities. We anticipate that we will assume direct responsibility for these activities in house in the fourth quarter 2006. We will expand production of our products with the addition of HP Hood, LLC as a second processor, with production commencing in the fourth quarter 2006

### United Kingdom

In February 2005, we executed an exclusive sales agency agreement with Drinks Brokers, Ltd., a division of Tactical Sales Resources Limited for sales of our product lines in the United Kingdom. Pursuant to terms of the agreement, Bravo! appointed Drinks Brokers as its Sales Agent in the United Kingdom for the marketing, promotion, distribution and sale of Bravo!'s Slammers(R) Marvel Heroes line of flavored milk, as well as other product lines that Bravo! may introduce to the UK in the near future.

Drinks Brokers utilizes its established networks to manage all matters relating to the sale and effective distribution of Bravo!'s products within the United Kingdom, including the solicitation of sales from customers in applicable market segments, marketing, advertising and promotion of Bravo!'s products, distribution, and merchandising.

Our products are processed in the United Kingdom by Waterfront Corporation Limited, on a third party co-pack basis. We generate revenue in the United Kingdom from the unit sales of finished branded flavored milks to retail consumer outlets. Currently, we use a single third-party processor in the United Kingdom to produce all of our single serve milk based beverages. We recognize revenue in the United Kingdom at the gross amount of our invoices for the sale of finished product to wholesale buyers.. We take title to our branded flavored milks when they are shipped by our third party processor and recognize as revenue the gross wholesale price charged to our wholesale customers. Our gross margin is determined by the reported wholesale price less the cost charged by Waterfront Corporation Limited.

### Middle East

In September 2005, we entered into a third party production agreement with Oman National Dairy Products Co. Ltd., a Middle East dairy processor, headquartered in Ruwi, Oman. Oman Dairy will process our Slammers (R) branded flavored milks, including the Marvel line, for distribution in nine Middle East countries. We generate revenue in the Middle East by the sale of flavor ingredients and production rights for our branded products. We are not responsible for production, marketing, promotion or distribution of the product in the Middle East.

### Products

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In September of 2000, we commenced our United States business using third party dairy processors for the production and sale of fresh branded flavored milk in single serve plastic bottles. Our flavored milk products had a limited shelf life of, generally, 21 days.

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In early 2002, we developed branded extended shelf life and aseptic, bacteria free, long life flavored milk products. The extended shelf life product was sold in 11.5oz single serve plastic bottles and had to be refrigerated. The shelf life of this product is 90 days. In addition, we developed a line of aseptic packaged milks that do not require refrigeration and have a shelf life of 8 months. This product

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was packaged in an 11.2oz Tetra Pak Prisma(TM) sterile paper container. Both of these products were introduced to the public in the second and third quarters of 2002.

Commencing in May 2002, we developed a new branded fortified flavored milk product under the "Slammers(R) Fortified Reduced Fat Milk" brand name. We use our Slammers(R) brand in conjunction with our licensed third party trademarks. Slammers(R) is made from reduced fat milk and is fortified with essential vitamins. The introduction of this new product and the phase out of our "regular" branded milks occurred in the fourth quarter of 2002. Our Slammers(R) flavored milks were sold in the United States in single serve extended shelf life plastic bottles, as well as the long life aseptic Tetra Pak Prisma(TM) package.

In November 2002, we introduced Slim Slammers(R) Fortified Milk, a low calorie version of our Slammers (R)Fortified Reduced Fat Milk. Slim Slammers(R) Fortified Milk has no added sugar and is sweetened with sucralose, a natural sweetener made from sugar. Slim Slammers(R) Fortified Milk is made from 1 percent fat milk, is fortified with 11 essential vitamins and is available in the same flavors as our Slammers(R) brand. We reintroduced this product in the United States with a new package and formulation during 2004.

In 2004, we announced our product development and brand strategy for seven new, separate and distinct single serve product lines: Ultimate Slammers(TM), Slim Slammers(R), Moon Pie Slammers(R), Pro-Slammers(TM), Starburst(R) Slammers(R), 3 Musketeers(R) Slammers(R) and Milky Way(R) Slammers(R). These product lines are all fortified and positioned to appeal directly to profiled demographic segments, including teens and pre teens for Ultimate Slammers(TM), Starburst(R) Slammers(R) and Milky Way(R) Slammers(R), teens and sports enthusiasts for Pro-Slammers(TM), young to old for Moon Pie(R) Slammers(R) and health conscious adults for Slim Slammers(R) and 3 Musketeers(R) Slammers(R).

We launched four brands in 2004, beginning with Ultimate Slammers(R) in April and achieved national distribution of Ultimate Slammers(R) through both retail grocers and convenience stores by mid- summer. Roughly 10,000 retail supermarket stores carried this brand nationwide in 2004. This was followed by our June launch of Slim Slammers(R) and Moon Pie (R)Slammers(R) and the July release of our Pro-Slammers(TM) line.

In January 2005, we launched our Slammers(R) Starburst line of Fruit & Cream Smoothies utilizing a "shelf stable" re-sealable plastic bottle for milk products that does not require refrigeration. Until that launch, all single serve flavored milk in plastic bottles required refrigeration for storage, distribution and shelf placement. The tactical advantage of distributing milk products ambient enables us to side-step a major entry barrier in our immediate consumption strategy. Refrigerated milk is relegated to dairy direct-store-delivery systems that are controlled by either regional dairy processors or larger national dairy holding companies. Shelf stable re-sealable plastic bottles allow us to use a more traditional distribution network that accommodates the non-refrigerated beverages. Also, milk products packaged in



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shelf stable re-sealable plastic bottles have significantly longer shelf life for storage, allowing us to ship in full truckloads resulting in decreased freight costs. We currently are converting all of our products to "shelf stable" re-sealable plastic bottles.

In the first quarter 2005, we launched our Slammers(R) MilkyWay and 3 Musketeers lines utilizing a "shelf stable" re-sealable plastic bottle for milk products that does not require refrigeration, under the Masterfoods License. During this period, we also introduced Breakfasts Blenders(TM), which is a meal replacement milk beverage developed for the "on the go" consumer.

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### Industry Trends

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The flavored milk industry has grown from approximately \$750 million in 1995 to \$2.5 billion in 2004. The single serve portion of this category is difficult to measure, since approximately 2/3 of the sales in the single serve milk industry are sold in immediate consumption channels or other channels that do not report scan-data. For example, Wal-Mart has become the largest retailer in the USA for milk, selling an estimated 15% of total milk sales. Wal-Mart does not report sales for the industry data resources embodied in A.C. Neilson or IRI analyses. Similarly, most convenience stores and "up-and-down-the-street" retailers in the immediate consumption sales channels do not report either, and neither do vending and schools.

We have analyzed the industry using reports available from milk and beverage industry sources. These include the total, segmented and rate of growth sales that are reported, the immediate consumption sales rates for all consumables compared to retail grocery buying patterns and opinions of experts in the milk industry as to the relative size of reported versus non-reported sales. Based upon these reports and analysis, we believe the current size of the single serve flavored milk industry (packaging 16 oz. or smaller) is approximately \$1.5 billion domestically. The industry grew at annual rates of between 5 and 15 percent during the last five years but was virtually flat in the last two years while it digested the remarkable 10-year growth rates. We believe that this space is positioned for growth now and will continue to be in the immediate consumption channels such as vending, convenience stores and food service market segments.

### Market Analysis

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The flavored milk business is a relatively new category in the dairy field. The flavored "refreshment" segment is both the fastest growing and most profitable category in the industry and is receiving the most attention in the industry today. Pioneered by Nestle with the NesQuik line and Dean Foods with its Chug brand, this "good for you" segment is in demand both in the U.S. and internationally.

The International Dairy Foods Association reports that, although flavored milk currently amounts to only 5 to 6 percent of milk sales, it represents over 59% of the growth in milk sales. With the total milk category exceeding \$9.3 billion in 2004, the flavored milk segment was approximately \$2.5 billion in 2004, with single serve flavored milk growing to approximately \$1.5 billion for the same period. Statistically, as the flavored segment grows, the entire category grows as well. In the past ten years, selling more flavored milks has resulted in more sales of white milk as well.

In addition, the International Dairy Foods Association and Dairy

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Management Inc. have reported on studies suggesting that dairy products may help in weight loss efforts when coupled with a reduced calorie diet, based on data associating adequate calcium intake with lower body weight and reduced body fat. We continue to develop a niche in the single serve flavored milk business by utilizing strong, national branding as part of the promotion of our Slammers(R), Pro Slammers(TM) and Slim Slammers(R) products. This niche has as its focus the increased demand for single serve, healthy and refreshing drinks.

### Market Segment Strategy

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The Bravo! product model addresses a very clear and concise target market. We know from experience that the largest retailers of milk products are demanding new and more diverse refreshment drinks, specifically in the dairy area, in response to consumer interest and demand. To that end, we have and will continue to differentiate our products from those of our competitors through innovative product formulations and packaging designs, such as those implemented in our Slammers(R) and Pro Slammers(TM) fortified milk product lines and our Slim Slammers(R) low calorie, no sugar added products. Our Slammers(R) milk products have had promising results penetrating this arena as consumers continue to look for healthy alternatives to carbonated beverages. The positioning of our products as a healthy, fun

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and great tasting alternative refreshment drink at competitive prices to more traditional beverages creates value for the producer and the retailer alike. This "profit orientation" for the trade puts old-fashioned milk products in a whole new light. The consumer is happy, the retailer is happy and the producer is able to take advantage of the value added by the brand and the resulting overall increase in milk sales.

We currently are implementing a very important "first-to-market" strategy that we feel will dramatically reposition our brands and company. Until now, all single served flavored milk in plastic bottles required refrigeration for storage, distribution, and shelf placement. Our strategic partner, Jasper Products, became America's first processor with FDA approval to offer a "shelf stable" re-sealable plastic bottle for ambient milk products that do not require refrigeration.

The tactical advantage of distributing our milk products at ambient temperatures enables us to side-step a major entry barrier in our immediate consumption strategy. Most beverages are distributed ambient either through beverage distribution channels or warehouse "candy and tobacco" distributors. Refrigerated milk was relegated to dairy direct-store-delivery systems that are controlled by either regional dairy processors or larger national dairy holding companies such as Dean Foods or H.P. Hood. We avoid the roadblock of being reliant upon our competition for chilled distribution since we are now in the unique position to use the more traditional distribution network that accommodates non-refrigerated beverages. We currently are converting all of our products into ambient "shelf stable" re-sealable plastic bottles.

We have been and continue to pursue a strategic goal of placing Slammers(R) milks in elementary, middle and high schools through ala carte lunch programs and vending facilities in school cafeterias, and we are promoting our Slim Slammers(R) milks as low calorie, non-sugar added alternatives to traditional soft drinks. Penetration of this market segment has been limited by logistic and economic concerns of school administrators in the push to remove traditional carbonated soft drinks from schools in favor of milk and milk based products.

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### Competition

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Nestle pioneered the single serve plastic re-sealable bottle which has become the standard for this industry, and they currently enjoy a dominant market share. Dean Foods owns a number of regional single serve brands that are sold in this format, and they also have an exclusive license to produce Hershey brand flavored milk nationwide. Our analysis indicates that the Nestle's Nesquik brand accounts for approximately 30-35 percent of the U.S. single serve milk category, while Hershey's market share is approximately half that, at around 15%. The other competition comes from private label and regional dairy brands. Our Slammers(R) milks are the only other single serve brand distributed nationally in America in plastic re-sealable containers.

Our resources for promotions have been limited, and we run significantly less promotional activities in comparison to our competitors. Where we are in direct competition with Nestle and Hershey, however, we have been able to maintain competitive sales levels.

### Employees

We have thirty three full time employees, twenty one of which work at our North Palm Beach corporate offices.

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### ITEM 2 - DESCRIPTION OF PROPERTY

Neither our company nor our subsidiaries currently own any real property. As of February 1, 1999, we moved our corporate offices from West Palm Beach to 11300 US Highway 1, Suite 202, North Palm Beach, Florida, pursuant to a lease with HCF Realty, Inc., having an initial term of five years. The current aggregate monthly rent amounts to approximately \$7,468, which includes an expansion of our office space from 2,485 square feet to 3,490 square feet. The term of this lease has been extended for six years to October 30, 2010.

We have executed a lease for an expansion of our office space in North Palm Beach, Florida to include an additional 2,190 square feet at \$18.50 per square foot.

We do not have a policy to acquire property for possible capital gains or income generation. In addition, we do not invest in securities of real estate entities or developed or underdeveloped properties.

### ITEM 3. LEGAL PROCEEDINGS

There currently are no claims or lawsuits against us for which a report is required.

### ITEM 4. SUBMISSION OF MATTERS TO VOTE OF SECURITY HOLDERS

None in the fourth quarter 2005 or the first and second quarters of 2006.

## PART II

### ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

#### Common stock market price

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Of the 184,253,753 shares of common stock outstanding as of December 31,

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2005, all but approximately 42,000,000 shares can be traded on the over-the-counter trading on the OTC Electronic Bulletin Board, which trading commenced October 24, 1997. Of this amount, 17,190,793 shares are held by affiliates. The following quarterly quotations for common stock transactions on the OTC Bulletin Board reflect inter-dealer prices, without retail mark-up, markdown or commissions and may not represent actual transactions.

| QUARTER        | HIGH BID PRICE | LOW BID PRICE |
|----------------|----------------|---------------|
| 2004           |                |               |
| First Quarter  | .17            | .06           |
| Second Quarter | .34            | .14           |
| Third Quarter  | .27            | .13           |
| Fourth Quarter | .22            | .09           |
| 2005           |                |               |
| First Quarter  | .18            | .10           |
| Second Quarter | 1.21           | .14           |
| Third Quarter  | 1.43           | .51           |
| Fourth Quarter | 0.80           | .47           |

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### Equity holders at September 25, 2006

|                          |                    |                             |
|--------------------------|--------------------|-----------------------------|
| Common stock             | 195,018,001 shares | 7,200 holders (approximate) |
| Series B preferred stock | 107,440 shares     | 1 holder                    |
| Series H preferred stock | 64,500 shares      | 1 holder                    |
| Series J preferred stock | 200,000 shares     | 1 holder                    |
| Series K preferred stock | 95,000 shares      | 1 holder                    |

### Dividends

We have not paid dividends on our common stock and do not anticipate paying dividends. Management intends to retain future earnings, if any, to finance working capital, to expand our operations and to pursue our acquisition strategy.

The holders of common stock are entitled to receive, pro rata, such dividends and other distributions as and when declared by our board of directors out of the assets and funds legally available therefore. The availability of funds is dependent upon dividends or distribution of profits from our subsidiaries and may be subject to regulatory control and approval by the appropriate government authorities on either a regional or national level.

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We have dividends in arrearage for our convertible preferred stock in the amount of \$336,303 and \$388,632 for the years ended December 31, 2005 and 2004, respectively.

### Sale of unregistered securities

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Quarter Ended December 31, 2005

On November 28, 2005, we closed a funding transaction with 13 accredited institutional investors, for the issuance and sale of 40,500,000 shares of our common stock for a purchase price of \$20,250,000. We also issued five-year warrants for the purchase of an additional 15,187,500 shares of common stock at an exercise price of \$0.80 per share. The securities are restricted and have been issued pursuant to an exemption to the registration requirements of Section 5 of the Securities Act of 1933 for "transactions of the issuer not involving any public offering" provided in Section 4(2) of the Act and pursuant to a Regulation D offering. In connection with this financing, we issued common stock purchase warrants to purchase 1,012,500 shares of common stock at an exercise price of \$.50 per share and 304,688 shares of common stock at an exercise price of \$.80 per share to SG Cowen & Co., LLC, who acted as placement agent for this financing.

The shares of common stock and the shares of common stock underlying the warrants carry registration rights that obligate us to file a registration statement within 45 days from closing and have the registration statement declared effective within 120 days from closing.

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## ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### OVERVIEW

Our business model includes the development and marketing of our Company owned Slammers(R) and Bravo!(TM) trademarked brands, the obtaining of license rights from third party holders of intellectual property rights to other trademarked brands, logos and characters and the production of our branded flavored milk drinks through third party processors. In the United States and the United Kingdom, we generate revenue from the unit sales of finished branded flavored milk drinks to retail consumer outlets or distributors. We generate revenue in our Middle East business through the sale of flavor ingredients per kit used to produce the flavored milk and a fee charged to the dairy processors for the production, promotion and sales rights for the branded flavored milk.

Our new product introduction and growth expansion continues to be expensive, and we reported a net loss of \$79,528,653 for the year ended December 31, 2005, which included \$60,823,574 of derivative expenses discussed at length in the Results of Operations Section, and a \$3,000,000 one time finder's fee paid in connection with our execution of a Master Distribution Agreement with Coca-Cola Enterprises, Inc. As shown in the accompanying financial statements, we have suffered operating losses and negative cash flows from operations since inception and, at December 31, 2005, have an accumulated deficit. These conditions give rise to substantial doubt about our ability to continue as a going concern. As discussed herein, we plan to work toward profitability in our U.S. and international business and obtain additional financing. While there is no assurance that funding will be available or that we will be able to improve our operating results, we are continuing to seek equity and/or debt financing. We cannot give any assurances, however, that management will be successful in carrying out our plans.

CRITICAL ACCOUNTING POLICIES

Estimates

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This discussion and analysis of our consolidated financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles that are generally accepted in the United States of America. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant estimates included in our financial statements are the following:

- Estimating future bad debts on accounts receivable that are carried at net realizable values.
- Estimating our reserve for unsalable and obsolete inventories that are carried at lower of cost or market.
- Estimating the fair value of our financial instruments that are required to be carried at fair value.
- Estimating the recoverability of our long-lived assets.

We use all available information and appropriate techniques to develop our estimates. However, actual results could differ from our estimates.

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Revenue Recognition and Accounts Receivable

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Our revenues are derived from the sale of branded milk products to customers in the United States of America, Great Britain and the Middle East. Geographically, our revenues are dispersed 98% and 2% between the United States of America and internationally, respectively. We currently have one customer in the United States that provided 34% and 0% of our revenue during the years ended December 31, 2005 and 2004, respectively. Since we commenced selling to this customer during the fourth fiscal quarter of 2005, we expect that our revenue related to this customer as a percentage of our total revenue will increase.

Revenues are recognized pursuant to formal revenue arrangements with our customers, at contracted prices, when our product is delivered to their premise and collectibility is reasonably assured. We extend merchantability warranties to our customers on our products, but otherwise do not afford our customers with rights of return. Warranty costs have historically been insignificant.

Our revenue arrangements often provide for industry-standard slotting fees where we make cash payments to the respective customer to obtain rights to place our products on their retail shelves for a stipulated period of time. We also engage in other promotional discount programs in order to enhance our sales activities. We believe our participation in these arrangements is essential to ensuring continued volume and revenue growth in the competitive marketplace. These payments, discounts and allowances are recorded as reductions to our reported revenue. Unamortized slotting fees are recorded in prepaid expenses.

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Our accounts receivable are exposed to credit risk. During the normal course of business, we extend unsecured credit to our customers with normal and traditional trade terms. Typically credit terms require payments to be made by the thirtieth day following the sale. We regularly evaluate and monitor the creditworthiness of each customer. We provide an allowance for doubtful accounts based on our continuing evaluation of our customers' credit risk and our overall collection history. As of December 31, 2005 and 2004, the allowance of doubtful accounts aggregated \$350,000 and \$90,396, respectively.

In addition, our accounts receivable are concentrated with one customer who represents 70% of our accounts receivable balances at December 31, 2005. Approximately 2% of our accounts receivable at December 31, 2005 are due from international customers.

### Inventories

Our inventories, which consists primarily of finished goods, is stated at the lower of cost on the first in, first-out method or market. Further, our inventories are perishable. Accordingly, we estimate and record lower-of-cost or market and unsalable-inventory reserves based upon a combination of our historical experience and on a specific identification basis.

### Impairment of Long-Lived Assets

Our long-lived assets consist of furniture and equipment and intangible assets. We evaluate the carrying value and recoverability of our long-lived assets when circumstances warrant such evaluation by applying the provisions of Financial Accounting Standard No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ("FAS 144"). FAS 144 requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable through the estimated undiscounted cash flows expected to result from the use and eventual disposition of the assets. Whenever any such impairment exists, an impairment loss will be recognized for the amount by which the carrying value exceeds the fair value.

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### Financial Instruments

We generally do not use derivative financial instruments to hedge exposures to cash-flow, market or foreign-currency risks. However, we frequently enter into certain other financial instruments and contracts, such as debt financing arrangements, redeemable preferred stock arrangements, and freestanding warrants with features that are either (i) not afforded equity classification, (ii) embody risks not clearly and closely related to host contracts, or (iii) may be net-cash settled by the counterparty. As required by FAS 133, these instruments are required to be carried as derivative liabilities, at fair value, in our financial statements.

We estimate fair values of derivative financial instruments using various techniques (and combinations thereof) that are considered to be consistent with the objective measuring fair values. In selecting the appropriate technique(s), we consider, among other factors, the nature of the instrument, the market risks that it embodies and the expected means of settlement. For less complex derivative instruments, such as free-standing warrants, we generally use the Black Scholes option valuation technique because it embodies all of the requisite assumptions (including trading volatility, estimated terms and risk

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free rates) necessary to fair value these instruments. For complex derivative instruments, such as embedded conversion options, we generally use the Flexible Monte Carlo valuation technique because it embodies all of the requisite assumptions (including credit risk, interest-rate risk and exercise/conversion behaviors) that are necessary to fair value these more complex instruments. For forward contracts that contingently require net-cash settlement as the principal means of settlement, we project and discount future cash flows applying probability-weightage to multiple possible outcomes. Estimating fair values of derivative financial instruments requires the development of significant and subjective estimates that may, and are likely to, change over the duration of the instrument with related changes in internal and external market factors. In addition, option-based techniques are highly volatile and sensitive to changes in our trading market price which has high-historical volatility. Since derivative financial instruments are initially and subsequently carried at fair values, our income will reflect the volatility in these estimate and assumption changes.

### RESULTS OF OPERATIONS

Year Ended December 31, 2005 Compared to Year Ended December 31, 2004

#### Consolidated Revenues

We reported revenues for the year ended December 31, 2005 of \$11,948,921, an increase of \$8,604,222, or 257%, compared to revenues of \$3,344,699 in 2004. This increase is the result of the acquisition of a significant new customer ("Coca Cola Enterprises" or "CCE") during the third fiscal quarter with sales generation commencing in the fourth fiscal quarter. Our revenues to CCE for the year ended December 31, 2005 comprise 34% of our total revenue. CCE will continue to be a significant customer in the foreseeable future. Since we commenced revenue generation with CCE in the fourth fiscal quarter, in future periods we expect that our revenues from sales to CCE will increase as a percentage of our total revenues.

Our revenues and gross margin are net of industry-standard slotting fees and promotional discounts for the year ended December 31, 2005 in the amount of \$487,221 compared to \$204,755 in 2004. We record these programs as reductions in our revenues and we may enter into similar programs in future periods to increase our market penetration.

Geographically, during the 2005 fiscal year, our revenues are dispersed 98% and 2% between the United States of America and internationally, respectively. While our current international revenues have not been significant, we are taking measures to further penetrate international markets and increase our international revenues as a percentage of our total revenues.

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#### Consolidated Product and Shipping Costs

We incurred product costs and shipping costs of \$8,938,692 and \$1,505,035, respectively, for the year ended December 31, 2005. Product costs in 2005 increased by \$6,563,887, a 276% increase compared to \$2,374,805 in 2004. Shipping costs in 2005 increased \$1,006,722, or 202%, compared to \$498,313 in 2004. The increase in product costs reflects an increase in revenues and the concomitant increase in reported product and shipping costs associated with that increase. Our overall gross margin for 2005 of 12.6% decreased slightly from our 14.0% gross margin in 2004 due to slightly higher production costs that were not offset with reciprocal pricing increases due to competitive constraint.



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### Consolidated Operating Expenses

#### Selling Expense:

We incurred selling expense of \$7,464,876 during the year ended December 31, 2005. We expense these costs, consisting largely of advertising and promotion, as they are incurred. Our selling expense for this period increased by \$6,164,203, a 474% increase compared to our selling expenses of \$1,300,673 for the same period in 2004. The increase in selling expense in the current period was due to higher advertising expenses as we penetrate new markets and, to a lesser degree, the hiring of additional sales staff. In addition, in connection with the acquisition of our new customer, CCE during 2005, we entered into a commitment to spend an aggregate of \$5,000,000 for advertising and promotion of our products during the years ended 2005 and 2006. Thereafter, we have agreed to spend an aggregate annual amount of 3% of our total CCE revenue for advertising programs. Generally, since our revenue producing activities with CCE did not commence until November of 2005, we did not incur a significant amount of expense under this commitment. Accordingly, our selling expenses can be expected to increase during 2006 and 2007 as we fulfill our obligations under these important arrangements and we continue to address additional markets.

#### Product Development Expense:

We incurred product development expense for the years ended December 31, 2005 of \$636,342, representing a 209% increase over product development expense in 2004. Additional expenditures were incurred in 2005 due to the launching of our Slammers Starburst line of Fruit & Cream Smoothies, and to package redesign costs associated with several of our product lines including Slim Slammers, Pro Slammers and Breakfast Blenders.

#### General and Administrative Expense:

Our general and administrative expense for the year ended December 31, 2005 was \$7,263,284, an increase of \$4,586,223 compared to \$2,677,061 in 2004. The increase is the result of additional payroll, increased occupancy costs, office overhead costs and travel necessary to support the increase in revenues. As a percentage of total revenue, our general and administrative expense decreased from 80% in 2004, to 61% for 2005. We anticipate a continued effort to reduce these expenses as a percentage of sales through revenue growth, certain cost cutting efforts and the refinement of business operations.

#### Non-Recurring Finders' Fee:

We recorded a \$3,000,000 one time, non-recurring finder's fee in connection with our execution of the Master Distribution Agreement with CCE in 2005. We do not currently anticipate incurring similar costs

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during 2006 or in the foreseeable future since our business opportunity with CCE is expected to be further developed over that period.

#### Consolidated Other Income (Expense)

#### Derivative Expense

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Our derivative expense amounted to \$60,823,574 for the year ended December 31 2005, compared to \$6,309,933 in 2004. Derivative expense (and in some instances income) arises from changes in the fair value of our derivative financial

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instruments and, in rare instances, day-one losses when the fair value of embedded and freestanding derivative financial instruments issued or included in financing transactions exceed the proceeds or other basis. Derivative financial instruments include freestanding warrants, compound embedded derivative features that have been bifurcated from debt and preferred stock financings. In addition, our derivative financial instruments arise from the reclassification of other non-financing derivative and other contracts from stockholders' equity because share settlement is not within our control while certain variable share price indexed financing instruments are outstanding.

Our derivative loss during each of the years ended December 31, 2005 and 2004 is significant to our consolidated financial statements. The magnitude of the derivative loss during the year ended December 31, 2005 when compared with the loss for the year ended December 31, 2004 reflects the following:

(a) During the year ended December 31, 2005, and specifically commencing in the second quarter, the trading price of our common stock reached significantly high levels relative to its trend. The trading price of our common stock significantly affects the fair value of our derivative financial instruments. To illustrate, our trading stock price at the end of the first quarter of 2005 was \$0.15 and then increased to \$0.93 by the end of the second quarter. Our trading stock price then declined to \$0.61 and \$0.59 at the end of the third and fourth quarters, respectively. However, the higher stock price had the effect of significantly increasing the fair value of our derivative liabilities and, accordingly, we were required to adjust the derivatives to these higher values with charges to our income. Also, due to the higher stock price commencing in the second quarter, we experienced significant exercise and conversion activity related to our derivative warrants and, to a lesser degree, with respect to the embedded conversion options. Accordingly, our year end derivative liability balances reflect, among other elements of our valuation assumptions, the higher intrinsic values of the arrangements caused by the significant changes in our stock price, which are offset by a smaller number of common shares indexed to outstanding warrants due to the extraordinary level of exercise activity.

(b) During the year ended December 31, 2005, we entered into a \$2,300,000 debt and warrant financing arrangement, more fully discussed in Note 6(b). In connection with our accounting for this financing we encountered the unusual circumstance of a day-one loss related to the recognition of derivative instruments arising from the arrangement. That means that the fair value of the bifurcated compound derivative and warrants exceeded the proceeds that we received from the arrangement and we were required to record a loss to record the derivative financial instruments at fair value. The loss that we recorded amounted to \$8,663,869. We did not enter into any other financing arrangements during the periods reported that reflected day-one losses.

Because our derivative financial instruments are carried at, and periodically adjusted to, fair value, our income is likely to experience continuing volatility as assumptions underlying our fair value techniques (including internal factors and external market indicators) change. However, we are currently evaluating contracts underlying the origination of these derivative financial instruments to determine whether they may be modified with the investor. There can be no assurance that we can reach an agreement to modify these arrangements and, if we are able to execute such modifications, we would be required to consider

whether such modification(s) is significant. In instances where modifications are considered significant, we may be required to extinguish the original financial instrument and reestablish it at fair value. These extinguishments,

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if any, would likely be accompanied with extinguishment gains or losses that we would be required to reflect in our income.

Finally, we entered into a \$30.0 million debt and warrant financing in July 2006 (see "Material Events" below) that will likely require the bifurcation of additional derivative financial instruments. We have not yet calculated the amounts of these derivatives, but their effects on our income, arising from fair value changes, will be afforded the same accounting treatment as those that we currently carry.

### Liquidated Damages

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During the year ended December 31, 2005, we recorded liquidated damages expense of \$303,750 (none in 2004). We have entered into registration rights agreements with certain investors that require us to file a registration statement covering underlying indexed shares, become effective on the registration statement, maintain effectiveness and, in some instances, maintain the listing of the underlying shares. Certain of these registration rights agreements require our payment of cash penalties to the investors in the event we do not achieve the requirements. We also record estimated liquidated damages penalties as liabilities and charges to our income when the cash penalties are probable and estimable. We will evaluate our estimate of liquidated damages in future periods and adjust our estimates for changes, if any, in the facts and circumstances underlying their calculation. We record these liquidated damages when they are probable and estimable pursuant to Financial Accounting Standard No. 5, Accounting for Contingencies.

### Interest Expense

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We incurred interest expense for the year ended December 31, 2005 of \$1,667,294. Our interest expense increased by \$231,889, a 16% increase compared to \$1,435,405 in 2004. The increase was due to the effects of application of the effective interest method where an effective interest amount, as calculated at the inception of the debt is applied to the carrying value at the end of each period. Under this method, periodic interest charges increases over the debt term as the debt carrying value increases.

### Other expense

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Other expense consists of debt extinguishment losses and (gains). These amounts arose from certain modifications that we made to our debt arrangements that required our re-measurement of the carrying value to fair value because the modification was significant. We may modify other debt arrangements as discussed under the discussion related to our derivative financial instruments. Each modification will require a determination whether an extinguishment occurred and, if so, an extinguishment gain or loss may require recognition.

Subsequent to our year ended December 31, 2005, we began to incur penalties related to a financing arrangement that required us to, among other things, become effective on a registration statement. We have not become effective on the registration statement. As of June 30, 2006, we incurred in excess of \$2.1 million of penalties under this arrangement, and we paid these amounts beginning in the third fiscal quarter of our year ending December 31, 2006. Our other expense in future periods will reflect charges related to these penalties, and such penalties will continue until the events that give rise to the penalties are cured. In the event that we cure the default events that give rise to the penalties, certain default provisions will continue, such as maintaining effectiveness, that could give rise to additional penalties.

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### Consolidated Net Loss

We had a net loss for the year ended December 31 2005 of \$79,528,653 compared with a net loss of \$11,517,620 in 2004. There were a number of factors that gave rise to our losses in 2005 and 2004. First, we are currently expending funds in developing our administrative and operating infrastructure and our sales channels and, as a result, our current revenue volume has not been sufficient to offset our operating expenses resulting in an operating loss during the years ended December 31, 2005 and 2004. We anticipate that our operating expenses as a percentage of our sales will decrease in future periods as our revenues increased and our costs level. In addition, we incurred a one-time \$3,000,000 fee during the year ended December 31, 2005 related to the acquisition of our customer, CCE. We do not currently anticipate incurring similar costs in the foreseeable future. Finally, the overall magnitude of both the 2005 and 2004 net loss can be attributable largely to the fair value adjustments related to our derivative financial instruments of \$60,823,574 and \$6,309,933 in 2005 and 2004, respectively. See the discussion above, about our derivative income (expense) for additional information. Our earnings will continue to be affected by the fair value adjustments of our derivative financial instruments until they are disposed of

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through contractual modifications, conversions and exercises of our share indexed instruments, or expiration.

### Consolidated Loss Applicable to Common Shareholders

Loss applicable to common shareholders represents net loss as adjusted for preferred stock dividends and accretion of our redeemable preferred stock and our equity classified preferred stock to redemption values using the effective method. Many of our preferred stock series have cumulative dividend features and we will continue to reflect preferred stock dividends in our loss applicable common shareholders until the preferred stock is converted, if ever. In addition, many of our redeemable preferred stock series were initially discounted due to the allocation of financing proceeds to detachable warrants and embedded derivative financial instruments. We use the effective method to amortize these discounts. The use of the effective method to accrete our discounted redeemable preferred stock to redemption values causes accretion to increase over the redemption period as the carrying values increase. Accordingly, accretions will increase in future periods until the preferred is fully accreted to redemption values or converted.

### Consolidated Loss per Common Share

The Company's basic loss per common share applicable to common stockholders for the year ended December 31, 2005 was \$(0.60) compared with a basic loss per common share applicable to common stockholders for the same period in 2004 of \$(0.31). Because the Company experienced net losses in 2005 and 2004, all potential common share conversions existing in our financial instruments would have an antidilutive impact on earnings per share; therefore, diluted loss per common share equals basic loss per common share for both years.

The weighted average common shares outstanding increased from 40,229,738 for the year ended December 31, 2004 to 135,032,836 for the year ended December 31, 2005. The increase is attributed primarily to conversions of our convertible debt and preferred instruments into common shares. Potential common stock conversions excluded from the computation of diluted earnings per share amounted to 108,059,082 and 126,767,057 for the years ending December 31 2005 and 2004, respectively.

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### Consolidated Comprehensive Loss

Comprehensive loss differs from net loss for the year ended December 2005 and 2004 by (\$30,759) and (\$689), respectively, which represents the effects of foreign currency translation on the financial statements of our subsidiaries denominated in foreign currencies. Our foreign operations are currently not significant. Increases in our foreign operations will likely increase the effects of foreign currency translation adjustments on our financial statements.

### LIQUIDITY AND CAPITAL RESOURCES

We have incurred operating losses and negative cash flow from operations and have negative working capital of \$39,287,983 as of December 31, 2005. This negative figure is largely the effect of our recording of \$35,939,235 for derivative liabilities. In addition, we have experienced delays in filing our financial statements and registration statements due to errors in our historical accounting which have been corrected. Our inability to make these filings is resulting in our recognition of penalties payable to the investors following December 31, 2005. In fact, we incurred a total of \$4.5 million in penalties by June 30, 2006. Further, these penalties will continue until we can complete our filings and register the common shares into which the investors' financial instruments are convertible. Finally, commencing in the fourth fiscal quarter of 2005, our revenues are significantly concentrated with one major customer. This concentration is currently expected to continue into the foreseeable future. The loss of this customer or

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curtailment in business with this customer could have a material adverse affect on our business. These conditions raise substantial doubt about our ability to continue as a going concern.

We have been dependent upon third party financings as we execute on our business model and plans. In August 2006, we completed a \$30.0 million convertible note financing that is expected to fulfill our liquidity requirements through the end of 2006. However, \$15.0 million of this financing is held in escrow, and there can be no assurance that the investor will release these amounts. We have entered into an Amendment Agreement with the holders of the Notes to amend the Notes in certain respects as consideration for the holders' release of the Company's default resulting from its delay in the filing of the second quarterly report.

We plan to increase our revenues, improve our gross margins, augment our international business and, if necessary, obtain additional financing. Ultimately, our ability to continue is dependent upon the achievement of profitable operations. There is no assurance that further funding will be available at acceptable terms, if at all, or that we will be able to achieve profitability.

The accompanying financial statements do not reflect any adjustments that may result from the outcome of this uncertainty.

### Information about our cash flows

For the year ended December 31, 2005, we reported that net cash used in operating activities was \$9,301,078, net cash provided by financing activities was \$18,209,600 and net cash used in investing activities was \$4,043,665. We had a negative working capital of \$39,287,983 as of December 31, 2005.

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Compared to \$3,629,863 of net cash used in operating activities in the year ended December 31, 2004, our current year net cash used in operating activities increased by \$5,671,215 to \$9,301,078. Changes in accounts receivable contributed to an increase in cash used by operating activities of \$3,356,477, as compared to contributing to an increase of \$77,217 for 2004 for a difference of \$3,279,260. Cash used by operating activities increased as a result of changes in inventory during 2005 by \$379,489, compared to cash provided of \$43,339 for the same period in 2004. This was the result of our building inventory during 2005 in connection with the continued implementation of our Master Distribution Agreement with Coca-Cola Enterprises. The changes in accounts payable and accrued liabilities for the year ended December 31, 2005 contributed to a reduction in cash used by operating activities of \$7,294,548, whereas such changes in 2004 contributed to a decrease in cash used by operating activities of \$542,282. Cash flows generated by our operating activities were inadequate to cover our cash disbursement needs for the year ended December 31, 2005, and we had to rely on private placement financing, prior equity and new convertible debt financing to cover operating expenses.

Cash used in the year ended December 31, 2005 in our investing activities was \$4,043,665 for license and trademark costs and equipment purchases, compared to \$531,263 for the same period in 2004.

Net cash provided by our financing activities for the year ended December 31, 2005 was \$18,209,600. Net cash provided by financing activities for the same period in 2004 was \$4,216,844, for a net increase of \$13,992,756. The increase is attributed to private placement financings amounting to \$20,690,000.

Going forward, our primary requirements for cash consist of the following:

- o the continued development of our business model in the United States and on an international basis;

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- o promotional and logistic production support for the capacity demands presented by our Master Distribution Agreement with Coca-Cola Enterprises;
- o general overhead expenses for personnel to support the new business activities;
- o development, launch and marketing costs for our line of new branded flavored milk products; and
- o the payment of guaranteed license royalties.

We estimate that our need for financing to meet cash requirements for operations will continue through the fourth quarter of 2006, when we expect that cash supplied by operating activities will approach the anticipated cash requirements for operating expenses. We anticipated the need for additional financing in 2006 to reduce our liabilities, assist in marketing and to improve stockholders' equity status, and we secured \$30 million in senior convertible note financing in July 2006. We have received half of the proceeds from this financing in the third quarter, with the balance held in escrow pending a shareholder vote to increase our authorized shares to cover the escrowed balance. No assurances can be given that we will be able to obtain the approval of our shareholders to increase our authorized shares, or that operating cash flows will be sufficient to fund our operations.

We currently have monthly working capital needs of approximately \$550,000 for operations. We expect that we will continue to incur significant selling and other expenses in 2006 in order to derive more revenue in retail markets,

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through the introduction and ongoing support of our new products and the implementation of the Master Distribution Agreement with Coca-Cola Enterprises. We anticipate that certain of these expenses, such as slotting fees and freight charges, will be reduced as a function of unit sales costs as we expand our sales markets and increase our revenues within established markets and that freight charges will be reduced as we are able to ship more full truckloads of product given the reduced per unit cost associated with full truckloads versus less than full truckloads. Similarly, slotting fees, which are paid to warehouses or chain stores as initial set up or shelf space fees, are essentially one-time charges per new customer. We believe that along with the increase in our unit sales volume, the average unit selling expenses and associated costs will decrease, resulting in gross margins sufficient to mitigate cash needs. In addition, we are actively seeking additional financing to support our operational needs and to develop an expanded promotional program for our products.

### External Sources of Liquidity

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On May 12, 2006, we obtained financing in the amount \$2,500,000 and issued promissory notes in that aggregate principal amount to two accredited investors. One of these investors has exercised rights of participation and has reinvested \$1,000,000 of this note in the July 27, 2006 financing described below. The remaining \$1,500,000 principal of the notes has been paid in full with the part of the July 27, 2006 financing proceeds.

On July 27, 2006, we entered into definitive agreements to sell \$30 million senior convertible notes (the "Notes") that are due in 2010 to several institutional and accredited investors in a private placement exempt from registration under the Securities Act of 1933. The notes initially carry a 9% coupon, payable quarterly, and are convertible into shares of common stock at \$0.70 per share. In 2007, the coupon may decline to LIBOR upon the Company achieving certain financial milestones. The Notes will begin to amortize in equal, bi-monthly payments beginning in mid-2007. We issued warrants to purchase 12,857,143 shares of common stock at \$0.73 per share that expire in July 2011 to the investors in the private placement. Under the terms of the financing, we sold \$30 million notes, of which \$15.0 million of the notes are being held in escrow. The release of the funds will be subject to stockholder approval of the increase of our authorized shares from 300,000,000 to 500,000,000 and the effectiveness of a registration statement covering the common stock underlying the outstanding Notes, and the additional notes and associated warrants currently held in escrow. We will utilize this financing for, among other things, our

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working capital needs. We have filed a proxy statement seeking such shareholder approval at a Special Meeting of Shareholders.

As a result of our failure to file our June 30, 2006 Form 10-QSB timely, an event of default has occurred under the terms of the notes and the interest rate on the Notes, payable quarterly, was increased from 9% to 14% per annum. Pursuant to the terms of the Notes, upon the occurrence of an event of default, holders of the Notes may, upon written notice to the Company, each require the Company to redeem all or any portion of their notes, at a default redemption price calculated pursuant to the terms of the Notes. We have entered into an Amendment Agreement with the holders of the notes to amend the Notes in certain respects as consideration for the holders' release of the Company's default resulting from its delay in the filing of this quarterly report.

### Material Events

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In January 2005, we launched our Slammers(R) Starburst line of Fruit & Cream Smoothies utilizing a "shelf stable" re-sealable plastic bottle for milk products that does not require refrigeration. Until that launch, all single served flavored milk in plastic bottles required refrigeration for storage, distribution, and shelf placement. The tactical advantage of distributing milk products ambient enables us to side-step a major entry barrier in our immediate consumption strategy. Refrigerated milk is relegated to dairy direct-store-delivery systems that are controlled by either regional dairy processors or larger national dairy holding companies. Shelf stable re-sealable plastic bottle allows us to use a more traditional distribution network that accommodates the non-refrigerated beverages. Also, milk products packaged in shelf stable re-sealable plastic bottles have significantly longer shelf life for storage, allowing us to ship in full truckloads resulting in decreased freight costs. We currently are converting all of our products to "shelf stable" re-sealable plastic bottles.

On August 31, 2005, we entered into a Master Distribution Agreement with Coca-Cola Enterprises, Inc., which included the attendant grant of three year warrants by CCE for the right to purchase 30 million shares of the Company's common stock at an exercise price of \$0.36 per share. The ten year exclusive Master Distribution Agreement will expand significantly the distribution and sales of our products. The Company capitalized a \$15,960,531 intangible asset associated with this agreement, which will be amortized over the 10-year term of the Master Distribution Agreement.

On November 28, 2005, we closed a funding transaction with 13 accredited institutional investors, for the issuance and sale of 40,500,000 shares of our common stock for a purchase price of \$20,250,000. In addition, we also issued five-year warrants for the purchase of an additional 15,187,500 shares of common stock at an exercise price of \$0.80 per share. The securities are restricted and have been issued pursuant to an exemption to the registration requirements of Section 5 of the Securities Act of 1933 for "transactions of the issuer not involving any public offering" provided in Section 4(2) of the Act and pursuant to a Regulation D offering. In connection with this financing, we issued common stock purchase warrants to purchase 1,012,500 shares of common stock at an exercise price of \$.50 per share and 304,688 shares of common stock at an exercise price of \$.80 per share to SG Cowen & Co., LLC, who acted as placement agent for this financing.

### EFFECTS OF INFLATION

We believe that inflation has not had any material effect on our net sales and results of operations.

### ITEM 7. - FINANCIAL STATEMENTS

The consolidated financial statements for the years ended December 31, 2005 and 2004 are contained on Pages F-1 to F-69 which follow.

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BRAVO! FOODS INTERNATIONAL CORP. AND SUBSIDIARY

CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEARS ENDED DECEMBER 31, 2005 and 2004

F-1



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BRAVO! FOODS INTERNATIONAL CORP. AND SUBSIDIARY

## INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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| Report of Independent Registered Public Accounting Firm      | F-3          |
| Consolidated Financial Statements                            |              |
| Consolidated Balance Sheets                                  | F-4 to F-5   |
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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders  
Bravo! Foods International Corp.  
North Palm Beach, Florida

We have audited the accompanying consolidated balance sheets of Bravo! Foods International Corp. as of December 31, 2005 and 2004 and the related consolidated statements of operations and comprehensive loss, stockholders' deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Bravo! Foods International Corp. as of December 31, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As shown in the financial statements, the Company incurred a net loss of \$79,528,653 for the year ended December 31,

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2005 and as of that date had a working capital deficiency of \$39,287,983. The Company is also delinquent in payment of certain debts. These conditions raise substantial doubt about their ability to continue as a going concern. Management's actions in regard to these matters are more fully described in Note 1. The financial statements do not include any adjustments relating to the recoverability and classification of recorded assets, or the amounts and classification of liabilities that might be necessary in the event the Company cannot continue in existence.

As more fully described in Note 13 to the consolidated financial statements, the accompanying consolidated balance sheets as of December 31, 2005 and 2004, and the related consolidated statements of operations and comprehensive loss, stockholders' deficit and cash flows for the years then ended, have been restated to reflect the proper accounting for certain transactions.

/s/ Lazar Levine & Felix LLP

New York, New York

February 9, 2006, except for Note 13

as to which the date is September 8, 2006

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### BRAVO! FOODS INTERNATIONAL CORP. AND SUBSIDIARY

#### CONSOLIDATED BALANCE SHEETS

|  | Decem<br>2005<br>(Restated) |
|--|-----------------------------|
| Assets   |                             |
| Current assets:  |                             |
| Cash and cash equivalents  | \$ 4,947,986                |
| Accounts receivable, net of allowance for doubtful accounts of<br>\$350,000 and \$90,396 for 2005 and 2004, respectively | 3,148,841                   |
| Inventories  | 391,145                     |
| Prepaid expenses   | 973,299                     |
|  | 9,461,271                   |
| Fixed assets   | 288,058                     |
| Intangible assets, net   | 18,593,560                  |
| Other assets   | 15,231                      |
|  | \$ 28,358,120               |

See accompanying notes

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### BRAVO! FOODS INTERNATIONAL CORP. AND SUBSIDIARY

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## CONSOLIDATED BALANCE SHEETS

### Liabilities, Redeemable Preferred Stock and Stockholders' Deficit

#### Current liabilities:

|                               |              |
|-------------------------------|--------------|
| Accounts payable              | \$ 5,987,219 |
| Accrued liabilities           | 4,872,277    |
| Notes payable                 | 937,743      |
| Convertible notes payable     | 1,012,780    |
| Derivative liabilities        | 35,939,235   |
|                               | -----        |
| Current and total liabilities | 48,749,254   |
|                               | -----        |

Commitments and contingencies (Note 11)

-

#### Redeemable preferred stock:

|   |         |
|---|---------|
| Series F convertible, par value \$0.001 per share, 200,000 shares designated<br>Convertible Preferred Stock, stated value \$10.00 per share,<br>5,248 and 55,515 shares issued and outstanding                  | 52,480  |
| Series H convertible, par value \$0.001 per share, 350,000 shares designated,<br>7% Cumulative Convertible Preferred Stock, stated value<br>\$10.00 per share, 64,500 and 165,500 shares issued and outstanding | 388,305 |
| Series I convertible, par value \$0.001 per share, 200,000 shares designated,<br>8% Cumulative Convertible Preferred Stock, stated value<br>\$10.00 per share, 0 and 30,000 shares issued and outstanding       | -       |
| Series J, par value \$0 001 per share, 500,000 shares designated, 8%<br>Cumulative Convertible Preferred Stock, stated value \$10.00 per share,<br>200,000 shares issued and outstanding                        | 871,043 |
| Series K, par value \$0 001 per share, 500,000 shares designated, 8%<br>Cumulative Convertible Preferred Stock, stated value \$10.00 per share,<br>95,000 shares issued and outstanding                         | 792,672 |
|   | -----   |

Total redeemable preferred stock

2,104,500

#### Stockholders' Deficit:

Preferred stock, 5,000,000 shares authorized

|  |         |
|--|---------|
| Series B convertible, par value \$0.001 per share, 1,260,000 shares<br>designated, 9% Convertible Preferred Stock, stated value \$1.00 per<br>share, 107,440 shares issued and outstanding | 107,440 |
|--|---------|

Common stock, par value \$0.001 per share, 300,000,000 shares

|  |             |
|--|-------------|
| authorized, 184,253,753 and 184,254, 501 shares issued and outstanding | 184,254     |
| Additional paid-in capital   | 96,507,932  |
| Common stock subscription receivable                                   | (10,000)    |
| Accumulated deficit  | 119,254,501 |
| Translation adjustment   | (30,759)    |
|  | -----       |

Total stockholders' deficit

(22,495,634)

Total liabilities, redeemable preferred stock and stockholders' deficit

\$ 28,358,120

See accompanying notes

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BRAVO! FOODS INTERNATIONAL CORP. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS  
AND COMPREHENSIVE LOSS

|  | Years ended December 31, |               |
|--|--------------------------|---------------|
|  | 2005                     | 2004          |
|  | (Restated)               | (Restated)    |
| Revenues   | \$ 11,948,921            | \$ 3,344,69   |
| Product costs  | (8,938,692)              | (2,374,80     |
| Shipping costs   | (1,505,035)              | (498,31       |
| Gross margin   | 1,505,194                | 471,58        |
| Operating expenses:  |                          |               |
| Selling  | 7,464,876                | 1,300,67      |
| General and administrative   | 7,263,284                | 2,677,06      |
| Product development  | 636,342                  | 206,12        |
| Non-recurring finder's fee   | 3,000,000                |               |
| Loss from operations   | (16,859,308)             | (3,712,28     |
| Other income (expenses), net:  |                          |               |
| Derivative income (expense)  | (60,823,574)             | (6,309,93     |
| Interest   | (1,667,294)              | (1,435,40     |
| Other  | 125,273                  | (60,00        |
| Liquidated damages   | (303,750)                |               |
| Loss before income taxes   | (79,528,653)             | (11,517,62    |
| Provision for income taxes   | -                        |               |
| Net loss   | (79,528,653)             | (11,517,62    |
| Adjustments to net loss to arrive at loss applicable to common stockholders: |                          |               |
| Preferred stock dividends  | (336,300)                | (388,63       |
| Accretion of preferred stock   | (985,717)                | (599,38       |
| Loss applicable to common stockholders                                       | \$ (80,850,670)          | \$ (12,505,64 |
| Basic and diluted loss per common share                                      | \$ (0.60)                | \$ (0.3       |
| Weighted average number of common shares outstanding                         | 135,032,836              | 40,229,73     |
| Comprehensive loss and its components consist of the following:              |                          |               |
| Net loss   | \$ (79,528,653)          | \$ (11,517,62 |
| Foreign currency translation adjustment                                      | (30,759)                 | (68           |
| Comprehensive loss   | \$ (79,559,412)          | \$ (11,518,30 |

See accompanying notes

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BRAVO! FOODS INTERNATIONAL CORP. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004

|   | Years ended De     |
|---|--------------------|
|   | 2005<br>(Restated) |
|   | -----              |
| Cash flows from operating activities:                                       |                    |
| Net loss  | \$(79,528,653)     |
| Adjustments to reconcile net loss to net cash used in operating activities: |                    |
| Depreciation and amortization   | 2,251,646          |
| Stock issuances for compensation  | 346,438            |
| Equity instruments to be issued for consulting expenses                     | 1,472,261          |
| Options issued for compensation   | 798,869            |
| Bad debt expense  | 259,604            |
| (Gain) loss on debt extinguishment  | (125,273)          |
| Derivative expense  | 60,823,574         |
| Amortization of debt discount   | 1,428,638          |
| Loss on disposal of fixed assets  | -                  |
| Increase (decrease) in cash from changes in:                                |                    |
| Accounts receivable   | (3,356,477)        |
| Other receivable  | -                  |
| Inventories   | (379,489)          |
| Prepaid expenses and other assets   | (586,764)          |
| Accounts payable and accrued expenses                                       | 7,294,548          |
|   | -----              |
| Net cash used in operating activities                                       | (9,301,078)        |
|   | -----              |
| Cash flows from investing activities:                                       |                    |
| Licenses and trademark costs  | (3,823,521)        |
| Purchase of equipment   | (220,144)          |
|   | -----              |
| Net cash used in investing activities                                       | (4,043,665)        |
|   | -----              |
| Cash flows from financing activities:                                       |                    |
| Proceeds from sale of preferred stock                                       | -                  |
| Exercise of warrants  | 3,208,509          |
| Proceeds from convertible notes payable                                     | 2,850,000          |
| Proceeds from sale of common stock and warrants                             | 20,690,000         |
| Payments for redemption of warrants   | (5,900,000)        |
| Payment of note payable   | (500,000)          |
| Registration costs of financing   | (2,138,909)        |
|   | -----              |
| Net cash provided by financing activities                                   | 18,209,600         |
|   | -----              |
| Effect of changes in exchange rate on cash                                  | (30,759)           |
|   | -----              |
| Net increase in cash and cash equivalents                                   | 4,834,098          |
| Cash and cash equivalents, beginning of period                              | 113,888            |
|   | -----              |

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Cash and cash equivalents, end of period \$ 4,947,986  
=====

See accompanying notes

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BRAVO! FOODS INTERNATIONAL CORP. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004

| Supplemental Cash Flow Information                             | 2005<br>(Restated)<br>----- |
|--|-----------------------------|
| Cash paid during the year for interest                         | \$ 10,741<br>=====          |
| Cash paid for taxes  | \$ -<br>=====               |
| Non-cash investing and financing activities:                   |                             |
| Purchase of intangible assets with derivative warrants         | \$ 15,960,531<br>=====      |
| Conversion of notes payable and accrued interest               | \$ 20,343,934<br>=====      |
| Conversion of redeemable preferred stock and related dividends | \$ 2,644,326<br>=====       |
| Exercise of derivative warrants                                | \$ 35,230,018<br>=====      |
| Beneficial Conversion Feature                                  | \$ -<br>=====               |

See accompanying notes

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BRAVO! FOODS INTERNATIONAL CORP. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT  
FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004

|   | Preferred Stock | Common Stock | Additional         | Accumulated | Common             |                 |    |
|---|-----------------|--------------|--------------------|-------------|--------------------|-----------------|----|
|   | Shares          | Amount       | Paid In<br>Capital | Deficit     | Subscrip<br>Receiv |                 |    |
| Balance, January 1, 2004<br>(Restated)                    | 107,440         | \$107,440    | 28,047,542         | \$ 28,045   | \$18,430,875       | \$ (26,556,046) | \$ |
| Issuance of common stock<br>for services                  | -               | -            | 9,332,300          | 9,332       | 666,300            | -               |    |
| Conversion redeemable<br>preferred stock and<br>dividends | -               | -            | 15,897,701         | 15,898      | 1,553,713          | (642,465)       |    |

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|   |         |           |             |           |              |                 |       |
|---|---------|-----------|-------------|-----------|--------------|-----------------|-------|
| Conversion notes payable                            | -       | -         | 4,265,958   | 4,266     | 527,228      | -               |       |
| Private Placement financing                         | -       | -         | 250,000     | 250       | 29,750       | -               |       |
| Beneficial conversion feature                       | -       | -         | -           | -         | 220,000      | -               |       |
| Financing Costs                                     | -       | -         | -           | -         | (40,656)     | -               |       |
| Net loss for 2004                                   | -       | -         | -           | -         | -            | (11,517,620)    |       |
| Translation adjustment                              | -       | -         | -           | -         | -            | -               |       |
| -----   |         |           |             |           |              |                 |       |
| Balance, December 31, 2004 (Restated)               | 107,440 | 107,440   | 57,793,501  | 57,791    | 21,387,210   | (38,716,131)    |       |
| Conversion redeemable preferred stock and dividends | -       | -         | 9,245,352   | 9,247     | 2,659,079    | (24,000)        |       |
| Exercise of warrants                                | -       | -         | 32,474,792  | 32,475    | 38,406,052   | -               |       |
| Conversion notes payable                            | -       | -         | 41,248,858  | 41,249    | 20,302,685   | -               |       |
| Private placement financing                         | -       | -         | 40,950,000  | 40,950    | 20,649,050   | -               |       |
| Common stock subscribed but not paid                | -       | -         | -           | -         | -            | -               | (10   |
| Stock issued for compensation                       | -       | -         | 2,541,250   | 2,542     | 343,896      | -               |       |
| Financing costs                                     | -       | -         | -           | -         | (2,138,909)  | -               |       |
| Stock option expense                                | -       | -         | -           | -         | 798,869      | -               |       |
| Redemption of warrants                              | -       | -         | -           | -         | (5,900,000)  | -               |       |
| Accretion of preferred stock                        | -       | -         | -           | -         | -            | (985,717)       |       |
| Net loss for 2005                                   | -       | -         | -           | -         | -            | (79,528,653)    |       |
| Translation adjustment                              | -       | -         | -           | -         | -            | -               |       |
| -----   |         |           |             |           |              |                 |       |
| Balance, December 31, 2005 (Restated)               | 107,440 | \$107,440 | 184,253,753 | \$184,254 | \$96,507,932 | \$(119,254,501) | \$(10 |
| =====   |         |           |             |           |              |                 |       |

See accompanying notes

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BRAVO! FOODS INTERNATIONAL CORP. AND SUBSIDIARY  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 FOR THE YEARS ENDED DECEMBER 31 2005 AND 2004

Note 1 - Nature of Business, Liquidity and Management's Plans and Significant Accounting Policies

Nature of Business:

We are engaged in the sale of flavored milk products and flavor ingredients in the United States, the United Kingdom, Central America and the Middle East, and we are establishing an infrastructure to conduct business in Canada.

Liquidity and Management's Plans:

As reflected in the accompanying consolidated financial statements, we have incurred operating losses and negative cash flows from operations and have a working capital deficiency of \$39,287,983 as of December 31, 2005. In addition, we are delinquent on certain of our debt agreements at December 31, 2005, and we have experienced delays in filing our financial statements and registration statements due to errors in our historical accounting that have been corrected

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(See Note 13). Our inability to make these filings is resulting in our recognition of penalties to the investors, and these penalties will continue until we can complete our filings and register the common shares into which the investors' financial instruments are convertible. Finally, our revenues are significantly concentrated with one major customer. The loss of this customer or curtailment in business with this customer could have a material adverse affect on our business. These conditions raise substantial doubt about our ability to continue as a going concern.

We have been dependent upon third party financings as we execute our business model and plans. We completed a \$30.0 million convertible note financing in August 2006 that is expected to fulfill our liquidity requirements through the end of 2006. However, \$15.0 million of this financing is held in escrow, pending approval by our shareholders of an increase in our authorized shares of common stock. We were in default on this instrument due to the delay in filing our quarterly financial report for the quarterly period ended June 30, 2006. As a result, an event of default has occurred under the terms of the Notes and the interest rate on the Notes, payable quarterly, was increased from 9% to 14% per annum. Pursuant to the terms of the Notes, upon the occurrence of an event of default, holders of the Notes may, upon written notice to the Company, each require the Company to redeem all or any portion of their Notes, at a default redemption price calculated pursuant to the terms of the Notes. During September 2006, we entered into an Amendment Agreement with the holders of the Notes to amend the Notes in certain respects as consideration for the holders' release of the Company's default resulting from its delay in the filing of our Form 10-QSB for the quarter ended June 30, 2006.

We plan to increase our sales, improve our gross profit margins, augment our international business and, if necessary, obtain additional financing. Ultimately, our ability to continue is dependent upon the achievement of profitable operations. There is no assurance that further funding will be available at acceptable terms, if at all, or that we will be able to achieve profitability.

The accompanying financial statements do not reflect any adjustments that may result from the outcome of this uncertainty.

### Significant Accounting Policies:

#### Use of Estimates

-----

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the

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reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant estimates included in our financial statements are the following:

- Estimating future bad debts on accounts receivable that are carried at net realizable values.
- Estimating our reserve for unsalable and obsolete inventories that are carried at lower of cost or market.
- Estimating the fair value of our financial instruments that are required to be carried at fair value.



- Estimating the recoverability of our long-lived assets.

We use all available information and appropriate techniques to develop our estimates. However, actual results could differ from our estimates.

#### Business Segment and Geographic Information

-----

We operate in one dominant industry segment that we have defined as the single serve flavored milk industry. While our international business is expected to grow in the future, it currently contributes less than 10% of our revenues, and we have no physical assets outside of the United States.

#### Revenue Recognition

-----

Our revenues are derived from the sale of branded milk products to customers in the United States of America, Great Britain and the Middle East. Geographically, our revenues are dispersed 98% and 2% between the United States of America and internationally, respectively. We currently have one customer in the United States that provided 34% and 0% of our revenue during the years ended December 31, 2005 and 2004, respectively. Since we commenced business with this customer during our fourth fiscal quarter of 2005, we expect that our revenue from this customer will increase as a percentage of total sales in the near future.

Revenues are recognized pursuant to formal revenue arrangements with our customers, at contracted prices, when our product is delivered to their premises and collectibility is reasonably assured. We extend merchantability warranties to our customers on our products but otherwise do not afford our customers with rights of return. Warranty costs have historically been insignificant.

Our revenue arrangements often provide for industry-standard slotting fees where we make cash payments to the respective customer to obtain rights to place our products on their retail shelves for a stipulated period of time. We also engage in other promotional discount programs in order to enhance our sales activities. We believe our participation in these arrangements is essential to ensuring continued volume and revenue growth in the competitive marketplace. These payments, discounts and allowances are recorded as reductions to our reported revenue. Unamortized slotting fees are recorded in prepaid expenses.

#### Principles of Consolidation

-----

Our consolidated financial statements include the accounts of Bravo! Foods International Corp. (the "Company"), and its wholly-owned subsidiary Bravo! Brands (UK) Ltd. All material intercompany balances and transactions have been eliminated. Cumulative translation adjustments that we make to reflect the accounts of Bravo! Brands (UK) Ltd. in United States Dollars are recorded as a component of other comprehensive income (loss) and stockholder's equity. Foreign currency transaction gains and losses are reported as a component of other income (expense).

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#### Shipping and Handling Costs

-----

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Shipping and handling costs incurred to deliver products to our customers are included as a component of cost of sales. These costs amounted to approximately \$1,505,035 and \$498,313 for the years ended December 31, 2005 and 2004, respectively.

### Cash and Cash Equivalents

-----

We consider all highly liquid investments purchased with a remaining maturity of three months or less to be cash equivalents.

### Accounts Receivable

-----

Our accounts receivable are exposed to credit risk. During the normal course of business, we extend unsecured credit to our customers with normal and traditional trade terms. Typically credit terms require payments to be made by the thirtieth day following the sale. We regularly evaluate and monitor the creditworthiness of each customer. We provide an allowance for doubtful accounts based on our continuing evaluation of our customers' credit risk and our overall collection history. As of December 31, 2005 and 2004, the allowance of doubtful accounts aggregated \$350,000 and \$90,396, respectively.

In addition, our accounts receivable are concentrated with one customer that represents 70% and 0% of our gross accounts receivable balances at December 31, 2005 and 2004, respectively. Approximately 2% of our gross accounts receivable at December 31, 2005 are due from international customers.

### Inventories

-----

Inventories, which consist primarily of finished goods, are stated at the lower of cost on the first in, first-out method or market. Further, our inventories are perishable. Accordingly, we estimate and record lower-of-cost or market and unsalable-inventory reserves based upon a combination of our historical experience and on a specific identification basis. During the years ended December 31, 2005 and 2004, we did not provide for unsaleable inventories.

In November 2004, the FASB issued Financial Accounting Standard No. 151, Inventory Costs, an amendment of ARB No. 43 Chapter 4 (FAS 151), which clarifies that inventory costs that are "abnormal" are required to be charged to expense as incurred as opposed to being capitalized into inventory as a product cost. FAS 151 provides examples of "abnormal" costs to include costs of idle facilities, excess freight and handling costs and spoilage. FAS 151 will become effective for our fiscal year beginning January 1, 2006. The adoption of FAS No. 151 is not expected to have a material effect on our consolidated financial statements.

### Fixed Assets

-----

Fixed assets are stated at cost. Depreciation is computed using the straight-line method over a period of seven years for furniture and five years for equipment. Maintenance, repairs and minor renewals are charged directly to expenses as incurred. Additions and betterments to property and equipment are capitalized. When assets are disposed of, the related cost and accumulated depreciation thereon are removed from the accounts, and any resulting gain or loss is included in the statement of operations.

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### Intangible Assets

Our intangible assets, which we record at cost, consist of our distribution agreement with Coca-Cola Enterprises ("CCE") that we entered into during the third fiscal quarter of 2005, our manufacturing agreement with Jasper Products, Inc. and licenses and trademark costs with estimated lives of ten years, five years and one-to-five years, respectively.

### Impairment of Long-Lived Assets

We evaluate the carrying value and recoverability of our long-lived assets when circumstances warrant such evaluation by applying the provisions of Financial Accounting Standard No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ("FAS 144"). FAS 144 requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable through the estimated undiscounted cash flows expected to result from the use and eventual disposition of the assets. Whenever any such impairment exists, an impairment loss will be recognized for the amount by which the carrying value exceeds the fair value.

### Financial Instruments

Financial instruments, as defined in Financial Accounting Standard No. 107 Disclosures about Fair Value of Financial Instruments (FAS 107), consist of cash, evidence of ownership in an entity and contracts that both (i) impose on one entity a contractual obligation to deliver cash or another financial instrument to a second entity, or to exchange other financial instruments on potentially unfavorable terms with the second entity, and (ii) conveys to that second entity a contractual right (a) to receive cash or another financial instrument from the first entity or (b) to exchange other financial instruments on potentially favorable terms with the first entity. Accordingly, our financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities, notes payable, derivative financial instruments, convertible debt and redeemable preferred stock that we have concluded is more akin to debt than equity.

We carry cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities at historical costs; their respective estimated fair values approximate carrying values due to their current nature. We also carry notes payable, convertible debt and redeemable preferred stock at historical cost; however, fair values of debt instruments and redeemable preferred stock are estimated for disclosure purposes (below) based upon the present value of the estimated cash flows at market interest rates applicable to similar instruments.

As of December 31, 2005, estimated fair values and respective carrying values of our notes payable, convertible debt and redeemable preferred stock are as follows:

| Instrument                         | Note  | Fair Value | Carrying Value |
|------------------------------------|-------|------------|----------------|
| \$200,000 Convertible Note Payable | 6 (a) | \$ 190,000 | \$187,934      |
| \$ 15,000 Convertible Note Payable | 6 (b) | 13,300     | 1,620          |
| \$600,000 Convertible Note Payable | 6 (c) | 668,000    | 600,000        |

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|                                    |       |           |         |
|------------------------------------|-------|-----------|---------|
| \$ 6,250 Convertible Note Payable  | 6 (e) | 6,375     | 5,188   |
|                                    |       | =====     | =====   |
| \$ 25,000 Convertible Note Payable | 6 (f) | 25,500    | 30,278  |
|                                    |       | =====     | =====   |
| \$187,760 Convertible Note Payable | 6 (g) | 187,760   | 187,760 |
|                                    |       | =====     | =====   |
| Series F Preferred Stock           | 7 (d) | 46,000    | 52,480  |
|                                    |       | =====     | =====   |
| Series H Preferred Stock           | 7 (a) | 525,000   | 388,305 |
|                                    |       | =====     | =====   |
| Series J Preferred Stock           | 7 (b) | 1,731,000 | 871,043 |
|                                    |       | =====     | =====   |
| Series K Preferred Stock           | 7 (c) | 881,000   | 792,672 |
|                                    |       | =====     | =====   |

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Derivative financial instruments, as defined in Financial Accounting Standard No. 133, Accounting for Derivative Financial Instruments and Hedging Activities (FAS 133), consist of financial instruments or other contracts that contain a notional amount and one or more underlying (e.g. interest rate, security price or other variable), require no initial net investment and permit net settlement. Derivative financial instruments may be free-standing or embedded in other financial instruments. Further, derivative financial instruments are initially, and subsequently, measured at fair value and recorded as liabilities or, in rare instances, assets.

We generally do not use derivative financial instruments to hedge exposures to cash-flow, market or foreign-currency risks. However, we have entered into certain other financial instruments and contracts, such as debt financing arrangements, redeemable preferred stock arrangements, and freestanding warrants with features that are either (i) not afforded equity classification, (ii) embody risks not clearly and closely related to host contracts, or (iii) may be net-cash settled by the counterparty. As required by FAS 133, these instruments are required to be carried as derivative liabilities, at fair value, in our financial statements.

The following table summarizes the components of derivative liabilities as of December 31, 2005 and 2004:

|  | Note  | 2005           | 2004        |
|--|-------|----------------|-------------|
|  |       | -----          | -----       |
| Compound derivative financial instruments that have been bifurcated from the following financing arrangements: |       |                |             |
|  |       |                |             |
| \$ 400,000 Convertible Note Financing  | 6 (a) | \$ (1,311,000) | \$ (20,000) |
| \$2,300,000 Convertible Note Financing   | 6 (b) | (4,867)        | (15,000)    |
| \$ 600,000 Convertible Note Financing  | 6 (c) | (153,700)      | (2,000)     |
| \$ 693,000 Convertible Note Financing  | 6 (e) | (42,878)       | (79,000)    |
| \$ 660,000 Convertible Note Financing  | 6 (f) | (159,250)      | (44,000)    |
| \$1,008,000 Convertible Note Financing   | 6 (g) | -              | (37,000)    |
| \$ 240,000 Convertible Note Financing  | 6 (d) | -              | (25,000)    |
| Series F Preferred Stock Financing   | 7 (d) | (25,632)       | (24,000)    |
| Series H Preferred Stock Financing   | 7 (a) | (381,377)      | (15,000)    |
| Series I Preferred Stock Financing   | 7 (b) | -              | (1,000)     |
| Series J Preferred Stock Financing   | 7 (b) | (5,628,000)    | (72,000)    |
| Series K Preferred Stock Financing   | 7 (c) | (206,200)      | (7,000)     |

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Freestanding derivative contracts arising from financing and other business arrangements:

|   |       |                 |            |
|---|-------|-----------------|------------|
| Warrants issued with \$693,000 Convertible Notes                      | 6 (e) | (924,120)       | (33)       |
| Warrants issued with \$400,000 Convertible Notes                      | 6 (a) | -               | (1,26)     |
| Warrants issued with \$600,000 Convertible Notes                      | 6 (c) | -               | (90)       |
| Warrants issued with \$660,000 Convertible Notes                      | 6 (f) | -               | (44)       |
| Warrants issued with \$1,008,000 Convertible Notes                    | 6 (g) | (564,735)       | (1,44)     |
| Warrants issued with \$240,000 Convertible Notes                      | 6 (d) | -               | (12)       |
| Warrants issued with Series H Preferred Stock                         | 7 (a) | (1,264,109)     | (37)       |
| Warrants issued with Series I Preferred Stock                         | 7 (i) | -               | (17)       |
| Warrants issued with Series F Preferred Stock                         | 7 (d) | (563,096)       | (64)       |
| Warrants issued with Series D Preferred Stock                         | 7 (d) | (400,214)       | (18)       |
| Warrants issued with Series J Preferred Stock                         | 7 (b) | -               | (1,08)     |
| Other warrants, including warrants issued with common stock financing | 9 (b) | (24,310,057)    | (52)       |
| Total derivative liabilities  |       | \$(35,939,235)  | \$(10,83)  |
|   |       | \$ (35,939,235) | \$ (10,83) |

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See the notes referenced in the table for details of the origination and accounting for these derivative financial instruments. We estimate fair values of derivative financial instruments using various techniques (and combinations thereof) that are considered to be consistent with the objective measuring fair values. In selecting the appropriate technique, we consider, among other factors, the nature of the instrument, the market risks that it embodies and the expected means of settlement. For less complex derivative instruments, such as freestanding warrants, we generally use the Black-Scholes-Merton option valuation technique because it embodies all of the requisite assumptions (including trading volatility, estimated terms and risk free rates) necessary to fair value these instruments. For complex derivative instruments, such as embedded conversion options, we generally use the Flexible Monte Carlo valuation technique because it embodies all of the requisite assumptions (including credit risk, interest-rate risk and exercise/conversion behaviors) that are necessary to fair value these more complex instruments. For forward contracts that contingently require net-cash settlement as the principal means of settlement, we project and discount future cash flows applying probability-weightage to multiple possible outcomes. Estimating fair values of derivative financial instruments requires the development of significant and subjective estimates that may, and are likely to, change over the duration of the instrument with related changes in internal factors and external market indicators. In addition, option-based techniques are highly volatile and sensitive to changes in our trading market price which has a high-historical volatility. Since derivative financial instruments are initially and subsequently carried at fair values, our income will reflect the volatility in these estimate and assumption changes.

The following table summarizes the effects on our income (loss) associated with changes in the fair values of our derivative financial instruments by type of financing for the years ended December 31, 2005 and 2004:

| Derivative income (expense):            | 2005            | 2004           |
|---|-----------------|----------------|
| Convertible note and warrant financings | \$(42,172,053)  | \$(3,432,061)  |
| Preferred stock and warrant financings  | (11,314,733)    | (2,561,043)    |
| Other warrants and derivative contracts | (7,336,788)     | (316,829)      |
|   | \$ (60,823,574) | \$ (6,309,933) |

=====

Additional information related to individual financings can be found in notes 6, 7 & 9.

Our derivative liabilities as of December 31, 2005 and 2004, and our derivative loss during each of the years ended December 31, 2005 and 2004 is significant to our consolidated financial statements. The magnitude of the derivative loss during the year ended December 31, 2005 when compared with the loss for the year ended December 31, 2004 reflects the following:

(a) During the year ended December 31, 2005, and specifically commencing in the second quarter, the trading price of our common stock reached significantly high levels relative to its trend. The trading price of our common stock significantly affects the fair value of our derivative financial instruments. To illustrate, our trading stock price at the end of the first quarter of 2005 was \$0.15 and then increased to \$0.93 by the end of the second quarter. Our trading stock price then declined to \$0.61 and \$0.59 at the end of the third and fourth quarters, respectively. However, the higher stock price had the effect of significantly increasing the fair value of our derivative liabilities and, accordingly, we were required to adjust the derivatives to these higher values with charges to our income. Also, due to the higher stock price commencing in the second quarter, we experienced significant exercise and conversion activity related to our derivative warrants and, to a lesser degree, with respect to the embedded conversion options. Accordingly, our year end derivative liability balances reflect, among other elements of our valuation assumptions, the higher intrinsic values of the arrangements caused by the significant changes

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in our stock price, which are offset by a smaller number of common shares indexed to outstanding warrants due to the extraordinary level of exercise activity.

(b) During the year ended December 31, 2005, we entered into a \$2,300,000 debt and warrant financing arrangement, more fully discussed in Note 6(b). In connection with our accounting for this financing we encountered the unusual circumstance of a day-one loss related to the recognition of derivative instruments arising from the arrangement. That means that the fair value of the bifurcated compound derivative and warrants exceeded the proceeds that we received from the arrangement and we were required to record a loss to record the derivative financial instruments at fair value. The loss that we recorded amounted to \$8,663,869. We did not enter into any other financing arrangements during the periods reported that reflected day-one losses.

The following table summarizes the number of common shares indexed to the derivative financial instruments as of December 31, 2005:

| Financing or other contractual arrangement: | Note | Conversion Features | Warrants  | Total     |
|---|------|---------------------|-----------|-----------|
| \$ 400,000 Convertible Note Financing       | 6(a) | 4,320,000           | -         | 4,320,000 |
| \$2,300,000 Convertible Note Financing      | 6(b) | 120,000             | 2,000,000 | 2,120,000 |
| \$ 600,000 Convertible Note Financing       | 6(c) | 4,100,000           | -         | 4,100,000 |
| \$ 693,000 Convertible Note Financing       | 6(e) | 65,104              | 1,700,000 | 1,765,104 |
| \$ 660,000 Convertible Note Financing       | 6(f) | 250,000             | 1,500,000 | 1,750,000 |

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|   |      |            |            |            |
|---|------|------------|------------|------------|
| \$1,080,000 Convertible Note Financing  | 6(g) | 1,924,540  | -          | 1,924,540  |
| Series D Convertible Preferred Stock    | 7(d) | -          | 611,250    | 611,250    |
| Series F Convertible Preferred Stock    | 7(d) | 220,969    | 1,038,259  | 1,259,228  |
| Series H Convertible Preferred Stock(a) | 7(a) | -          | 4,387,500  | 4,387,500  |
| Series J Convertible Preferred Stock    | 7(b) | 20,000,000 | -          | 20,000,000 |
| Series K Convertible Preferred Stock(a) | 7(c) | -          | -          | -          |
| Other warrants and contracts            | 9(b) | -          | 49,504,688 | 49,504,688 |
|   |      | 31,000,613 | 60,741,697 | 91,742,310 |

(a) As more fully described in Notes 7(a) and 7(c) these instruments were afforded the conventional convertible exemption, which means we did not have to bifurcate the embedded conversion feature. However, we were required to bifurcate certain other embedded derivatives as discussed in the notes. Although the conversion features did not require derivative accounting, we are required to also consider the 953,443 and 9,500,000 common shares, respectively, into which these instruments are indexed in determining whether we have sufficient authorized and unissued common shares for all of our share-settled obligations.

We have entered into registration rights agreements with certain investors that require us to file a registration statement covering shares underlying a financing arrangement, become effective on the registration statement, maintain effectiveness and, in some instances, maintain the listing of the underlying shares. Certain of these registration rights agreements require our payment of liquidating damages to the investors in the event we do not achieve the requirements. We record estimated liquidated damages as liabilities and charges to our income when the liquidated damages are probable and estimable under Financial Accounting Standard No. 5 Accounting for Contingencies. During the years ended December 31, 2005 and 2004, we recorded liquidated damages expense of \$303,750 and \$0, respectively.

Advertising and Promotion Costs

Advertising and promotion costs, which are included in selling expenses, are expensed as incurred and aggregated \$2,515,062 and \$656,614 for the years ended December 31, 2005 and 2004, respectively.

Share-Based Payments

Prior to 2005, we accounted for our stock options under the recognition and measurement provisions of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations. Effective January 1, 2005, the Company adopted the fair value recognition provisions of FASB Statement No. 123, Accounting for Stock Based Compensation ("FAS 123"). Under the modified prospective method of adoption selected by the Company under the provisions of FASB Statement No. 148, Accounting for Stock Based

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Compensation - Transition and Disclosure, ("FAS 148") compensation costs recognized in 2005 were the same as that which would have been recognized had the recognition provisions of FAS 123 been applied from the options' grant dates. This is because all outstanding options at December 31, 2004 were fully vested on that date. Consistent with the requirements of this method of adoption, results for prior years have not been restated. We recognized no tax benefit for share-based compensation arrangements due to the fact that we are

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in a cumulative loss position and recognize no tax benefits in our Consolidated Statements of Operations. For further information regarding the adoption of SFAS No. 123, see Note 8 to the consolidated financial statements.

### Income Taxes

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We account for income taxes using the liability method, which requires an entity to recognize deferred tax liabilities and assets. Deferred income taxes are recognized based on the differences between the tax bases of assets and liabilities and their reported amounts in the financial statements that will result in taxable or deductible amounts in future years. Further, the effects of enacted tax laws or rate changes are included as part of deferred tax expense or benefit in the period that covers the enactment date. A valuation allowance is recognized if it is more likely than not that some portion, or all, of a deferred tax asset will not be realized.

### Loss Per Common Share

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Our basic loss per common share is computed by dividing loss applicable to common stockholders by the weighted average number of common share outstanding during the reporting period. Diluted loss per common share is computed similar to basic loss per common share except that diluted loss per common share includes dilutive common stock equivalents, using the treasury stock method, and assumes that the convertible debt instruments were converted into common stock upon issuance, if dilutive. For the years ended December 31, 2005 and 2004 potential common shares arising from our stock options, stock warrants, convertible debt and convertible preferred stock amounting to 108,059,082 and 126,767,057 shares, respectively, were not included in the computation of diluted loss per share because their effect was antidilutive.

### Note 2 - Fixed Assets

Our fixed assets are comprised of the following as of December 31, 2005 and 2004:

|   | 2005       | 2004       |
|---|------------|------------|
|   | ----       | ----       |
| Office equipment                                | \$ 209,085 | \$ 151,577 |
| Furniture and fixtures                          | 189,068    | 150,871    |
| Automobiles                                     | 29,295     | -          |
| Leasehold improvements                          | 23,714     | 23,714     |
| Purchased software                              | 3,223      | 3,223      |
|   | -----      | -----      |
|   | 454,385    | 329,385    |
| Less: accumulated depreciation and amortization | (166,327)  | (218,179)  |
|   | -----      | -----      |
|   | \$ 288,058 | \$ 111,206 |
|   | =====      | =====      |

Depreciation and amortization expense of fixed assets aggregated \$43,292 and \$30,153 for 2005 and 2004, respectively.

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### Note 3 - Intangible Assets

Our intangible assets consist of our distribution agreement with Coca-Cola Enterprises ("CCE"), our manufacturing agreement with Jasper Products, Inc. and



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licenses and trademark costs, with estimated lives of ten years, five years and one-to-five years, respectively. The following table summarizes the components of our intangible assets as of December 31, 2005 and 2004:

|                               | 2005<br>---- | 2004<br>---- |
|-------------------------------|--------------|--------------|
| Distribution agreement        | \$15,960,531 | \$ -         |
| Manufacturing agreement       | 2,700,000    | -            |
| Licenses and trademarks       | 1,370,958    | 365,431      |
| Less accumulated amortization | (1,437,929)  | (288,393)    |
|                               | -----        | -----        |
|                               | \$18,593,560 | \$ 77,038    |
|                               | =====        | =====        |

Amortization expense amounted to \$1,411,004 and \$269,242 for the years ended December 31, 2005 and 2004, respectively.

Estimated future amortization of our intangible assets for each of the next five years is as follows as of December 31, 2005:

|                   |             |
|-------------------|-------------|
| December 31, 2006 | \$2,685,671 |
|                   | =====       |
| December 31, 2007 | \$2,367,947 |
|                   | =====       |
| December 31, 2008 | \$2,356,342 |
|                   | =====       |
| December 31, 2009 | \$2,355,844 |
|                   | =====       |
| December 31, 2010 | \$2,203,289 |
|                   | =====       |

#### Note 4 - Accrued Liabilities

Accrued liabilities consist of the following as of December 31, 2005 and December 31, 2004:

|  | 2005<br>---- | 2004<br>---- |
|--|--------------|--------------|
| Investor relations liability                   | \$1,545,565  | \$ -         |
| Production processor liability                 | 182,814      | -            |
| Accrued payroll and related                    | 636,757      | 15,000       |
| Accrued interest                               | 376,198      | 255,173      |
| Discontinued products (a)                      | 1,710,733    | -            |
| Liquidated damages due to late registraton (b) | 303,750      | -            |
| Other  | 116,460      | 174,813      |
|  | -----        | -----        |
|  | \$4,872,277  | \$444,986    |
|  | =====        | =====        |

(a) During the year ended December 31, 2005, we discontinued certain product lines and, as a result, incurred certain penalties under purchase commitments with our manufacturing vendors. We accrued these penalties upon our decision to discontinue the products.

(b) Certain of our financings provide for penalties in the event of non-registration of securities underlying the financial instruments. Generally, these penalties are calculated as a percentage of the financing proceeds, usually between 1.0% and 3.0% monthly. We record these liquidated damages when they are probable and estimable pursuant to FAS 5.

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### Note 5 -- Notes Payable

Notes payable consist of the following as of December 31, 2005 and 2004:

|  | 2005      | 2004       |
|--|-----------|------------|
|  | ----      | ----       |
| \$750,000 face value note payable, due September 3, 2004 (a) | \$750,000 | \$ 750,000 |
| \$187,743 face value note payable, due December 31, 2005 (b) | 187,743   | 187,743    |
| \$100,000 face value note payable due February 1, 2002 (c)   | -         | 100,000    |

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|                         |         |           |
|-------------------------|---------|-----------|
| Other                   |         | 147,115   |
|                         | -----   | -----     |
| Total notes payable     | 937,743 | 1,184,858 |
| Less current maturities | 937,743 | 1,184,858 |
|                         | -----   | -----     |
| Long-term notes payable | \$ -    | \$ -      |
|                         | =====   | =====     |

- (a) On May 9, 2004 we received the proceeds of a \$750,000 loan from Mid-Am Capital, payable September 3, 2004, with an interest rate of 8%. This loan is secured by a general security interest in all of our assets. Mid-Am has agreed to extend the note on a demand basis.
- (b) In 1999, we issued a promissory note to assume existing debt owed by our then Chinese joint venture subsidiary to a supplier, International Paper. The face value of that unsecured note was \$282,637 at an annual interest rate of 10.5%. The note originally required 23 monthly payments of \$7,250 and a balloon payment of \$159,862 due on July 15, 2000. During 2000, we negotiated an extension of this note to July 1, 2001. International Paper imposed a charge of \$57,000 to renegotiate the note, which amount represents interest due through the extension date. The balance due on this note is \$187,743 at December 31, 2005, all of which is delinquent. Although International Paper has not pursued collection of the note, it is possible that they could do so in the future and, if they do, such collection effort may have a significant adverse impact on the liquidity of the Company.
- (c) On November 6 and 7, 2001 respectively, the Company received proceeds of two loans aggregating \$100,000 from two offshore lenders. The two promissory notes, one for \$34,000 and the other for \$66,000, were payable on February 1, 2002 with interest at an annual rate of 8%. These loans were secured by a general security interest on all of the assets of the Company. These lenders had agreed to extend the notes without default on a demand basis. Interest accrued and unpaid at December 31, 2004 aggregated \$25,380.

### Note 6. Convertible Notes Payable

Convertible debt carrying values consist of the following as of December 31, 2005 and 2004:

|  |      |      |
|--|------|------|
|  | 2005 | 2004 |
|--|------|------|

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|  |             |             |
|--|-------------|-------------|
|  | ----        | ----        |
| \$200,000 Convertible Note Payable, due November 2006 (a)    | \$ 187,934  | \$ 175,055  |
| \$15,000 Convertible Note Payable, due May 2007 (b)          | 1,620       | -           |
| \$600,000 Convertible Note Payable, due December 2005 (c)    | 600,000     | 240,088     |
| \$6,250 Convertible Note Payable, due April 30, 2006 (e)     | 5,188       | 73,057      |
| \$25,000 Convertible Note Payable, due October 1, 2006 (f)   | 30,278      | 208,424     |
| \$187,760 Convertible Note Payable, due December 1, 2005 (g) | 187,760     | 402,607     |
|  | -----       | -----       |
|  | \$1,012,780 | \$1,099,231 |
|  | =====       | =====       |

(a) \$400,000 Convertible Note Financing

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On November 20, 2003, we issued \$400,000 of 8.0% convertible notes payable, due November 20, 2005 plus warrants to purchase 14,000,000 shares of our common stock with strike prices ranging from \$0.05 to \$1.00 for a period of three years. The convertible notes had a face value outstanding of \$200,000 and \$275,000 on December 31, 2005 and 2004, respectively following the modification of the underlying note agreement, extending the maturity date of the remaining balance to November 20, 2006. The convertible notes are convertible into a variable number of our common shares based upon a variable conversion price of the lower of \$0.05 or 75% of the closing market price near the conversion date. The holder has the option to redeem the convertible notes payable for cash at 130% of the face value in the event of defaults and certain other contingent events, including events related to the common stock into which the

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instrument is convertible, registration and listing (and maintenance thereof) of our common stock and filing of reports with the Securities and Exchange Commission (the "Default Put"). In addition, we extended registration rights to the holder that required registration and continuing effectiveness thereof; we would be required to pay monthly liquidating damages of 2.0% for defaults under this provision.

In our evaluation of this instrument, we concluded that the conversion feature was not afforded the exemption as a conventional convertible instrument due to a variable conversion feature, and it did not otherwise meet the conditions for equity classification. Since equity classification is not available for the conversion feature, we were required to bifurcate the embedded conversion feature and carry it as a derivative liability at fair value. We also concluded that the Default Put required bifurcation because, while puts on debt instruments are generally considered clearly and closely related to the host, the Default Put is indexed to certain events, noted above, that are not associated with debt instruments. We combined all embedded features that required bifurcation into one compound instrument that is carried as a component of derivative liabilities. We also determined that the warrants did not meet the conditions for equity classification because, as noted above, share settlement and maintenance of an effective registration statement are not within our control. Therefore, the warrants are also required to be carried as a derivative liability, at fair value.

We estimated the fair value of the compound derivative on the inception dates, and subsequently, using the Monte Carlo Valuation technique, because that technique embodies all of the assumptions (including credit risk, interest risk, stock price volatility and conversion estimates) that are necessary to fair value complex derivative instruments. We estimated the fair value of the

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warrants on the inception dates, and subsequently, using the Black-Scholes-Merton Valuation technique, because that technique embodies all of the assumptions (including, volatility, expected terms, and risk free rates) that are necessary to fair value freestanding warrants. As a result of these estimates, our valuation model resulted in compound derivative balances associated with this financing arrangement of \$1,311,000 and \$201,000 as of December 31, 2005 and 2004, respectively. This amount is included in Derivative Liabilities on our balance sheet. Warrants related to the financing were fully converted prior to December 31, 2005.

The following table illustrates fair value adjustments that we have recorded related to the derivative financial instruments associated with the \$400,000 convertible note financing.

|                             | Year ended<br>December 31,<br>2005 | Year ended<br>December 31,<br>2004 |
|-----------------------------|------------------------------------|------------------------------------|
| Derivative income (expense) |                                    |                                    |
| Compound derivative         | \$(1,110,000)                      | \$ 23,000                          |
|                             |                                    |                                    |
| Warrant derivative          | \$(5,842,900)                      | \$(1,031,800)                      |
|                             |                                    |                                    |

Changes in the fair value of the compound derivative and, therefore, derivative income (expense) related to the compound derivative is insignificantly affected by changes in our trading stock price and the credit risk associated with our financial instruments. The fair value of the warrant derivative is significantly affected by changes in our trading stock prices. Future changes in these underlying market conditions will have a continuing effect on derivative income (expense) associated with the remaining compound derivatives.

The aforementioned allocations to the compound and warrant derivatives resulted in the discount in the carrying value of the notes to zero. This discount, along with related deferred finance costs and future interest payments, are amortized through periodic charges to interest expense using the effective method. Interest expense during the years ended December 31, 2005 and 2004 amounted to approximately \$88,000 and \$204,000, respectively.

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As noted in the introductory paragraph of this section, the holders extended the notes one additional year to November 2006. This modification was accounted for as an extinguishment because the present value of the amended debt was significantly different than the present value immediately preceding the modification. As a result of the extinguishment, the existing debt carrying value was adjusted to fair value using projected cash flows at market rates for similar instruments. This extinguishment resulted in our recognition of a gain on extinguishment of \$22,733 in the fourth fiscal quarter of our year ended December 31, 2005.

(b) \$2,300,000 Convertible Note Financing:

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On January 28, 2005, May 23, 2005 and August 18, 2005, we issued \$1,150,000, \$500,000 and \$650,000, respectively of 8.0% convertible notes payable, due January 28, 2007 plus warrants to purchase 9,200,000, 4,000,000 and 5,200,000, respectively, shares of our common stock with a strike price of \$0.129 for a period of five years. The convertible notes had a face value outstanding of \$15,000 on December 31, 2005 resulting from conversions to common stock. The convertible notes are convertible into a fixed number of our common shares based upon a conversion price of \$0.125 with anti-dilution protection for sales

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of securities below the fixed conversion price. We have the option to redeem the convertible notes for cash at 120% of the face value. The holder has the option to redeem the convertible notes payable for cash at 120% of the face value in the event of defaults and certain other contingent events, including events related to the common stock into which the instrument is convertible, registration and listing (and maintenance thereof) of our common stock and filing of reports with the Securities and Exchange Commission (the "Default Put").

In our evaluation of this instrument, we concluded that the conversion feature was not afforded the exemption as a conventional convertible instrument due to the anti-dilution protection; and it did not otherwise meet the conditions for equity classification. Since equity classification is not available for the conversion feature, we were required to bifurcate the embedded conversion feature and carry it as a derivative liability, at fair value. We also concluded that the Default Put required bifurcation because, while puts on debt instruments are generally considered clearly and closely related to the host, the Default Put is indexed to certain events, noted above, that are not associated debt instruments. We combined all embedded features that required bifurcation into one compound instrument that is carried as a component of derivative liabilities. We also determined that the warrants did not meet the conditions for equity classification because these instruments did not meet all of the criteria necessary for equity classification. Therefore, the warrants are also required to be carried as a derivative liability, at fair value.

We estimated the fair value of the compound derivative on the inception dates, and subsequently, using the Monte Carlo Valuation technique, because that technique embodies all of the assumptions (including credit risk, interest risk, stock price volatility and conversion estimates) that are necessary to fair value complex derivative instruments. We estimated the fair value of the warrants on the inception dates, and subsequently, using the Black-Scholes-Merton Valuation technique, because that technique embodies all of the assumptions (including volatility, expected terms, and risk free rates) that are necessary to fair value freestanding warrants. As a result of these estimates, our valuation model resulted in compound derivative balances associated with this financing arrangement of \$4,867 as of December 31, 2005.

As of December 31, 2005 2,000,000 warrants related to the financing remain unconverted.

The following table illustrates fair value adjustments that we have recorded related to the derivative financial instruments associated with the \$2,300,000 convertible note financing:

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|                             | Year ended<br>December 31,<br>2005 | Year ended<br>December 31,<br>2004 |
|-----------------------------|------------------------------------|------------------------------------|
| Derivative income (expense) |                                    |                                    |
| Compound derivative         | \$ (3,779,033)                     | \$-                                |
| Warrant derivative          | \$ (17,141,306)                    | \$-                                |

Changes in the fair value of the compound derivative and, therefore, derivative income (expense) related to the compound derivative is significantly affected by changes in our trading stock price and the credit risk associated with our financial instruments. The fair value of the warrant derivative is significantly affected by changes in our trading stock prices. Future changes in these underlying market conditions will have a continuing effect on

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derivative income (expense) associated with these instruments.

In connection with our accounting for this financing arrangement we encountered the unusual circumstance of a day-one loss related to the recognition of derivative instruments arising from the arrangement. That means that the fair value of the bifurcated compound derivative and warrants exceeded the proceeds that we received from the arrangement and we were required to record a loss to record the derivative financial instruments at fair value. The loss that we recorded amounted to \$8,663,869.

The aforementioned allocations to the compound and warrant derivatives resulted in the discount in the carrying value of the notes. This discount, along with related deferred finance costs and future interest payments, are amortized through periodic charges to interest expense using the effective method. Interest expense during the year ended December 31, 2005 amounted to approximately \$462,000.

### (c) \$600,000 Convertible Note Financing:

-----  
On June 29, 2004, we issued \$600,000 of 10.0% convertible notes payable, due December 31, 2005, plus warrants to purchase 2,000,000 and 5,000,000 shares of our common stock with strike prices of \$0.25 and \$2.00, respectively, for a periods of five and two years, respectively. Net proceeds from this financing arrangement amounted to \$500,000. As of December 31, 2005, this debt is past due and, accordingly, the outstanding carrying value of \$600,000 does not include the \$68,000 of capitalized interest, which is being reflected as accrued liabilities. The convertible notes are convertible into a fixed number of our common shares based upon a conversion price of \$0.15 with anti-dilution protection for sales of securities below the fixed conversion price. We have the option to redeem the convertible notes for cash at 120% of the face value. The holder has the option to redeem the convertible notes payable for cash at 130% of the face value in the event of defaults and certain other contingent events, including events related to the common stock into which the instrument is convertible, registration and listing (and maintenance thereof) of our common stock and filing of reports with the Securities and Exchange Commission (the "Default Put"). In addition, we extended registration rights to the holder that required registration and continuing effectiveness thereof; we are required to pay monthly liquidating damages of 2.0% for defaults under this provision.

In our evaluation of this instrument, we concluded that the conversion feature was not afforded the exemption as a conventional convertible instrument due to the anti-dilution protection; and it did not otherwise meet the conditions for equity classification. Since equity classification is not available for the conversion feature, we were required to bifurcate the embedded conversion feature and carry it as a derivative liability, at fair value. We also concluded that the Default Put required bifurcation because, while puts on debt instruments are generally considered clearly and closely related to the host, the Default Put is indexed to certain events, noted above, that are not associated with debt instruments. We combined all embedded features that required bifurcation into one compound instrument that is carried as a component of derivative liabilities. We also determined that the warrants did not meet the conditions for

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equity classification because these instruments did not meet all of the criteria necessary for equity classification. Therefore, the warrants are also required to be carried as a derivative liability, at fair value.

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We estimated the fair value of the compound derivative on the inception dates, and subsequently, using the Monte Carlo Valuation technique, because that technique embodies all of the assumptions (including credit risk, interest risk, stock price volatility and conversion estimates) that are necessary to fair value complex derivative instruments. We estimated the fair value of the warrants on the inception dates, and subsequently, using the Black-Scholes-Merton Valuation technique, because that technique embodies all of the assumptions (including, volatility, expected terms, and risk free rates) that are necessary to fair value freestanding warrants. As a result of these estimates, our valuation model resulted in compound derivative balances associated with this financing arrangement of \$153,700 and \$27,833 as of December 31, 2005 and 2004, respectively. These amounts are included in Derivative Liabilities on our balance sheet.

As of December 31, 2005 all warrants related to the financing had been converted.

The following table illustrates fair value adjustments that we have recorded related to the derivative financial instruments associated with the \$600,000 convertible note financing:

|                             | Year ended<br>December 31,<br>2005 | Year ended<br>December 31,<br>2004 |
|-----------------------------|------------------------------------|------------------------------------|
| Derivative income (expense) | -----                              | -----                              |
| Compound derivative         | \$ (125,867)                       | \$ 47,134                          |
|                             | =====                              | =====                              |
| Warrant derivative          | \$ (5,478,300)                     | \$ (479,067)                       |
|                             | =====                              | =====                              |

Changes in the fair value of the compound derivative and, therefore, derivative income (expense) related to the compound derivative is significantly affected by changes in our trading stock price and the credit risk associated with our financial instruments. The fair value of the warrant derivative is significantly affected by changes in our trading stock prices. Future changes in these underlying market conditions will have a continuing effect on derivative income (expense) associated with these instruments.

The aforementioned allocations to the compound and warrant derivatives resulted in the discount in the carrying value of the notes. This discount, along with related deferred finance costs and future interest payments, are amortized through periodic charges to interest expense using the effective method. Interest expense during the years ended December 31, 2005 and 2004 amounted to approximately \$428,000 and \$240,000, respectively.

#### (d) \$240,000 Convertible Note Financing:

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On December 22, 2004, we issued \$240,000 of 10.0% convertible notes payable, due April 30, 2006, plus warrants to purchase 800,000 shares of common stock at \$0.15 for five years. Net proceeds from this financing arrangement amounted to \$200,000. As of December 31, 2005, this debt had been fully converted. As of December 31, 2004, this debt had a face value of \$210,000. The convertible notes were convertible into a fixed number of our common shares based upon a conversion price of \$0.10 with anti-dilution protection for sales of securities below the fixed conversion price. We had the option to redeem the convertible notes for cash at 120% of the face value. The holder has the option to redeem the convertible notes payable for cash at 130% of the face value in the event of defaults and certain other contingent events, including events related to the common stock into which the instrument is convertible, registration and listing (and maintenance thereof) of our common stock and filing of reports with the Securities and Exchange Commission (the "Default Put"). In addition,

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we extended registration rights to

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the holder that required registration and continuing effectiveness thereof; we are required to pay monthly liquidating damages of 2.0% for defaults under this provision.

In our evaluation of this instrument, we concluded that the conversion feature was not afforded the exemption as a conventional convertible instrument due to the anti-dilution protection; and it did not otherwise meet the conditions for equity classification. Since equity classification is not available for the conversion feature, we were required to bifurcate the embedded conversion feature and carry it as a derivative liability, at fair value. We also concluded that the Default Put required bifurcation because, while puts on debt instruments are generally considered clearly and closely related to the host, the Default Put is indexed to certain events, noted above, that are not associated with debt instruments. We combined all embedded features that required bifurcation into one compound instrument that is carried as a component of derivative liabilities. We also determined that the warrants did not meet the conditions for equity classification because these instruments did not meet all of the criteria necessary for equity classification. Therefore, the warrants are also required to be carried as a derivative liability, at fair value.

We estimated the fair value of the compound derivative on the inception dates, and subsequently, using the Monte Carlo Valuation technique, because that technique embodies all of the assumptions (including credit risk, interest risk, stock price volatility and conversion estimates) that are necessary to fair value complex derivative instruments. These amounts are included in Derivative Liabilities on our balance sheet. We estimated the fair value of the warrants on the inception dates, and subsequently, using the Black-Scholes-Merton Valuation technique, because that technique embodies all of the assumptions (including, volatility, expected terms, and risk free rates) that are necessary to fair value freestanding warrants.

As of December 31, 2005 all warrant liabilities related to the financing had been fully converted.

The following table illustrates fair value adjustments that we have recorded related to the derivative financial instruments associated with the \$240,000 convertible note financing:

|                             | Year ended<br>December 31,<br>2005 | Year ended<br>December 31,<br>2004 |
|-----------------------------|------------------------------------|------------------------------------|
| Derivative income (expense) |                                    |                                    |
| Compound derivative         | \$ (55,604)                        | \$ 64,600                          |
|                             |                                    |                                    |
| Warrant derivative          | \$ 55,540                          | \$ (220,515)                       |
|                             |                                    |                                    |

Changes in the fair value of the compound derivative and, therefore, derivative income (expense) related to the compound derivative is significantly affected by changes in our trading stock price and the credit risk associated with our financial instruments. The fair value of the warrant derivative is significantly affected by changes in our trading stock prices. Future changes in these underlying market conditions will have a continuing effect on derivative income (expense) associated with the remaining compound derivative.

The aforementioned allocations to the compound and warrant derivatives resulted



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in the discount in the carrying value of the notes. This discount, along with related deferred finance costs and future interest payments, were amortized through periodic charges to interest expense using the effective method. Interest expense during the years ended December 31, 2005 and 2004 amounted to approximately \$66,781 and \$-0-, respectively.

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### (e) \$693,000 Convertible Note Financing:

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On October 29, 2004, we issued \$693,000 of 10.0% convertible notes payable, due April 30, 2006, plus warrants to purchase 2,200,000 at \$0.15 for five years. Net proceeds from this financing arrangement amounted to \$550,000. As of December 31, 2005, this debt had face value \$6,250 outstanding. The convertible notes were convertible into a fixed number of our common shares based upon a conversion price of \$0.10 with anti-dilution protection for sales of securities below the fixed conversion price. We had the option to redeem the convertible notes for cash at 120% of the face value. The holder has the option to redeem the convertible notes payable for cash at 130% of the face value in the event of defaults and certain other contingent events, including events related to the common stock into which the instrument is convertible, registration and listing (and maintenance thereof) of our common stock and filing of reports with the Securities and Exchange Commission (the "Default Put"). In addition, we extended registration rights to the holder that required registration and continuing effectiveness thereof; we are required to pay monthly liquidating damages of 2.0% for defaults under this provision.

In our evaluation of this instrument, we concluded that the conversion feature was not afforded the exemption as a conventional convertible instrument due to the anti-dilution protection; and it did not otherwise meet the conditions for equity classification. Since equity classification is not available for the conversion feature, we were required to bifurcate the embedded conversion feature and carry it as a derivative liability, at fair value. We also concluded that the Default Put required bifurcation because, while puts on debt instruments are generally considered clearly and closely related to the host, the Default Put is indexed to certain events, noted above, that are not associated with debt instruments. We combined all embedded features that required bifurcation into one compound instrument that is carried as a component of derivative liabilities. We also determined that the warrants did not meet the conditions for equity classification because these instruments did not meet all of the criteria necessary for equity classification. Therefore, the warrants are also required to be carried as a derivative liability, at fair value.

We estimated the fair value of the compound derivative on the inception dates, and subsequently, using the Monte Carlo Valuation technique, because that technique embodies all of the assumptions (including credit risk, interest risk, stock price volatility and conversion estimates) that are necessary to fair value complex derivative instruments. We estimated the fair value of the warrants on the inception dates, and subsequently, using the Black-Scholes-Merton Valuation technique, because that technique embodies all of the assumptions (including, volatility, expected terms, and risk free rates) that are necessary to fair value freestanding warrants. As a result of these estimates, our valuation model resulted in a compound derivative balance of \$42,878 as of December 31, 2005. Our valuation model resulted in a warrant derivative balance, arising from the convertible note financing, of \$924,120 and \$330,220 as of December 31, 2005 and 2004, respectively. These amounts are included in Derivative Liabilities on our balance sheet.

The following table illustrates fair value adjustments that we have recorded

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related to the derivative financial instruments associated with the \$693,000 convertible note financing:

|                             | Year ended<br>December 31,<br>2005 | Year ended<br>December 31,<br>2004 |
|-----------------------------|------------------------------------|------------------------------------|
| Derivative income (expense) | -----                              |                                    |
| Compound derivative         | \$ (2,610,699)                     | \$ (133,492)                       |
|                             | =====                              |                                    |
| Warrant derivative          | \$ (668,950)                       | \$ (373,967)                       |
|                             | =====                              |                                    |

Changes in the fair value of the compound derivative and, therefore, derivative income (expense) related to the compound derivative is significantly affected by changes in our trading stock price and the credit

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risk associated with our financial instruments. The fair value of the warrant derivative is significantly affected by changes in our trading stock prices. Future changes in these underlying market conditions will have a continuing effect on derivative income (expense) associated with the remaining compound instruments.

The aforementioned allocations to the compound and warrant derivatives resulted in the discount in the carrying value of the notes. This discount, along with related deferred finance costs and future interest payments, were amortized through periodic charges to interest expense using the effective method. Interest expense during the years ended December 31, 2005 and 2004 amounted to approximately \$199,000 and \$73,000, respectively.

(f) \$660,000 Convertible Note Financing:

-----

On April 2, 2004, we issued \$660,000 of 10.0% convertible notes payable, due October 1, 2005, plus warrants to purchase 3,000,000 at \$0.15 for five years. Net proceeds from this financing arrangement amounted to \$500,000. As of December 31, 2005, this debt had a face value of \$25,000 outstanding. The convertible notes were convertible into a fixed number of our common shares based upon a conversion price of \$0.10 with anti-dilution protection for sales of securities below the fixed conversion price. We had the option to redeem the convertible notes for cash at 120% of the face value. The holder has the option to redeem the convertible notes payable for cash at 130% of the face value in the event of defaults and certain other contingent events, including events related to the common stock into which the instrument is convertible, registration and listing (and maintenance thereof) of our common stock and filing of reports with the Securities and Exchange Commission (the "Default Put"). In addition, we extended registration rights to the holder that required registration and continuing effectiveness thereof; we are required to pay monthly liquidating damages of 2.0% for defaults under this provision.

In our evaluation of this instrument, we concluded that the conversion feature was not afforded the exemption as a conventional convertible instrument due to the anti-dilution protection; and it did not otherwise meet the conditions for equity classification. Since equity classification is not available for the conversion feature, we were required to bifurcate the embedded conversion feature and carry it as a derivative liability, at fair value. We also concluded that the Default Put required bifurcation because, while puts on debt instruments are generally considered clearly and closely related to the host, the Default Put is indexed to certain events, noted above, that are not associated with debt instruments. We combined all embedded features that

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required bifurcation into one compound instrument that is carried as a component of derivative liabilities. We also determined that the warrants did not meet the conditions for equity classification because these instruments did not meet all of the criteria necessary for equity classification. Therefore, the warrants are also required to be carried as a derivative liability, at fair value.

We estimated the fair value of the compound derivative on the inception dates, and subsequently, using the Monte Carlo Valuation technique, because that technique embodies all of the assumptions (including credit risk, interest risk, stock price volatility and conversion estimates) that are necessary to fair value complex derivative instruments. We estimated the fair value of the warrants on the inception dates, and subsequently, using the Black-Scholes-Merton Valuation technique, because that technique embodies all of the assumptions (including, volatility, expected terms, and risk free rates) that are necessary to fair value freestanding warrants. As a result of these estimates, our valuation model resulted in a compound derivative balance of \$159,250 and \$440,648 as of December 31, 2005 and 2004, respectively. This amount is included in Derivative Liabilities on our balance sheet.

As of June 30, 2005, all warrants related to the financing had been fully converted.

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The following table illustrates fair value adjustments that we have recorded related to the derivative financial instruments associated with the \$660,000 convertible note financing:

|                             | Year ended<br>December 31,<br>2005 | Year ended<br>December 31,<br>2004 |
|-----------------------------|------------------------------------|------------------------------------|
| Derivative income (expense) | -----                              | -----                              |
| Compound derivative         | \$ (2,787,246)                     | \$ (194,962)                       |
|                             | =====                              | =====                              |
| Warrant derivative          | \$ 61,800                          | \$ (276,188)                       |
|                             | =====                              | =====                              |

Changes in the fair value of the compound derivative and, therefore, derivative income (expense) related to the compound derivative is significantly affected by changes in our trading stock price and the credit risk associated with our financial instruments. The fair value of the warrant derivative is significantly affected by changes in our trading stock prices. Future changes in these underlying market conditions will have a continuing effect on derivative income (expense) associated with the remaining compound instruments.

The aforementioned allocations to the compound and warrant derivatives resulted in the discount in the carrying value of the notes. This discount, along with related deferred finance costs and future interest payments, were amortized through periodic charges to interest expense using the effective method. Interest expense during the years ended December 31, 2005 and 2004 amounted to approximately \$74,000 and \$256,000, respectively.

(g) \$1,008,000 Convertible Note Financing:

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On June 29, 2004, we issued \$1,008,000 of 10.0% convertible notes payable, due April 30, 2006, plus warrants to purchase 3,200,000 and 8,000,000 shares of our common stock at \$0.25 and \$2.00, respectively, for periods of five and two years, respectively. Net proceeds from this financing arrangement amounted to \$800,000. As of December 31, 2005, this debt had a face value of \$187,760

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outstanding. The convertible notes were convertible into a fixed number of our common shares based upon a conversion price of \$0.15 with anti-dilution protection for sales of securities below the fixed conversion price. We had the option to redeem the convertible notes for cash at 120% of the face value. The holder has the option to redeem the convertible notes payable for cash at 130% of the face value in the event of defaults and certain other contingent events, including events related to the common stock into which the instrument is convertible, registration and listing (and maintenance thereof) of our common stock and filing of reports with the Securities and Exchange Commission (the "Default Put"). In addition, we extended registration rights to the holder that required registration and continuing effectiveness thereof; we are required to pay monthly liquidating damages of 2.0% for defaults under this provision.

In our evaluation of this instrument, we concluded that the conversion feature was not afforded the exemption as a conventional convertible instrument due to the anti-dilution protection; and it did not otherwise meet the conditions for equity classification. Since equity classification is not available for the conversion feature, we were required to bifurcate the embedded conversion feature and carry it as a derivative liability, at fair value. We also concluded that the Default Put required bifurcation because, while puts on debt instruments are generally considered clearly and closely related to the host, the Default Put is indexed to certain events, noted above, that are not associated with debt instruments. We combined all embedded features that required bifurcation into one compound instrument that is carried as a component of derivative liabilities. We also determined that the warrants did not meet the conditions for equity classification because these instruments did not meet all of the criteria necessary for equity classification. Therefore, the warrants are also required to be carried as a derivative liability, at fair value.

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We estimated the fair value of the compound derivative on the inception dates, and subsequently, using the Monte Carlo Valuation technique, because that technique embodies all of the assumptions (including credit risk, interest risk, stock price volatility and conversion estimates) that are necessary to fair value complex derivative instruments. We estimated the fair value of the warrants on the inception dates, and subsequently, using the Black-Scholes-Merton Valuation technique, because that technique embodies all of the assumptions (including, volatility, expected terms, and risk free rates) that are necessary to fair value freestanding warrants. As a result of these estimates, our valuation model resulted in a compound derivative balance of \$564,735 and \$1,446,560 as of December 31, 2005 and 2004, respectively. This amount is included in Derivative Liabilities on our balance sheet.

As of December 31, 2005, all warrants related to the financing had been fully converted.

The following table illustrates fair value adjustments that we have recorded related to the derivative financial instruments associated with the \$1,008,000 convertible note financing:

|                             | Year ended<br>December 31,<br>2005 | Year ended<br>December 31,<br>2004 |
|-----------------------------|------------------------------------|------------------------------------|
| Derivative income (expense) |                                    |                                    |
| Compound derivative         | \$ (185,979)                       | \$ (29,988)                        |
|                             | =====                              | =====                              |
| Warrant derivative          | \$ (1,661,859)                     | \$ (826,816)                       |
|                             | =====                              | =====                              |

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Changes in the fair value of the compound derivative and, therefore, derivative income (expense) related to the compound derivative is significantly affected by changes in our trading stock price and the credit risk associated with our financial instruments. The fair value of the warrant derivative is significantly affected by changes in our trading stock prices. Future changes in these underlying market conditions will have a continuing effect on derivative income (expense) associated with these instruments.

The aforementioned allocations to the compound and warrant derivatives resulted in the discount in the carrying value of the notes. This discount, along with related deferred finance costs and future interest payments, were amortized through periodic charges to interest expense using the effective method. Interest expense during the years ended December 31, 2005 and 2004 amounted to approximately \$383,000 and \$403,000, respectively.

### (h) \$360,000 Convertible Note Financing:

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On April 21, 2005, we issued \$360,000, six-month-term, 10% convertible notes payable, due October 31, 2005. Net proceeds for this financing transaction amounted to \$277,488. The notes were convertible into shares of common stock at a fixed conversion rate of \$0.20, with anti-dilution protection for sales of securities below the fixed conversion price. The holder converted the notes on September 30, 2005. We had the option to redeem the notes payable for cash at 120% of the face value. The holder has the option to redeem the convertible notes payable for cash at 130% of the face value in the event of defaults and certain other contingent events, including events related to the common stock into which the instrument is convertible, registration and listing (and maintenance thereof) of our common stock and filing of reports with the Securities and Exchange Commission (the "Default Put").

In our evaluation of this instrument, we concluded that the conversion feature was not afforded the exemption as a conventional convertible instrument due to the anti-dilution protection afforded the holder; and it did not otherwise meet the conditions for equity classification. Therefore, we were required to bifurcate the embedded conversion feature and carry it as a derivative liability. We also concluded that

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the Default Put required bifurcation because, while puts on debt instruments are generally considered clearly and closely related to the host, the Default Put is indexed to certain events, noted above, that are not associated debt instruments. We combined all embedded features that required bifurcation into one compound instrument that was carried as a component of derivative liabilities through the date of conversion.

We allocated the initial proceeds from the financing first to the compound derivative instrument in the amount of \$113,925 and the balance to the debt host instrument. We estimated the fair value of the compound derivative on the inception dates, and subsequently, using the Monte Carlo Valuation technique, because that technique embodies all of the assumptions (including credit risk, interest risk, stock price volatility and conversion estimates) that are necessary to fair value complex derivative instruments.

The following table illustrates fair value adjustments that we have recorded related to the compound derivative arising from the \$360,000 convertible notes payable.

| Year ended   | Year ended   |
|--------------|--------------|
| December 31, | December 31, |

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|                             | 2005        | 2004 |
|-----------------------------|-------------|------|
| Derivative income (expense) | -----       |      |
| Compound derivative         | \$(841,650) | \$-  |
|                             | =====       |      |
| Warrant derivative          | \$ -        | \$-  |
|                             | =====       |      |

Changes in the fair value of the compound derivative and, therefore, derivative income (expense) related to the compound derivative is significantly affected by changes in our trading stock price and the credit risk associated with our financial instruments. Since the instrument was converted on September 30, 2005, there will be no future charges or credits to derivative income (expense) associated with this instrument.

The above allocations resulted in a discount to the carrying value of the notes amounting to approximately \$173,925. This discount, along with related deferred finance costs and future interest payments, was amortized through periodic charges to interest expense using the effective method. Interest expense during the year ended December 31, 2005 amounted to approximately \$163,000.

Derivative warrant fair values are calculated using the Black-Scholes-Merton Valuation technique. Significant assumptions as of December 31, 2005, corresponding to each of the above financings (by paragraph reference) are as follows:

|                             | 6 (a)        | 6 (b)  | 6 (c)  | 6 (d)  | 6 (e)  | 6 (f)  |
|-----------------------------|--------------|--------|--------|--------|--------|--------|
|                             | -----        |        |        |        |        |        |
| Trading market price        | \$0.59       | \$0.59 | \$0.59 | \$0.59 | \$0.59 | \$0.59 |
| Strike price                | \$.05-\$1.00 | \$.129 | \$.10  | \$.15  | \$.15  | \$.15  |
| Volatility                  | 148%         | 133%   | 136%   | 136%   | 136%   | 142%   |
| Risk-free rate              | 3.25%        | 3.71%  | 3.30%  | 3.57%  | 3.30%  | 3.45%  |
| Remaining term/life (years) | .92          | 4.63   | 3.5    | 4.0    | 3.83   | 3.25   |

Our stock prices have been highly volatile. Future fair value changes are significantly influenced by our trading common stock prices. As previously discussed herein, changes in fair value of derivative financial instruments are reflected in earnings.

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Note 7. Preferred Stock

Our articles of incorporation authorize the issuance of 5,000,000 shares of preferred stock. We have designated this authorized preferred stock, as follows:

(a) Series H Preferred Stock:

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We have designated 350,000 shares of our preferred stock as Series H Cumulative Convertible Preferred Stock with a stated and liquidation value of \$10.00 per share. Series H Preferred Stock has cumulative dividend rights at 7.0% of the stated amount, ranks senior to common stock and is non-voting. It is also convertible into our common stock at a fixed conversion price of \$0.40 per common share. The Series H Preferred Stock is mandatorily redeemable for common stock on the fifth anniversary of its issuance. We have the option to redeem

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the Series H Preferred Stock for cash at 135% of the stated value. The holder has the option to redeem the Series H Preferred Stock for cash at 140% of the stated value in the event of defaults and certain other contingent events, including events related to the common stock into which the instrument is convertible, listing of our common stock and filing of reports with the Securities and Exchange Commission (the "Default Put").

Based upon our evaluation of the terms and conditions of the Series H Preferred Stock, we concluded that it was more akin to a debt instrument than an equity instrument, which means that our accounting conclusions are based upon those related to a traditional debt security, and that it should be afforded the conventional convertible exemption regarding the embedded conversion feature because the conversion price is fixed. Therefore, we are not required to bifurcate the embedded conversion feature and carry it as a liability. However, we concluded that the Default Put required bifurcation because, while puts on debt-type instruments are generally considered clearly and closely related to the host, the Default Put is indexed to certain events, noted above, that are not associated debt-type instruments. In addition, due to the default and contingent redemption features of the Series H Preferred Stock, we classified this instrument as redeemable preferred stock, outside of stockholders' equity.

Between December 2001 and March 2002, we issued 175,500 shares of Series H Preferred Stock for cash of \$1,755,000, plus warrants to purchase an aggregate of 4,387,500 shares of common stock at \$0.50 for five years. As of December 31, 2005, 64,500 shares of preferred stock remain outstanding; all of the warrants remain outstanding. We allocated \$1,596,228 of the proceeds from the Series H Preferred financings to the warrants at their fair values because the warrants did not meet all of the conditions necessary for equity classification and, accordingly, are carried as derivative liabilities, at fair value. We also allocated \$134,228 to the Default Puts which, as described above are carried as derivative liabilities, at fair value. We also allocated proceeds of \$34,210 to paid-in capital because the aforementioned allocations resulted in an effective beneficial conversion feature, which is recorded in equity. Finally, we recorded derivative expense of \$9,666 because one of the financings did not result in sufficient proceeds to record the derivative financial instruments at fair values on the inception date.

We estimated the fair value of the derivative warrants on the inception dates, and subsequently, using the Black-Scholes-Merton valuation technique. As a result of applying this technique, our valuation of the derivative warrants amounted to \$1,264,109 and \$376,212 as of December 31, 2005 and 2004, respectively. We estimated the fair value of the Default Puts on the inception dates, and subsequently, using a cash flow technique that involves probability-weighting multiple outcomes at net present values. Significant assumptions underlying the probability-weighted outcomes included both our history of similar default events, all available information about our business plans that could give rise to or risk defaults, and the imminence of impending or current defaults. As a result of these subjective estimates, our valuation model resulted in Default Put balances associated with the Series H Preferred Stock of

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\$381,377 and \$156,927 as of December 31, 2005 and 2004, respectively. These amounts are included in Derivative Liabilities on our balance sheet. The following table illustrates fair value adjustments that we have recorded related to the Default Puts on the Series H Preferred Stock.

| Year ended<br>December 31,<br>2005 | Year ended<br>December 31,<br>2004 |
|------------------------------------|------------------------------------|
|------------------------------------|------------------------------------|

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|                             |              |              |
|-----------------------------|--------------|--------------|
| Derivative income (expense) | -----        |              |
| Compound derivative         | \$ (224,451) | \$ (22,701)  |
|                             | =====        | =====        |
| Warrant derivative          | \$ (887,896) | \$ (253,571) |
|                             | =====        | =====        |

Derivative income (expense) related to the Default Put includes changes to the fair value arising from changes in our estimates about the probability of default events and amortization of the time-value element embedded in our calculations. Higher derivative expense in the year ended December 31, 2005 when compared to the same period of 2004, reflected the increased probability that the Default Put would become exercisable because we would not timely file certain reports with the Securities and Exchange Commission. In fact, we ultimately did not file our Quarterly Report on Form 10-QSB for the June 2006 reporting period on a timely basis. While the Default Put became exercisable at that time, the holders of the Series H Preferred Stock did not exercise their right prior to curing the event. There can be no assurances that the holders of the Series H Preferred Stock would not exercise their rights should further defaults arise.

The discounts to the Series H Preferred Stock that resulted from the aforementioned allocations are being accreted through periodic charges to retained earnings using the effective method. The following table illustrates the components of preferred stock dividends and accretions for the years ended December 31, 2005 and 2004:

|                           | Year ended<br>December 31,<br>2005 | Year ended<br>December 31,<br>2004 |
|---------------------------|------------------------------------|------------------------------------|
|                           | -----                              | -----                              |
| Preferred stock dividends | \$140,400                          | \$140,400                          |
|                           | =====                              | =====                              |
| Accretions                | \$558,089                          | \$357,392                          |
|                           | =====                              | =====                              |

As of December 31, 2005, \$315,900 of cumulative dividends are in arrears on Series H Preferred Stock.

(b) Series J Preferred Stock:

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We have designated 500,000 shares of our preferred stock as Series J Cumulative Convertible Preferred Stock with a stated and liquidation value of \$10.00 per share. Series J Preferred Stock has cumulative dividend rights at 8.0% of the stated amount, ranks senior to common stock and is non-voting. It is also convertible into our common stock at a conversion price of \$0.20 per common share. The Series J Preferred Stock is mandatorily redeemable for common stock on the fifth anniversary of its issuance. We have the option to redeem the Series J Preferred Stock for cash at 135% of the stated value. The holder has the option to redeem the Series J Preferred Stock for cash at 140% of the stated value in the event of defaults and certain other contingent events, including events related to the common stock into which the instrument is convertible, registration and listing (and maintenance thereof) of our common stock and filing of reports with the Securities and Exchange Commission (the "Default Put").

Based upon our evaluation of the terms and conditions of the Series J Preferred Stock, we concluded that its features were more akin to a debt instrument than an equity instrument, which means that our accounting conclusions are generally based upon standards related to a traditional debt security. Our



evaluation concluded that the embedded conversion feature was not afforded the exemption as a conventional convertible instrument due to certain variability in the conversion price and it further did not meet the conditions for equity classification. Therefore, we are required to bifurcate the embedded conversion feature and carry it as a liability. We also concluded that the Default Put required bifurcation because, while puts on debt-type instruments are generally considered clearly and closely related to the host, the Default Put is indexed to certain events, noted above, that are not associated debt-type instruments. We combined all embedded features that required bifurcation into one compound instrument that is carried as a component of derivative liabilities. In addition, due to the default and contingent redemption features of the Series J Preferred Stock, we classified this instrument as redeemable preferred stock, outside of stockholders' equity.

In September 2002, February 2003 and May 2003 we issued 100,000 shares, 50,000 shares and 50,000 shares, respectively, of Series J Preferred Stock for cash of \$2,000,000. We also issued warrants for an aggregate of 14,000,000 shares of our common stock in connection with the financing arrangement. The warrants have terms of five years and an exercise price of \$0.25. We initially allocated proceeds of \$658,000 and \$1,190,867 from the financing arrangements to the compound derivative discussed above and to the warrants, respectively. Since these instruments did not meet the criteria for classification, they are required to be carried as derivative liabilities, at fair value.

We estimated the fair value of the compound derivative on the inception dates, and subsequently, using the Monte Carlo Valuation technique, because that technique embodies all of the assumptions (including credit risk, interest risk, stock price volatility and conversion estimates) that are necessary to fair value complex derivative instruments. We estimated the fair value of the warrants on the inception dates, and subsequently, using the Black-Scholes-Merton Valuation technique, because that technique embodies all of the assumptions (including, volatility, expected terms, and risk free rates) that are necessary to fair value freestanding warrants. As a result of these estimates, our valuation model resulted in a compound derivative balance associated with the Series J Preferred Stock of \$5,628,000 and \$728,000 as of December 31, 2005 and December 31, 2004, respectively. This amount is included in Derivative Liabilities on our balance sheet.

The following table illustrates fair value adjustments that we have recorded related to the derivative financial instruments associated with the Series J Preferred Stock.

|                             | Year ended<br>December 31,<br>2005 | Year ended<br>December 31,<br>2004 |
|-----------------------------|------------------------------------|------------------------------------|
| Derivative income (expense) | -----                              |                                    |
| Compound derivative         | \$(4,900,000)                      | \$(644,000)                        |
|                             | =====                              |                                    |
| Warrant derivative          | \$(3,136,000)                      | \$(713,600)                        |
|                             | =====                              |                                    |

Changes in the fair value of the compound derivative and, therefore, derivative income (expense) related to the compound derivative is significantly affected by changes in our trading stock price and the credit risk associated with our financial instruments. The fair value of the warrant derivative is significantly affected by changes in our trading stock prices. Future changes

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in these underlying market conditions will have a continuing effect on derivative income (expense) associated with these instruments.

The discounts to the Series J Preferred Stock that resulted from the aforementioned allocations are being accreted through periodic charges to paid-in capital using the effective method. The following table illustrates the components of preferred stock dividends and accretions for the years ended December 31, 2005 and 2004:

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|                           | Year ended<br>December 31,<br>2005 | Year ended<br>December 31,<br>2004 |
|---------------------------|------------------------------------|------------------------------------|
| Preferred stock dividends | \$160,000                          | \$160,000                          |
| Accretions                | \$385,218                          | \$214,856                          |

As of December 31, 2005 \$480,000 of cumulative dividends are in arrears on Series J Preferred Stock.

(c) Series K Preferred Stock:

We have designated 500,000 shares of our preferred stock as Series K Cumulative Convertible Preferred Stock with a stated and liquidation value of \$10.00 per share. Series K Preferred Stock has cumulative dividend rights at 8.0% of the stated amount, ranks senior to common stock and is non-voting. It is also convertible into our common stock at a fixed conversion price of \$0.10 per common share. The Series K Preferred Stock is mandatorily redeemable for common stock on the fifth anniversary of its issuance. We have the option to redeem the Series K Preferred Stock for cash at 120% of the stated value. The holder has the option to redeem the Series K Preferred Stock for cash at 140% of the stated value in the event of defaults and certain other contingent events, including events related to the common stock into which the instrument is convertible, listing of our common stock and filing of reports with the Securities and Exchange Commission (the "Default Put").

Based upon our evaluation of the terms and conditions of the Series K Preferred Stock, we concluded that it was more akin to a debt instrument than an equity instrument, which means that our accounting conclusions are based upon those related to a traditional debt security, and that it should afforded the conventional convertible exemption regarding the embedded conversion feature because the conversion price is fixed. Therefore, we are not required to bifurcate the embedded conversion feature and carry it as a liability. However, we concluded that the Default Put required bifurcation because, while puts on debt-type instruments are generally considered clearly and closely related to the host, the Default Put is indexed to certain events, noted above, that are not associated debt-type instruments.. In addition, due to the default and contingent redemption features of the Series K Preferred Stock, we classified this instrument as redeemable preferred stock, outside of stockholders' equity.

In March 2004, we issued 80,000 shares of Series K Preferred Stock for cash of \$800,000. In April 2004, we issued 15,000 shares of Series K Preferred Stock to extinguish debt with a carrying value of \$150,000. At the time of these issuances, the trading market price of our common stock exceeded the fixed conversion price and, as a result, we allocated \$160,000 and \$60,000 from the March and April issuances, respectively, to stockholders' equity which amount represented a beneficial conversion feature. In addition, we recorded a debt

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extinguishment loss of \$60,000 in connection with the April exchange of Series K Preferred Stock for debt because we estimated that it had a fair value that exceeded the carrying value of the extinguished debt by that amount. Finally, we allocated approximately \$59,000 and \$11,000 to the Default Puts, representing fair values, in connection with the March and April issuances, respectively.

We estimated the fair value of the Default Puts on the inception dates, and subsequently, using a cash flow technique that involves probability-weighting multiple outcomes at net present values. Significant assumptions underlying the probability-weighted outcomes included both our history of similar default events, all available information about our business plans that could give rise to or risk defaults, and the imminence of impending or current defaults. As a result of these subjective estimates, our valuation model resulted in Default Put balances associated with the Series K Preferred Stock of \$206,200 and \$73,644 as of December 31, 2005 and 2004, respectively. These amounts are included in Derivative

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Liabilities on our balance sheet. The following table illustrates fair value adjustments that we have recorded related to the Default Puts on the Series K Preferred Stock.

|                             | Year ended<br>December 31,<br>2005 | Year ended<br>December 31,<br>2004 |
|-----------------------------|------------------------------------|------------------------------------|
| Derivative income (expense) |                                    |                                    |
| Compound derivative         | \$ (132,556)                       | \$ (3,768)                         |
|                             |                                    |                                    |
| Warrant derivative          | \$ -                               | \$ -                               |
|                             |                                    |                                    |

Derivative income (expense) related to the Default Put includes changes to the fair value arising from changes in our estimates about the probability of default events and amortization of the time-value element embedded in our calculations. Higher derivative expense in the year ended December 31, 2005, when compared to the same period of 2004, reflected the increased probability that the Default Put would become exercisable because we would not timely file certain reports with the Securities and Exchange Commission. In fact, we ultimately did not file our Quarterly Report on Form 10-QSB for the June 2006 reporting period in a timely basis. While the Default Put became exercisable at that time, the holders of the Series K Preferred Stock did not exercise their right prior to curing the event. There can be no assurances that the holders of the Series K Preferred Stock would not exercise their rights should further defaults arise.

The discounts to the Series K Preferred Stock that resulted from the aforementioned allocations are being accreted through periodic charges to paid-in capital using the effective method. The following table illustrates the components of preferred stock dividends and accretions for the years ended December 31, 2005 and 2004:

|                           | Year ended<br>December 31,<br>2005 | Year ended<br>December 31,<br>2004 |
|---------------------------|------------------------------------|------------------------------------|
| Preferred stock dividends | \$76,000                           | \$57,000                           |
|                           |                                    |                                    |
| Accretions                | \$40,407                           | \$30,140                           |
|                           |                                    |                                    |

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As of December 31, 2005, \$133,000 of cumulative dividends are in arrears on Series K Preferred Stock.

### (d) Other Preferred Stock Designations and Financings:

Series A Preferred: We have designated 500,000 shares of our preferred stock as Series A Convertible Preferred Stock. There were no Series A Preferred Stock outstanding during the periods presented.

Series B Preferred: We have designated 1,260,000 shares of our preferred stock as Series B Convertible Preferred Stock with a stated and liquidation value of \$1.00 per share. Series B Preferred has cumulative dividend rights of 9.0%, ranks senior to common stock and has voting rights equal to the number of common shares into which it may be converted. Series B Preferred is convertible into common on a share for share basis. Based upon our evaluation of the terms and conditions of the Series B Preferred Stock, we have concluded that it meets all of the requirements for equity classification. We have 107,440 shares of Series B Preferred outstanding as of December 31, 2005.

Series D Preferred: We have designated 165,000 shares of our preferred stock as Series D Cumulative Convertible Preferred Stock with a stated and liquidation value of \$10 per share. Series D Preferred has cumulative dividend rights of 6.0%, ranks senior to common stock and is non-voting. There are no shares of Series D Preferred Stock outstanding during any of the periods presented. However, we continue to

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have 611,250 warrants outstanding that were issued in connection with the original Series D Preferred Stock Financing arrangement.

Series F Preferred: We have designated 200,000 shares of our preferred stock as Series F Convertible Preferred Stock with a stated and liquidation value of \$10 per share. There were 5,248 and 55,515 shares of Series F Preferred Stock outstanding as of December 31, 2005 and 2004, respectively. Series F Preferred is non-voting and convertible into common stock at a variable conversion price equal to the lower of \$0.60 or 75% of the trading prices near the conversion date. In addition, the holder has the option to redeem the convertible notes payable for cash at 125% of the face value in the event of defaults and certain other contingent events, including events related to the common stock into which the instrument is convertible, registration and listing (and maintenance thereof) of our common stock and filing of reports with the Securities and Exchange Commission (the "Default Put"). We concluded that the conversion feature was not afforded the exemption as a conventional convertible instrument due to a variable conversion feature; and it did not otherwise meet the conditions for equity classification. Since equity classification is not available for the conversion feature, we were required to bifurcate the embedded conversion feature and carry it as a derivative liability, at fair value. We also concluded that the Default Put required bifurcation because, while puts on debt-type instruments are generally considered clearly and closely related to the host, the Default Put is indexed to certain events, noted above, that are not associated with debt-type instruments. These two derivative features were combined into one compound derivative instrument. In addition, due to the default and contingent redemption features of the Series F Preferred Stock, we classified this instrument as redeemable preferred stock, outside of stockholders' equity.

Series I Preferred: We have designated 200,000 shares of our preferred stock as Series I Convertible Preferred Stock with a stated and liquidation value of \$10.00 per share. Series I Preferred has cumulative dividend rights at 8.0% of

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the stated value, ranks senior to common stock and is non-voting. Series I Preferred is convertible into a variable number of common shares at the lower conversion price of \$0.40 or 75% of the average trading market price. There were no Series I Preferred Stock outstanding as of December 31, 2005. However, we had 30,000 shares outstanding during the year ended December 31, 2004. We accounted for Series I Preferred Stock, while it was outstanding as an instrument that was more akin to a debt instrument. We also bifurcated the embedded conversion feature and freestanding warrants issued with the financing and carried these amounts as derivative liabilities, at fair value. The table below reflects derivative income and (expense) associated with changes in the fair value of this derivative financial instrument.

The following table summarizes derivative income (expense) related to compound derivatives and freestanding warrant derivatives that arose in connection with the preferred stock transactions discussed above.

|                             | Year ended<br>December 31,<br>2005 | Year ended<br>December 31,<br>2004 |
|-----------------------------|------------------------------------|------------------------------------|
| Derivative income (expense) |                                    |                                    |
| Compound derivative         | \$ 152,310                         | \$ (22,535)                        |
|                             |                                    |                                    |
| Warrant derivative          | \$ (2,186,140)                     | \$ (900,868)                       |
|                             |                                    |                                    |

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The following table summarizes preferred stock dividends related to the convertible preferred stock discussed above:

|                           | Year ended<br>December 31,<br>2005 | Year ended<br>December 31,<br>2004 |
|---------------------------|------------------------------------|------------------------------------|
| Preferred stock dividends | \$5,600                            | \$31,200                           |
|                           |                                    |                                    |
| Accretions                | \$ -                               | \$ -                               |
|                           |                                    |                                    |

### Note 8. - Share Based Payments

On April 6, 2005, our Board of Directors adopted an incentive share-based plan (the "2005 Stock Incentive Plan") that provides for the grant of stock options for up to 10,397,745 shares of our common stock to our directors, officers, key employees, and consultants. On May 10, 2005, our Board of Directors adopted the recommendation of our Compensation Committee to grant options for 8,922,745 shares to our directors and key employees. As of December 31, 2005, there were 1,475,000 shares of common stock reserved for issuance under our stock plan. Options granted under 2005 Stock Incentive Plan have a contractual life of 10 years and vest over two years in equal annual installments with the first third exercisable on the grant date, provided that the individual is continuously employed by us.

In years prior to 2005, we granted options for 650,000 shares to now former employees and options for 220,000 shares to now former directors, all which are fully vested and exercisable, under individual plans. Currently, there are no shares reserved for future issuance under these individual plans.

We adopted the fair-value provisions of FAS No. 123, effective January 1, 2005, and we recorded compensation costs aggregating \$798,870 for the twelve months ended December 31, 2005. We recognized no tax benefit for share-based

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compensation arrangements due to the fact that we are in a cumulative loss position and recognize no tax benefits in our Consolidated Statements of Operations.

We estimate the fair value of each stock option on the date of grant using a Black-Scholes-Merton (BSM) option-pricing formula, applying the following assumptions and amortize that value to expense over the options' vesting periods using the straight-line attribution approach. In addition to the issuance of the outstanding options discussed above, we granted options for 750,000 shares in 2004, which were part of the options for 5,395,000 shares that were exchanged into an equivalent number of common shares in 2004, as discussed further below.

|                          | 2005 |
|--------------------------|------|
| Expected Term (in years) | 6    |
| Risk-free rate           | 5%   |
| Expected volatility      | 141% |
| Expected dividends       | 0%   |

**Expected Term:** The expected term represents the period over which the share-based awards are expected to be outstanding. It has been determined as the midpoint between the vesting date and the end of the contractual term.

**Risk-Free Interest Rate:** We based the risk-free interest rate used in our assumptions on the implied yield currently available on U.S. Treasury zero-coupon issues with a remaining term equivalent to the stock option award's expected term.

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**Expected Volatility:** The volatility factor used in our assumptions is based on the historical price of our stock over the most recent period commensurate with the expected term of the stock option award.

**Expected Dividend Yield:** We do not intend to pay dividends on our common stock for the foreseeable future. Accordingly, we use a dividend yield of zero in our assumptions.

A summary of option activity under the stock incentive plan for the years ended December 31, 2005 and 2004 are presented below:

|  | 2005                    |                              | 2004                                 |   |
|--|-------------------------|------------------------------|--------------------------------------|---|
|  | Number<br>of<br>Options | Average<br>Exercise<br>Price | Weighted-<br>Number<br>of<br>Options | Weighted-<br>Average<br>Exercise<br>Price |
| Outstanding Balance at beginning of year | 1,025,000               | \$0.46                       | 7,903,705                            | \$ 0.43                                   |
| Granted                                  | 9,122,743               | \$0.28                       | 750,000                              | \$ 0.29                                   |
| Exercised                                | -                       | -                            | -                                    | -   |
| Forfeited                                | (547,321)               | \$0.28                       | -                                    | -   |
| Expired                                  | -                       | -                            | (2,233,705)                          | \$(0.76)                                  |
| Cancelled                                | -                       | -                            | (5,395,000)                          | \$(0.27)                                  |

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|                                    | -----     |        | -----     |         |
|------------------------------------|-----------|--------|-----------|---------|
| Outstanding at the end of the year | 9,600,422 | \$0.30 | 1,025,000 | \$ 0.46 |
|                                    | =====     |        | =====     |         |
| Exercisable at the end of the year | 3,816,806 | \$0.33 | 1,025,000 | \$ 0.46 |
|                                    | =====     |        | =====     |         |

The following table summarized the status of the stock options outstanding and exercisable at December 31, 2005:

| Range<br>of Exercise<br>Prices | 2005<br>Options Outstanding |  |   | 2005<br>Options Exercisable |   |
|--------------------------------|-----------------------------|--|---|-----------------------------|---|
|                                | Number<br>of<br>Options     | Weighted-<br>Average<br>Remaining<br>Contractual<br>Term<br>(in years) | Weighted-<br>Average<br>Exercise<br>Price | Number<br>of<br>Options     | Weighted-<br>Average<br>Exercise<br>Price |
| \$.20 to \$.35                 | 9,200,422                   | 9.18   | \$0.28                                    | 3,416,806                   | \$0.16                                    |
| \$.60 to \$1.00                | 400,000                     | 4.94   | \$0.78                                    | 400,000                     | \$0.78                                    |
|                                | -----                       |  |   | -----                       |   |
|                                | 9,600,422                   | 9.00   | \$0.30                                    | 3,816,806                   | \$0.22                                    |
|                                | =====                       |  |   | =====                       |   |

The weighted-average exercise prices and weighted-average fair values of options granted during 2005 for which the exercise prices exceeded the market prices of the stock was \$0.23 and \$0.15, respectively. The weighted-average exercise price and weighted-average fair value of options granted during 2005 for which

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the exercise price equaled the market price of the stock was \$0.61 and \$0.56, respectively. There were no exercises of options during the years ended December 31, 2005 and 2004.

During 2004 we granted options for 750,000 shares which were cancelled and converted into common shares. These options were part of options for 5,395,000 shares that were exchanged into an equivalent number of unregistered common shares in 2004. In connection with such cancellation, we recorded \$269,750 of compensation expenses at the value of \$.05 per each common share. This valuation was discounted from the quoted market price of \$.08 due to restrictions imposed by insider trading and short swing profits rules on the transferability of such shares that were issued to our directors and senior management.

In May 2005, we extended the contractual life of fully vested options for 770,000 shares held by two directors. As a result of that modification, we have recognized, on a restated basis, additional compensation expense of \$104,000 for the second quarter of 2005

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### Note 9 - Stockholders' Deficit

#### (a) Convertible Preferred Stock

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We have designated 1,260,000 shares of our preferred stock as Series B Convertible Preferred Stock. Series B Preferred accumulates dividends at the rate of 9% per annum, payable only upon liquidation or redemption, as a percentage of the stated value, out of the assets and available funds. Voting rights of the Series B Convertible Preferred stock are the same as our common stock. Series B Convertible Preferred stock is convertible anytime after December 31, 1997 to our common stock at the fixed ratio of one share of common stock for one share of Series B Convertible Preferred stock surrendered for conversion. We account for Series B Preferred Stock as perpetual preferred equity.

#### (b) Common Stock Warrants

-----

As of December 31, 2005, we had the following outstanding warrants:

| Warrants                                | Grant date | Expiration date | Warrants/<br>Options<br>Granted | Exercis<br>Price |
|---|------------|-----------------|---------------------------------|------------------|
| Series D Preferred Stock Financing      | 3/9/1999   | 11/17/2008      | 17,500                          | 0.100            |
| Series D Preferred Stock Financing      | 4/23/1999  | 11/17/2008      | 8,750                           | 0.100            |
| Series D Preferred Stock Financing      | 2/1/2000   | 11/17/2008      | 130,000                         | 0.100            |
| Series D Preferred Stock Financing      | 2/1/2000   | 11/17/2008      | 455,000                         | 0.100            |
| Series F Preferred Stock Financing      | 10/13/2000 | 11/17/2008      | 1,038,259                       | 0.100            |
| Series H Preferred Stock Financing      | 12/5/2001  | 12/4/2006       | 2,637,500                       | 0.500            |
| Series H Preferred Stock Financing      | 1/30/2002  | 1/30/2007       | 375,000                         | 0.500            |
| Series H Preferred Stock Financing      | 2/15/2002  | 2/14/2007       | 125,000                         | 0.500            |
| Series H Preferred Stock Financing      | 3/18/2002  | 3/17/2007       | 1,250,000                       | 0.500            |
| January 2005 Convertible Debt Financing | 11/20/2003 | 11/20/2008      | 2,000,000                       | 0.050            |
| Warrant to Licensor                     | 6/20/2005  | 6/19/2007       | 1,000,000                       | 0.050            |
| Warrant Consultant                      | 4/8/2005   | 4/7/2007        | 1,000,000                       | 0.250            |
| Warrant to Distributor                  | 8/30/2005  | 8/29/2008       | 30,000,000                      | 0.360            |
| April 2004 Financing                    | 4/20/2004  | 4/19/09         | 1,500,000                       | 0.100            |
| October 2004 Financing                  | 10/29/2004 | 10/28/2009      | 500,000                         | 0.100            |

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|                                      |            |            |            |       |
|--------------------------------------|------------|------------|------------|-------|
| January 2005 Financing               | 1/31/05    | 1/30/2010  | 2,000,000  | 0.100 |
| November 2005 Common Stock Financing | 11/28/2005 | 11/27/2010 | 15,667,188 | 0.800 |
| November 2005 Common Stock Financing | 11/28/2005 | 11/27/2010 | 1,012,500  | 0.500 |
| Other Financings                     | 12/27/2001 | 2/28/2007  | 25,000     | 0.400 |
|                                      |            |            | -----      |       |
| Total Warrants                       |            |            | 60,741,697 |       |
|                                      |            |            | =====      |       |

Certain conversion features in our debt and preferred stock are indexed to a variable number of common shares based upon our trading stock price. Accordingly, in the event of stock price declines, we may have insufficient shares to share-settle all of our contracts that are convertible into or exercisable for common stock. As a result, current accounting standards require



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us to assume that we would not have sufficient authorized shares to settle these other warrants and, therefore, reclassify other warrants and contracts that were otherwise carried in stockholders' equity to derivative liabilities. Such warrants and contracts that required reclassification were indexed to 49,504,688 and 47,679,688 shares of our common stock as of December 31, 2005 and 2004, respectively. We are not required to reclassify certain exempt contracts and employee stock options, so those items are not included in this caption. Derivative income (expense) associated with these other warrants for the years ended December 31, 2005 and 2004 are as follows:

|                             |                |              |
|-----------------------------|----------------|--------------|
| Derivative income (expense) | 2005           | 2004         |
|                             | -----          | -----        |
| Warrant derivative          | \$ (7,336,788) | \$ (316,829) |
|                             | =====          | =====        |

Activity for our common stock warrants is presented below:

|   | Shares       | Weighted<br>Average<br>Price |
|---|--------------|------------------------------|
|   | -----        | -----                        |
| Total warrants outstanding at December 31, 2003 | 34,700,277   | \$ 0.33                      |
| Warrants granted                                | 27,950,000   | 1.03                         |
| Warrants exercised                              | -            | -                            |
| Warrants expired                                | (33,000)     | (2.75)                       |
|   | -----        | -----                        |
| Total warrants outstanding at December 31, 2004 | 62,617,277   | \$ 0.64                      |
| Warrants granted                                | 66,329,688   | 0.39                         |
| Warrants exercised                              | (32,873,601) | (0.15)                       |
| Warrants expired                                | (3,331,667)  | (1.62)                       |
| Warrants redeemed                               | (32,000,000) | (0.18)                       |
|   | -----        | -----                        |
| Total warrants outstanding at December 31, 2005 | 60,741,697   | \$ 0.44                      |
|   | =====        | =====                        |

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(c) Other Stockholders' Equity Transactions

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Year ended December 31, 2005

Quarter Ended March 31, 2005  
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New Financing: January 2005 Convertible Notes. On January 31, 2005, we closed a funding transaction with Longview Fund, LP, Longview Equity Fund, LP, Longview International Equity Fund, LP, Alpha Capital Aktiengesellschaft and Whalehaven Funds Limited, five institutional accredited investors, for the issuance and sale to the Subscribers of up to \$2,300,000 of principal amount of promissory notes convertible into shares of our common stock, and Warrants to purchase shares of common stock at 100% coverage of the common stock issuable in accordance with the principal amount of the notes. One Million One Hundred Fifty Thousand Dollars (\$1,150,000) of the

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purchase price was paid on the initial closing date, and One Million One Hundred Fifty Thousand Dollars (\$1,150,000) of the purchase price will be payable within five (5) business days after the actual effectiveness of an SB-2 Registration Statement as defined in the Subscription Agreement. The initial closing notes were at prime plus 4% interest in the aggregate amount of \$1,150,000, plus five-year Warrants for the purchase of, in the aggregate, 9,200,000 shares of common stock, at the lesser of (i) \$0.16, or (ii) 101% of the closing bid price of the Common Stock as reported by Bloomberg L.P. for the OTC Bulletin Board for the trading day preceding the Closing Date. The notes are convertible into shares of our common stock at \$0.125 per common share. Conversions are limited to a maximum ownership of 9.99% of the underlying common stock at any one time. The notes have a maturity date two years from closing and are payable in twelve equal monthly installments, commencing June 1, 2005. The installment payments consist of principal equal to 1/20th of the initial principal amount which, subject to certain conditions concerning trading volume and price, can be paid in cash at 103% of the monthly installment, or common stock or a combination of both. The notes have an acceleration provision upon the change in a majority of the present Board of Directors except as the result of the death of one or more directors, or a change in the present CEO. In connection with this transaction, we issued restricted common stock in the aggregate amount of 460,000 shares plus the aggregate cash amount of \$57,500 for due diligence fees to the investors in this transaction. We issued the Convertible Promissory Note and the underlying common stock upon conversion to an accredited investor, pursuant to a Regulation D offering. The underlying common stock is now registered pursuant to a Form SB-2 registration statement declared effective August 2, 2005.

November 2003 Convertible Notes. We converted \$25,000 of our November 2003 Convertible Promissory Notes into 549,340 shares of common stock pursuant to a notice of conversion from Gamma Opportunity Capital Partners LP, at a fixed conversion price of \$0.05. The conversion included \$2,467 of accrued and unpaid interest on the converted amount. We issued the underlying common stock upon conversion pursuant to a Form SB-2 registration statement, declared effective on August 3, 2004.

April 2004 Convertible Notes. We converted \$99,999 of our April 2004 Convertible Promissory Notes into 1,141,387 shares of common stock pursuant to notices of conversion from Longview Fund LP, at a fixed conversion price of \$0.10. The conversions included \$14,138 of accrued and unpaid interest. We issued the underlying common stock upon conversion pursuant to our SB-2 registration statement, declared effective on August 3, 2004.

June 2004 Convertible Notes. We converted \$41,666 of our June 2004 Convertible Promissory Notes into 430,327 shares of restricted common stock pursuant to a notice of conversion from Longview Fund LP, at a fixed conversion price of \$0.15. The conversion included \$22,822 of accrued and unpaid interest. We issued the Convertible Promissory Note and the underlying common stock upon conversion to an accredited investor, pursuant to a Regulation D offering. The underlying common stock is now registered pursuant to a Form SB-2 registration statement declared effective April 18, 2005.

Quarter Ended June 30, 2005  
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New Financing: April 2005 Convertible Note. On April 21, 2005, we closed a funding transaction with Alpha Capital Aktiengesellschaft for the issuance of a convertible 10% note in the aggregate amount of \$300,000. The promissory note is convertible into shares of common stock of the Company at \$0.20 per common share. Conversions are limited to a maximum ownership of 9.99% of the Company's common stock at any one time. The note has an October 31, 2005 maturity and is

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payable in five equal monthly installments, commencing June 1, 2005. The installment payments consist of principal (equal to 1/5th of the initial principal amount) plus accrued interest. Installments can be paid in cash or common stock valued at the average closing price of the Company's common stock during the

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five trading days immediately preceding the relevant installment due date. The Company has repriced Class B Warrants issued on June 30, 2004 from \$2.00 per share to \$0.125 per share and issued restricted common stock in the aggregate amount of 93,750 shares for finder's fees to a third-party to facilitate this transaction. The Company has the right to prepay the promissory note by paying to the holder cash equal to 120% of the principal to be prepaid plus accrued interest. The notes have an acceleration provision upon the change in a majority of the present Board of Directors except as the result of the death of one or more directors or a change in the present CEO of the Company. The common stock underlying the note and the finder's fee common stock have "piggy back" registration rights. We issued the convertible note and finder's fee common stock to accredited investors, pursuant to a Regulation D offering.

**New Financing: May 2005 Convertible Notes** On May 23, 2005, we closed a funding transaction (the "May '05 Transaction") with Longview Fund, LP, Whalehaven Funds Limited, Ellis International Ltd., and Osher Capital Corp., four institutional accredited investors, for the issuance and sale to the Subscribers of Five Hundred Thousand Dollars (\$500,000) of principal amount of promissory notes convertible into shares of our common stock and Warrants to purchase shares of common stock at 100% coverage of the common stock issuable in accordance with the principal amount of the notes. This May '05 Transaction was a part of a January 23, 2005 funding transaction for an aggregate of Two Million Three Hundred Thousand Dollars (\$2,300,000), One Million One Hundred Fifty Thousand Dollars (\$1,150,000) of which was paid on the initial closing date, and One Million One Hundred Fifty Thousand Dollars (\$1,150,000) of which (the "Second Tranche") was to be payable within five (5) business days after the actual effectiveness of an SB-2 Registration Statement covering the aggregate transaction, as defined in the Subscription Agreement. The May '05 Transaction for Five Hundred Thousand Dollars (\$500,000) is a partial interim closing of the Second Tranche, which occurred prior to the anticipated effectiveness of the SB-2 Registration Statement covering the aggregate transaction. Contemporaneous with the May '05 Transaction, we agreed to a modification of the January 23, 2005 aggregate transaction for the substitution of Ellis International Ltd. and Osher Capital Corp. in the place of Alpha Capital Aktiengesellschaft, one of the original investors. The May '05 Transaction convertible notes are at prime plus 4% interest in the aggregate amount of \$500,000, plus five-year Warrants for the purchase of, in the aggregate, 4,000,000 shares of common stock, at an exercise price of \$0.129. The notes are convertible into shares of our common stock at \$0.125 per common share. Conversions are limited to a maximum ownership of 9.99% of the underlying common stock at any one time. The notes have a maturity date two years from closing and are payable in twelve equal monthly installments, commencing June 1, 2005. The installment payments consist of principal equal to 1/20th of the initial principal amount which, subject to certain conditions concerning trading volume and price, can be paid in cash at 103% of the monthly installment or common stock or a combination of both. The notes have an acceleration provision upon the change in a majority of the present Board of Directors except as the result of the death of one or more directors, or a change in the present CEO. In connection with this transaction, we issued restricted common stock in the aggregate amount of 200,000 shares plus the aggregate cash amount of \$25,000 for due diligence fees to Longview Fund, LP, Gem Funding LLC, Ellis International Ltd., and Osher Capital Corp. in this transaction. The Second Tranche of the January 23, 2005 aggregate transaction,

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now in the amount of \$650,000, remains outstanding and will be triggered by the effectiveness of the pending SB-2 registration statement.

Conversions: November 2003 Convertible Notes. We converted \$50,000 of our November 2003 Convertible Promissory Note into 1,106,740 shares of common stock pursuant to a notice of conversion from Gamma Opportunity Capital Partners LP, at a fixed conversion price of \$0.05. The conversion included \$5,337 of accrued and unpaid interest. We issued the underlying common stock upon conversion pursuant to a Form SB-2 registration statement, declared effective on August 3, 2004.

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Warrant Exercise: November 2003 Warrant. We issued 1,000,000 shares of common stock to Gamma Opportunity Capital Partners LP pursuant to the exercise of a Warrant issued in connection with the November 2003 financing transaction, and received \$50,000 in warrant exercise payments. The shares of common stock underlying the warrant were issued pursuant to a Form SB-2 shelf registration statement, declared effective by the SEC on August 3, 2004.

Warrant Exercise: April 2004 Warrant. We issued 1,500,000 shares of common stock to Longview Fund LP pursuant to the exercise of a Warrant issued in connection with the April 2004 financing transaction, and received \$225,000 in warrant exercise payments. The shares of common stock underlying the warrant were issued pursuant to a Form SB-2 shelf registration statement, declared effective by the SEC on August 3, 2004.

Conversions: June 2004 Convertible Notes. We converted \$528,573 of our June 2004 Convertible Promissory Notes into 5,633,039 shares of common stock pursuant to notices of conversion from Longview Fund LP, Gem Funding LLC, Whalehaven Capital Fund Limited, Stonestreet Limited Partnership and Bi-Coastal Consulting Corp. at a fixed conversion price of \$0.10. The conversion included \$33,689 of accrued and unpaid interest. We issued the common stock upon conversion pursuant to a Form SB-2 registration statement declared effective by the Securities and Exchange Commission on April 18, 2005.

Warrant Exercise: June 2004 Warrant. We issued 2,200,000 shares of common stock to Longview Fund LP, Whalehaven Capital Fund Limited and Stonestreet Limited Partnership pursuant to the exercise of Warrants issued in connection with the June 2004 financing transaction, and received \$309,000 in warrant exercise payments. The shares of common stock underlying the warrants were issued pursuant to a Form SB-2 shelf registration statement, declared effective by the SEC on April 18, 2005.

Conversions: October 2004 Convertible Notes. We converted \$446,250 of our October 2004 Convertible Promissory Notes into 4,718,514 shares of common stock pursuant to notices of conversion from Longview Fund LP, Gem Funding LLC, Whalehaven Capital Fund Limited, Stonestreet Limited Partnership and Bi-Coastal Consulting Corp. at a fixed conversion price of \$0.10. The conversion included \$25,602 of accrued and unpaid interest. We issued the common stock upon conversion pursuant to a Form SB-2 registration statement declared effective by the Securities and Exchange Commission on April 18, 2005.

Warrant Exercise: October 2004 Warrant. We issued 1,700,000 shares of common stock to Longview Fund LP, Whalehaven Capital Fund Limited and Stonestreet Limited Partnership pursuant to the exercise of Warrants issued in connection with the October 2004 financing transaction, and received \$248,700 in warrant exercise payments. The shares of common stock underlying the warrants were issued pursuant to a Form SB-2 shelf registration statement, declared effective by the SEC on April 18, 2005.

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Conversions: December 2004 Convertible Notes. We converted \$210,000 of our December 2004 Convertible Promissory Notes into 2,176,706 shares of common stock pursuant to notices of conversion, to Momona Capital Corp. and Ellis International Ltd Inc., at a fixed conversion price of \$0.10 per share. The conversion included \$7,450 of accrued and unpaid interest. We issued the underlying common stock upon conversion pursuant to a Form SB-2 registration statement, declared effective on April 18, 2005.

Warrant Exercise: December 2004 Warrant. We issued 500,000 shares of common stock to Momona Capital Corp. and Ellis International Ltd Inc., pursuant to the exercise of Warrants issued in

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connection with the December 2004 financing transaction, and received \$72,500 in warrant exercise payments. The shares of common stock underlying the warrants were issued pursuant to a Form SB-2 shelf registration statement, declared effective by the SEC on April 18, 2005.

Conversions: January 2005 Convertible Notes. We converted \$534,304 of our January 2005 Convertible Promissory Notes into 4,461,685 shares of restricted common stock pursuant to notices of conversion, to Longview Fund LP, Longview Equity Fund LP and Longview International Equity Fund LP at a fixed conversion price of \$0.125 per share. We issued the Convertible Promissory Note and the underlying common stock upon conversion to an accredited investor, pursuant to a Regulation D offering. The underlying common stock is now registered pursuant to a Form SB-2 registration statement declared effective August 2, 2005.

Conversions: Series F Convertible Preferred. We converted 31,134 shares of our Series F Convertible Preferred, having a stated value of \$311,340 into 2,903,839 shares of common stock pursuant to notices of conversion, to Austinvest Anstalt Balzers and Esquire Trade & Finance Inc. We issued the Series F Convertible Preferred and the underlying common stock upon conversion to accredited investors, pursuant to a Regulation D offering and Rule 144(k).

Conversions: Series H Convertible Preferred. We converted 100,000 shares of our Series H Convertible Preferred, having a stated value of \$1,000,000 into 2,500,000 shares of common stock pursuant to notices of conversion, to four individual and two institutional investors. We issued the Convertible Preferred and the underlying common stock upon conversion to accredited investors, pursuant to a Regulation D offering and Rule 144(k).

Conversions: Series I Convertible Preferred. We converted 20,000 shares of our Series I Convertible Preferred, having a stated value of \$200,000 into 2,354,808 shares of common stock pursuant to a notice of conversion, to Alpha Capital AG. We issued the Convertible Preferred and the underlying common stock upon conversion to accredited investors, pursuant to a Regulation D offering and Rule 144(k).

Warrant Exercise: Series I Warrant. We issued 1,333,333 shares of restricted common stock to Alpha Capital AG, pursuant to the exercise of Warrants issued in connection with the Series I financing transaction, and received \$133,333 in warrant exercise payments. The shares of common stock underlying the warrants are now registered pursuant to a Form SB-2 shelf registration statement, declared effective by the SEC on August 2, 2005.

Private Placements. On May 17, 2005 we issued the aggregate of 27,500 restricted shares of the Company's common stock, with a recorded value of \$4,950, to eleven product sales brokers as a bonus for the performance of services for the Company. We issued the restricted common stock pursuant to Section 4(6) of the Securities Act of 1933, which provides an exemption from

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the registration requirements of the Act for transactions not involving a public offering.

S-8 Registration. On April 14, 2005 and April 18, 2005, we issued 750,000 and 250,000 shares, respectively, of our common stock to Geoffrey Eiten, for services rendered for strategic business planning. These shares were part of 1,500,000 shares of the Company's common stock registered under a Form S-8 registration statement filed December 23, 2004.

Warrant Issue. On June 20, 2005, we issued one year Warrant to Marvel Enterprises Inc. to purchase 1,000,000 shares of our common stock a \$0.05 per share. This Warrant was issued in connection with the execution of a License Agreement with Marvel for the United States, Canada and

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Mexico. We issued the Warrant pursuant to Section 4(6) of the Securities Act of 1933, which provides an exemption from the registration requirements of the Act for transactions not involving a public offering.

Quarter Ended September 30, 2005  
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Warrant Exercise: Series D Warrant. We issued 696,042 shares of common stock to Longview Fund LP, Longview Equity Fund LP, Longview International Equity Fund LP and Esquire Trade & Finance Inc., pursuant to the cashless exercises of warrants for 763,750 shares of common stock. We issued the Warrants and the underlying common stock upon exercise to accredited investors, pursuant to a Regulation D offering and Rule 144(k).

Conversions: Series F Convertible Preferred. We converted 19,133 shares of our Series F Convertible Preferred, having a stated value of \$191,330 into 804,752 shares of common stock pursuant to notices of conversion to Amro International, SA. We issued the Series F Convertible Preferred and the underlying common stock upon conversion to accredited investors, pursuant to a Regulation D offering and Rule 144(k).

Warrant Exercise: Series F Warrant. We issued 3,345,417 shares of common stock to Austinvest Anstalt Balzers and Esquire Trade & Finance Inc. and Libra Finance, SA., pursuant to the cashless exercise of warrants for 3,676,518 shares of common stock. We issued the Warrants and the underlying common stock upon exercise to accredited investors, pursuant to a Regulation D offering and Rule 144(k).

Conversions: Series H Convertible Preferred. We converted 1,000 shares of our Series H Convertible Preferred, having a stated value of \$10,000 into 25,000 shares of common stock pursuant to notices of conversion, to one individual investor. We issued the Convertible Preferred and the underlying common stock upon conversion to accredited investors, pursuant to a Regulation D offering and Rule 144(k).

Conversions: Series I Convertible Preferred. We converted 10,000 shares of our Series I Convertible Preferred, having a stated value of \$100,000 into 656,953 shares of common stock pursuant to a notice of conversion, to Tradersbloom Limited. The conversion included \$24,000 of accrued and unpaid interest. We issued the Convertible Preferred and the underlying common stock upon conversion to accredited investors, pursuant to a Regulation D offering and Rule 144(k).

Conversions: April 2004 Convertible Notes. We converted \$250,000 of our April 2004 Convertible Promissory Notes into 2,808,219 shares of common stock

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pursuant to notices of conversion from Osher Capital Inc., Ellis International Ltd Inc. and Alpha Capital AG. The conversion included \$3,082 of accrued and unpaid interest on the converted amount. We issued the underlying common stock upon conversion pursuant to a Form SB-2 registration statement, declared effective on August 4, 2004.

Conversions: June 2004 Convertible Notes. We converted \$250,000 of our June 2004 Convertible Promissory Notes into 2,796,575 shares of common stock pursuant to notices of conversion from Alpha Capital AG at a fixed conversion price of \$0.10. The conversion included \$29,657 of accrued and unpaid interest on the converted amount. We issued the common stock upon conversion pursuant to a Form SB-2 registration statement declared effective by the Securities and Exchange Commission on April 18, 2005.

Conversions: October 2004 Convertible Notes. We converted \$125,000 of our October 2004 Convertible Promissory Notes into 1,342,808 shares of common stock pursuant to notices of conversion

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from Alpha Capital AG at a fixed conversion price of \$0.10. The conversion included \$9,280 of accrued and unpaid interest on the converted amount. We issued the common stock upon conversion pursuant to a Form SB-2 registration statement declared effective by the Securities and Exchange Commission on April 18, 2005.

Warrant Exercise: December 2004 Warrant. We issued 300,000 shares of common stock to Momona Capital Corp. pursuant to the exercise of Warrants issued in connection with the December 2004 financing transaction, and received \$30,000 in warrant exercise payments. The shares of common stock underlying the warrants were issued pursuant to a Form SB-2 shelf registration statement, declared effective by the SEC on April 18, 2005.

Conversions: January 2005 Convertible Notes. We converted \$500,071 of our January 2005 Convertible Promissory Notes into 4,186,644 shares of restricted common stock pursuant to notices of conversion, to Longview Fund LP, Longview Equity Fund LP and Longview International Equity Fund LP at a fixed conversion price of \$0.125 per share. The conversion included \$23,260 of accrued and unpaid interest on the converted amount. We issued the common stock upon conversion pursuant to a Form SB-2 registration statement declared effective by the Securities and Exchange Commission on August 2, 2005.

Warrant Exercise: January 2005 Warrant. We issued 7,200,000 shares of common stock to Whalehaven Capital Fund Limited, Longview Fund LP, Longview Equity Fund LP and Longview International Equity Fund LP pursuant to the exercise of Warrants issued in connection with the January 2005 financing transaction, and received \$720,000 in warrant exercise payments. The shares of common stock underlying the warrants were issued pursuant to a Form SB-2 shelf registration statement, declared effective by the SEC on August 2, 2005.

Conversions: April 2005 Convertible Notes. We converted \$300,000 of our April 2005 Convertible Promissory Note into 1,556,438 shares of restricted common stock pursuant to notices of conversion, to Alpha Capital AG at a fixed conversion price of \$0.20 per share. The conversion included \$11,288 of accrued and unpaid interest on the converted amount. We issued the common stock upon conversion pursuant to a Form SB-2 registration statement declared effective by the Securities and Exchange Commission on August 2, 2005.

Conversions: May 2005 Convertible Notes. We converted \$475,000 of our May 2005 Convertible Promissory Notes into 4,141,270 shares of restricted common stock pursuant to notices of conversion, to Whalehaven Capital Fund Limited,

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Ellis International Ltd, Longview Fund LP and Osher Capital Corp. The conversion included \$9,317 of accrued and unpaid interest on the converted amount. We issued the common stock upon conversion pursuant to a Form SB-2 registration statement declared effective by the Securities and Exchange Commission on August 2, 2005.

Warrant Exercise: May 2005 Warrant. We issued 4,000,000 shares of common stock to Whalehaven Capital Fund Limited, Ellis International Ltd, Longview Fund LP and Osher Capital Corp. pursuant to the exercise of Warrants issued in connection with the January 2005 financing transaction, and received \$400,000 in warrant exercise payments. The shares of common stock underlying the warrants were issued pursuant to a Form SB-2 shelf registration statement, declared effective by the SEC on August 2, 2005.

New Financing: August 2005 Convertible Notes On August 18, 2005, we closed a funding transaction (the "August '05 Transaction") with Longview Fund, LP, Longview Equity Fund, LP and Longview International Equity Fund, LP, three institutional accredited investors, for the issuance and sale

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to the Subscribers of Six Hundred Fifty Thousand Dollars (\$650,000) of principal amount of promissory notes convertible into shares of our common stock and Warrants to purchase shares of common stock at 100% coverage of the common stock issuable in accordance with the principal amount of the notes. This August '05 Transaction was a part of a January 23, 2005 funding transaction for an aggregate of Two Million Three Hundred Thousand Dollars (\$2,300,000). The August '05 Transaction is the Second Tranche of the January '05 transaction, which occurred upon the effectiveness of the SB-2 Registration Statement covering the aggregate transaction. The August '05 Transaction convertible notes are at prime plus 4% interest in the aggregate amount of \$650,000, plus five-year Warrants for the purchase of, in the aggregate, 5,200,000 shares of common stock, at an exercise price of \$0.129. The notes are convertible into shares of our common stock at \$0.125 per common share. Conversions are limited to a maximum ownership of 9.99% of the underlying common stock at any one time. The notes have a maturity date two years from closing and are payable in twelve equal monthly installments. The installment payments consist of principal equal to 1/20th of the initial principal amount which, subject to certain conditions concerning trading volume and price, can be paid in cash at 103% of the monthly installment, or common stock or a combination of both. The notes have an acceleration provision upon the change in a majority of the present Board of Directors except as the result of the death of one or more directors, or a change in the present CEO. In connection with this transaction, we issued restricted common stock in the aggregate amount of 260,000 shares plus the aggregate cash amount of \$32,500 for due diligence fees to Longview Fund companies. We issued the equity equivalents, the underlying common stock upon conversion and the finders' fee common stock pursuant to a Form SB-2 registration statement declared effective by the Securities and Exchange Commission on August 2, 2005.

On September 30, 2005, we prepaid \$250,000 of the aggregate \$650,000 of the August '05 Transaction notes, as follows: \$57,692 to Longview Fund, LP, \$144,231 to Longview Equity Fund, LP and \$ 48,077 to Longview International Equity Fund, LP. The holders of these notes waived the prepayment premium in lieu of their retention of warrants attached to August '05 Transaction.

Conversions: August 2005 Convertible Notes. We converted \$91,217 of our August 2005 Convertible Promissory Notes into 743,750 shares of restricted common stock pursuant to a notice of conversion, to Longview Fund LP, at a fixed conversion price of \$0.125 per share. The conversion included \$1,752 of accrued and unpaid interest on the converted amount. We issued the common stock



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upon conversion pursuant to a Form SB-2 registration statement declared effective by the Securities and Exchange Commission on August 2, 2005.

**Warrant Exercise: August 2005 Warrant.** We issued 5,200,000 shares of common stock to Longview Fund LP, Longview Equity Fund LP and Longview International Equity Fund LP pursuant to the exercise of Warrants issued in connection with the August 2005 financing transaction, and received \$520,000 in warrant exercise payments. The shares of common stock underlying the warrants were issued pursuant to a Form SB-2 shelf registration statement, declared effective by the SEC on August 2, 2005.

**Private Placements.** On August 3, 2005 we issued 500,000 restricted shares of our common stock to Geoffrey Eiten, for services rendered for strategic business planning. We issued the restricted common stock pursuant to Section 4(6) of the Securities Act of 1933, which provides an exemption from the registration requirements of the Act for transactions not involving a public offering.

On August 29 and September 19, 2005 we issued the aggregate of 1,000,000 restricted shares of our common stock to National Financial Communications Corp. pursuant to the exercise of Warrants issued in connection with a consulting agreement for services rendered for strategic business planning. We issued the restricted common stock pursuant to Section 4(6) of the Securities Act of 1933, which

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provides an exemption from the registration requirements of the Act for transactions not involving a public offering.

On September 19, 2005, we issued 450,000 restricted shares of our common stock to Alpha Capital AG, an accredited investor, in a sale not involving a public offering at a price of \$1.00 per share. We issued the common stock pursuant to a Regulation D offering.

**Warrant Issue.** On August 31, 2005, we issued a three year Warrant to Coca-Cola Enterprises Inc. to purchase 30,000,000 shares of our common stock a \$0.36 per share. During the first 18 months of the exercise period, the Company has the option to "call" the exercise of up to 10,000,000 shares of common stock issuable upon exercise of the Warrant, upon the Company's satisfaction of certain conditions, including a trading price of not less than \$1.08 per share for 20 consecutive trading days. This Warrant was issued in connection with the execution of a Master Distribution Agreement on August 31, 2005. We issued the Warrant pursuant to Section 4(6) of the Securities Act of 1933, which provides an exemption from the registration requirements of the Act for transactions not involving a public offering. The Company will record an \$11,900,000 net charge in deferred distribution costs for the issuance of a three year warrant to Coca-Cola Enterprises to purchase of 30,000,000 shares of our common stock in connection with the Master Distribution Agreement. The Company will recognize that cost as a selling expense over the 10-year term of the agreement.

Quarter Ended December 31, 2005  
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On November 28, 2005, we closed a funding transaction with 13 accredited institutional investors, for the issuance and sale of 40,500,000 shares of our common stock for a purchase price of \$20,250,000. In addition, we also issued five-year warrants for the purchase of an additional 15,187,500 shares of common stock at an exercise price of \$0.80 per share. The securities are restricted and have been issued pursuant to an exemption to the registration requirements of Section 5 of the Securities Act of 1933 for "transactions of

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the issuer not involving any public offering" provided in Section 4(2) of the Act and pursuant to a Regulation D offering. In connection with this financing, we issued common stock purchase warrants to purchase 1,012,500 shares of common stock at an exercise price of \$.50 per share and 304,688 shares of common stock at an exercise price of \$.80 per share to SG Cowen & Co., LLC, who acted as placement agent for this financing.

The shares of common stock and the shares of common stock underlying the warrants carry registration rights that obligate us to file a registration statement within 45 days from closing and have the registration statement declared effective within 120 days from closing.

All of the above offerings and sales were deemed to be exempt under rule 506 of Regulation D and Section 4(2) of the Securities Act of 1933, as amended. No advertising or general solicitation was employed in offering the securities. The offerings and sales were made to a limited number of persons, all of whom were accredited investors, or business associates of Bravo! Foods International Corp., and transfer was restricted by Bravo! Foods International Corp. in accordance with the requirements of the Securities Act of 1933. In addition to representations by the above-referenced persons, we have made independent determinations that all of the above-referenced persons were accredited or sophisticated investors, and that they were capable of analyzing the merits and risks of their investment and that they understood the speculative nature of their investment. Furthermore, all of the above-referenced persons were provided with access to our Securities and Exchange Commission filings.

Warrant Exercise: June 2004 Warrant. In December 2005, we issued 2,500,000 shares of common stock to Alpha Capital AG pursuant to the exercise of a "B" Warrant issued in connection with

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the June 2004 financing transaction and received \$250,000 in warrant exercise payments. The shares of common stock underlying the warrants were issued pursuant to a Form SB-2 shelf registration statement, declared effective by the SEC on April 18, 2005.

Year ended December 31, 2004

On February 1, 2004, we agreed to issue 750,000 shares of our common stock and warrants to purchase an additional 750,000 shares of common stock to Marvel Enterprises, Inc. We issued this equity in connection with the grant of an intellectual property license by Marvel on January 17, 2004, giving us the right to use certain Marvel Comics characters on our Slammers(R) line of flavored milks. The warrants have an exercise price of \$0.10 per share for the first year and, upon the occurrence of certain conditions tied to the royalty performance under the license, can be extended for an additional year with an exercise price of \$0.14 per share. We made this private offering to Marvel Enterprises, an accredited investor, pursuant to Rule 506 of Regulation D and Section 4(2) of the Securities Act of 1933.

On February 12, 2004, we held a special meeting of shareholders at which the shareholders approved an increase of our authorized common stock from 50,000,000 shares to 300,000,000 shares.

On February 17, 2004, we converted 875 shares of Series G Convertible Preferred Stock into 215,164 shares of common stock pursuant to a January 12, 2004 notice of conversion from Neshor, LP, at a conversion price of \$0.0407. The conversion included accrued and unpaid dividends on the converted preferred. We delayed processing this notice in light of our special meeting of shareholders held February 12, 2004. The shares of common stock issued pursuant

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to this conversion were retired and cancelled on March 5, 2004 and issued to third parties on that date in accordance with the instructions of Neshet, LP.

On February 17, 2004, we converted 1,400 shares of Series G Convertible Preferred Stock into 343,980 shares of common stock pursuant to a January 12, 2004 notice of conversion from Talbiya Investments, Ltd., at a conversion price of \$0.0407. The conversion included accrued and unpaid dividends on the converted preferred. We delayed processing this notice in light of our special meeting of shareholders held February 12, 2004. The shares of common stock issued pursuant to this conversion were retired and cancelled on March 5, 2004 and issued to third parties on that date in accordance with the instructions of Talbiya Investments, Ltd.

On February 17, 2004, we converted 700 shares of Series G Convertible Preferred Stock into 172,162 shares of common stock pursuant to a January 12, 2004 notice of conversion from The Keshet Fund, LP, at a conversion price of \$0.0407. The conversion included accrued and unpaid dividends on the converted preferred. We delayed processing this notice in light of our special meeting of shareholders held February 12, 2004. The shares of common stock issued pursuant to this conversion were retired and cancelled on March 5, 2004 and issued to third parties on that date in accordance with the instructions of The Keshet Fund, LP.

On February 17, 2004, we converted 2,025 shares of Series G Convertible Preferred Stock into 497,951 shares of common stock pursuant to a January 12, 2004 notice of conversion from Keshet LP, at a conversion price of \$0.0407. The conversion included accrued and unpaid dividends on the converted preferred. We delayed processing this notice in light of our special meeting of shareholders held February 12, 2004. The shares of common stock issued pursuant to this conversion were retired and cancelled on March 5, 2004 and issued to third parties on that date in accordance with the instructions of Keshet, LP.

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On March 1, 2004, we issued 80,000 shares of non-voting Series K 8% Convertible Preferred stock, to Mid-Am Capital, LLC, having a stated value of \$10.00 per Preferred K share, for the aggregate purchase price of \$800,000. Each preferred share is convertible to 100 shares of our common stock at a conversion price of \$0.10, representing 8,000,000 shares of common stock underlying the preferred. In addition, we made the following adjustments to prior issued warrants for the purpose of facilitating future fund raising by us arising out of the exercise of the warrants by Holder. The purchase price, as defined in the Warrant No. 2003-B-002, has been reduced to \$0.10, subject to further adjustment as described in the warrant. The expiration date, as defined in the warrant, remains as stated. This private offering was made to Mid-Am, an accredited investor, pursuant to Rule 506 of Regulation D and Section 4(2) of the Securities Act of 1933.

On March 9, 2004, we converted 5,000 shares of Series F Convertible Preferred Stock into 1,315,789 shares of common stock pursuant to a January 8, 2004 notice of conversion from Esquire Trade & Finance Inc., at a conversion price of \$0.038. The conversion did not include accrued and unpaid dividends on the converted preferred. We delayed processing this notice in light of our special meeting of shareholders held February 12, 2004. The shares of common stock issued pursuant to this conversion were issued to third parties on that date in accordance with the instructions of Esquire Trade & Finance Inc.

On April 1 2004, we converted 5,000 shares of Series F Convertible Preferred Stock into 1,315,789 shares of common stock pursuant to a January 27, 2004 notice of conversion from Austinvest Anstalt Balzers, at a conversion price of \$0.038. The conversion did not include accrued and unpaid dividends on

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the converted preferred. We delayed processing this notice in light of our special meeting of shareholders held February 12, 2004. The shares of common stock issued pursuant to this conversion were issued to third parties on that date in accordance with the instructions of Austinvest Anstalt Balzers. We issued the preferred and the underlying common stock upon conversion to an accredited investor, pursuant to a Regulation D offering.

On April 2, 2004, the Company and Mid-Am Capital, LLC entered into Supplement No.1 to the Series K Convertible Preferred Subscription Agreement, by which we sold an additional 15,000 shares of our Series K Convertible Preferred Stock utilizing the proceeds from a certain promissory note issued by us to Mid-Am in the face amount of \$150,000. With the consummation of this sale, the \$150,000 promissory note was deemed paid by us in full. We issued the preferred and the underlying common stock upon conversion to an accredited investor, pursuant to a Regulation D offering.

On April 8, 2004, we converted 4,862 shares of Series G Convertible Preferred Stock into 700,000 shares of common stock pursuant to a March 25, 2004 notice of conversion from Neshet, LP, at a conversion price of \$0.0853. The conversion included accrued and unpaid dividends of \$11,089 on the preferred converted. We issued the preferred and the underlying common stock upon conversion to an accredited investor, pursuant to a Regulation D offering.

On April 8, 2004, we converted 4,478 shares of Series G Convertible Preferred Stock into 650,000 shares of common stock pursuant to a March 25, 2004 notice of conversion from Talbiya B. Investments, Ltd., at a conversion price of \$0.0853. The conversion included accrued and unpaid dividends of \$10,662 on the preferred converted. We issued the preferred and the underlying common stock upon conversion to an accredited investor, pursuant to a Regulation D offering.

On April 8, 2004, we converted 1,919 shares of Series G Convertible Preferred Stock into 275,000 shares of common stock pursuant to a March 25, 2004 notice of conversion from The Keshet Fund, LP, at a conversion price of \$0.0853. The conversion included accrued and unpaid dividends of

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\$4,265 on the preferred converted. We issued the preferred and the underlying common stock upon conversion to an accredited investor, pursuant to a Regulation D offering.

On April 8, 2004, we converted 7,677 shares of Series G Convertible Preferred Stock into 1,100,000 shares of common stock pursuant to a March 25, 2004 notice of conversion from Keshet, LP, at a conversion price of \$0.0853. The conversion included accrued and unpaid dividends of \$17,060 on the preferred converted. We issued the preferred and the underlying common stock upon conversion to an accredited investor, pursuant to a Regulation D offering.

On April 20, 2004, we entered into a Subscription Agreement with Longview Fund, LP and Alpha Capital Aktiengesellschaft for the issuance of two convertible 10% notes in the amount of \$250,000 each and five-year warrants for the purchase of, in the aggregate, 3,000,000 shares of common stock, at \$0.15 per share. The notes are convertible into shares of our common stock at \$0.10 per common share. Conversions are limited to a maximum ownership of 9.99% of the underlying common stock at any one time. The notes are payable in twelve equal monthly installments, commencing November 1, 2004. The installment payments consist of principal and a "premium" of 20% of the principal paid per installment. We have the option to defer such payment until the note's maturity date on October 1, 2005, if our common stock trades above \$0.20 for the five trading days prior to the due date of an installment payment. In connection

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with this transaction, we issued two additional notes in the aggregate amount of \$50,000, upon identical terms as the principal notes, as a finder's fee, and paid \$20,000 in legal fees. The common stock underlying all notes and warrants carry registration rights. We issued the convertible notes and warrants to accredited investors, pursuant to a Regulation D offering.

On April 30, 2004, we converted 20,000 shares of Series F Convertible Preferred Stock into 1,945,525 shares of common stock pursuant to an April 27, 2004 notice of conversion from Esquire Trade & Finance Inc., at a conversion price of \$0.1028. We issued the preferred and the underlying common stock upon conversion to an accredited investor, pursuant to a Regulation D offering.

On April 30, 2004, we converted 20,000 shares of Series F Convertible Preferred Stock into 1,945,525 shares of common stock pursuant to an April 27, 2004 notice of conversion from Austinvest Anstalt Balzers, at a conversion price of \$0.1028. We issued the preferred and the underlying common stock upon conversion to an accredited investor, pursuant to a Regulation D offering.

On April 30, 2004, we converted 2,500 shares of Series F Convertible Preferred Stock into 243,191 shares of common stock pursuant to an April 27, 2004 notice of conversion from Esquire Trade & Finance Inc., at a conversion price of \$0.1028. We issued the preferred and the underlying common stock upon conversion to an accredited investor, pursuant to a Regulation D offering.

On April 30, 2004, we converted 2,500 shares of Series F Convertible Preferred Stock into 243,191 shares of common stock pursuant to an April 27, 2004 notice of conversion from Austinvest Anstalt Balzers, at a conversion price of \$0.1028. We issued the preferred and the underlying common stock upon conversion to an accredited investor, pursuant to a Regulation D offering.

On May 20, 2004, we converted 9,226 shares of Series G Convertible Preferred Stock into 620,578 shares of common stock pursuant to a May 19, 2004 notice of conversion from Neshet, LP, at a conversion price of \$0.148. The conversion did not include accrued and unpaid dividends on the converted preferred. We issued the preferred and the underlying common stock upon conversion to an accredited investor, pursuant to a Regulation D offering.

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On May 20, 2004, we converted 13,972 shares of Series G Convertible Preferred Stock into 939,782 shares of common stock pursuant to a May 19, 2004 notice of conversion from Keshet, LP, at a conversion price of \$0.148. The conversion did not include accrued and unpaid dividends on the converted preferred. We issued the preferred and the underlying common stock upon conversion to an accredited investor, pursuant to a Regulation D offering.

On June 17, 2004, we issued 87,195 of our common stock to Stephen Nollau, a former consultant, for services rendered. We issued the common stock pursuant to a Form S-8 registration statement, filed by us on June 16, 2004.

On June 29, 2004, we converted 234 shares of Series G Convertible Preferred Stock into 13,604 shares of common stock pursuant to a June 15, 2004 notice of conversion from Neshet, LP, at a conversion price of \$0.172. The conversion did not include accrued and unpaid dividends on the converted preferred. We issued the preferred and the underlying common stock upon conversion to an accredited investor, pursuant to a Regulation D offering. This conversion exhausted the outstanding Series G convertible preferred held by this investor.

On June 29, 2004, we converted 1,850 shares of Series G Convertible Preferred Stock into 107,558 shares of common stock pursuant to a June 15, 2004

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notice of conversion from Keshet, LP, at a conversion price of \$0.172. The conversion did not include accrued and unpaid dividends on the converted preferred. We issued the preferred and the underlying common stock upon conversion to an accredited investor, pursuant to a Regulation D offering. This conversion exhausted the outstanding Series G convertible preferred held by this investor.

On June 29, 2004, we converted 3,472 shares of Series G Convertible Preferred Stock into 201,860 shares of common stock pursuant to a June 15, 2004 notice of conversion from The Keshet Fund, LP, at a conversion price of \$0.172. The conversion did not include accrued and unpaid dividends on the converted preferred. We issued the preferred and the underlying common stock upon conversion to an accredited investor, pursuant to a Regulation D offering. This conversion exhausted the outstanding Series G convertible preferred held by this investor.

On June 29, 2004, we converted 8,091 shares of Series G Convertible Preferred Stock into 470,406 shares of common stock pursuant to a June 15, 2004 notice of conversion from Talbiya B. Investments, Ltd, at a conversion price of \$0.172. The conversion did not include accrued and unpaid dividends on the converted preferred. We issued the preferred and the underlying common stock upon conversion to an accredited investor, pursuant to a Regulation D offering. This conversion exhausted the outstanding Series G convertible preferred held by this investor.

On June 30, 2004, we entered into Subscription Agreements with Longview Fund, LP, Alpha Capital Aktiengesellschaft, Whalehaven Funds Limited, Stonestreet Limited Partnership and Mid-Am Capital L.L.C for the issuance of convertible 10% notes in the aggregate amount of \$1,300,000 and five-year "A" warrants for the purchase of, in the aggregate, 5,200,000 shares of common stock, at \$0.25 per share, and five-year "B" warrants for the purchase of, in the aggregate, 13,000,000 shares of common stock, at \$2.00 per share. The notes are convertible into shares of our common stock at \$0.15 per common share. Conversions are limited to a maximum ownership of 9.99% of the underlying common stock at any one time. The notes are payable in twelve equal monthly installments, commencing January 1, 2005. The installment payments consist of principal and a "premium" of 20% of the principal paid per installment. We have the option to defer such payment until the note's maturity date on December 1, 2005, if our common stock trades above \$0.20 for the five trading days prior to the due date of an installment payment. In connection with this transaction, we issued additional notes in the aggregate

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amount of \$40,000 to Gem Funding, LLC, Bi-Coastal Consulting Corp., Stonestreet Limited Partnership and Libra Finance, S.A upon identical terms as the principal notes, as a finder's fee, and paid \$12,500 in legal fees. The common stock underlying all notes and warrants carry registration rights. We issued the convertible notes and warrants to accredited investors, pursuant to a Regulation D offering.

On August 9, 2004, we converted \$50,000 of our November 2003 Convertible Promissory Note into 1,000,000 shares of common stock pursuant to an August 5, 2004 notice of conversion from Gamma Opportunity Capital Partners LP, at a fixed conversion price of \$0.05. The conversion did not include accrued and unpaid interest on the converted amount. We issued the underlying common stock upon conversion pursuant to our SB-2 registration statement, declared effective on August 3, 2004.

On August 23, 2004, we converted \$50,000 of our April 2004 Convertible Promissory Note into 500,000 shares of common stock pursuant to an August 5,

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2004 notice of conversion from Longview Fund LP, at a fixed conversion price of \$0.10. The conversion did not include accrued and unpaid interest on the converted amount. We issued the underlying common stock upon conversion pursuant to our SB-2 registration statement, declared effective on August 3, 2004.

On September 27, 2004, we converted \$50,000 of our April 2004 Convertible Promissory Note into 500,000 shares of common stock pursuant to a September 21, 2004 notice of conversion from Longview Fund LP, at a fixed conversion price of \$0.10. The conversion did not include accrued and unpaid interest on the converted amount. We issued the underlying common stock upon conversion pursuant to our SB-2 registration statement, declared effective on August 3, 2004.

On October 6, 2004, we converted \$25,000 of our November 2003 Convertible Promissory Note into 500,000 shares of common stock pursuant to a September 23, 2004 notice of conversion from Gamma Opportunity Capital Partners LP, at a fixed conversion price of \$0.05. The conversion did not include accrued and unpaid interest on the converted amount. We issued the underlying common stock upon conversion pursuant to our SB-2 registration statement, declared effective on August 3, 2004.

On October 6, 2004, we issued 500,000 shares of our common stock to Knightsbridge Holdings, LLC, pursuant to a consulting agreement dated November 10, 2003. We issued the common stock pursuant to our SB-2 registration statement, declared effective on August 3, 2004. The issued and outstanding equity reported in our Form 10QSB for the period ended March 31, 2004 reflects these shares of common stock.

On October 13, 2004, we issued 250,000 restricted shares of our common stock in a private placement to Arthur Blanding, at the market price of \$0.12 per share, pursuant to Section 4(2) of the Securities Act of 1934. Mr. Blanding, who solicited the purchase, is an accredited investor and has been a director of the Company since 1999.

On October 15, 2004, we issued 750,000 shares of our common stock to Marvel Enterprises, Inc., as partial compensation under a license agreement dated February 1, 2004. We issued the common stock pursuant to our SB-2 registration statement, declared effective on August 3, 2004. The issued and outstanding equity reported in our Form 10QSB for the period ended March 31, 2004 reflects these shares of common stock.

On October 29, 2004, we entered into Subscription Agreements with Longview Fund, LP, Alpha Capital Aktiengesellschaft, Whalehaven Funds Limited and Stonestreet Limited Partnership for the issuance of convertible 10% notes in the aggregate amount of \$550,000 and five-year "C" warrants for the purchase of, in the aggregate, 2,200,000 shares of common stock, at \$0.15 per share, and the repricing

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of five-year "A" warrants, issued June 30, 2004 for the purchase of, in the aggregate, 3,200,000 shares of common stock, from \$0.25 to \$0.15 per share. The notes are convertible into shares of our common stock at \$0.10 per common share. Conversions are limited to a maximum ownership of 9.99% of the underlying common stock at any one time. The notes are payable in twelve equal monthly installments, commencing May 1, 2005. The installment payments consist of principal and a "premium" of 20% of the principal paid per installment. We have the option to defer such payment until the note's maturity date on April 30, 2006, if our common stock trades above \$0.15 for the five trading days prior to the due date of an installment payment and the underlying common stock

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is registered. In connection with this transaction, we issued additional notes, without attached warrants, in the aggregate amount of \$27,500 to Gem Funding, LLC, Bi-Coastal Consulting Corp., Stonestreet Limited Partnership and Libra Finance, S.A upon identical terms as the principal notes, as a finder's fee, and paid \$12,500 in legal fees. The common stock underlying all notes and warrants carry registration rights. We issued the convertible notes and warrants to accredited investors, pursuant to a Regulation D offering.

On December 17, 2004, we converted \$50,000 of our April 2004 Convertible Promissory Note into 500,000 shares of common stock pursuant to a December 8, 2004 notice of conversion from Longview Fund LP, at a fixed conversion price of \$0.10. The conversion did not include accrued and unpaid interest on the converted amount. We issued the underlying common stock upon conversion pursuant to our SB-2 registration statement, declared effective on August 3, 2004.

On December 20, 2004, we converted \$25,000 of our April 2004 Convertible Promissory Note into 265,958 shares of common stock pursuant to a December 9, 2004 notice of conversion from Bi Coastal Consulting Corp., at a fixed conversion price of \$0.10. The conversion included \$1,595.89 accrued and unpaid interest on the converted amount. We issued the underlying common stock upon conversion pursuant to our SB-2 registration statement, declared effective on August 3, 2004.

On December 20, 2004, we converted \$50,000 of our November 2003 Convertible Promissory Note into 1,000,000 shares of common stock pursuant to a December 8, 2004 notice of conversion from Gamma Opportunity Capital Partners LP, at a fixed conversion price of \$0.05. The conversion did not include accrued and unpaid interest on the converted amount. We issued the underlying common stock upon conversion pursuant to our SB-2 registration statement, declared effective on August 3, 2004.

On December 27, 2004, we converted 10,000 shares of Series F Convertible Preferred Stock into 1,290,323 shares of common stock pursuant to a December 27, 2004 notice of conversion from Austinvest Anstalt Balzers, at a conversion price of \$0.0775. The conversion did not include accrued and unpaid dividends on the converted preferred. We issued the preferred and the underlying common stock upon conversion to an accredited investor, pursuant to a Regulation D offering and Rule 144.

On December 27, 2004, we converted 10,000 shares of Series F Convertible Preferred Stock into 1,290,323 shares of common stock pursuant to a December 27, 2004 notice of conversion from Esquire Trade & Finance Inc., at a conversion price of \$0.0775. The conversion did not include accrued and unpaid dividends on the converted preferred. We issued the preferred and the underlying common stock upon conversion to an accredited investor, pursuant to a Regulation D offering and Rule 144.

On December 29, 2004, we closed a funding transaction with Momona Capital Corp. and Ellis International Ltd. for the issuance of convertible 10% notes in the aggregate amount of \$200,000 and five-year "C" warrants for the purchase of, in the aggregate, 800,000 shares of common stock, at \$0.15 per share. The notes are convertible into shares of our common stock at \$0.10 per common share. Conversions are limited to a maximum ownership of 9.99% of the underlying common stock at any one time. The notes are payable in twelve equal monthly installments, commencing May 1, 2005. The

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installment payments consist of principal and a "premium" of 20% of the principal paid per installment. We have the option to defer such payment until



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the note's maturity date on April 30, 2006, if our common stock trades above \$0.15 for the five trading days prior to the due date of an installment payment, and the underlying common stock is registered. In connection with this transaction, we issued additional notes, without attached warrants, in the aggregate amount of \$10,000 to the investors upon identical terms as the principal notes, as a finder's fee, and paid \$3,500 in legal fees. The common stock underlying all notes and warrants carry registration rights. We issued the convertible notes and warrants to accredited investors, pursuant to an amendment to an October 29, 2004 Regulation D offering.

On December 31, 2004, we issued 8,095,105 shares of our common stock and options for 150,000 shares at an exercise price of \$0.25 per share to our employees and consultants for services rendered, pursuant to a Form S-8 registration statement filed December 23, 2004.

### Note 10 - Income Taxes

We have recorded no income tax benefit for our taxable losses during the years ended December 31, 2005 and 2004 because there is no certainty that we will realize those benefits. The components of our deferred tax assets and liabilities as of December 31, 2005 and 2004 are as follows:

|   | 2005            | 2004           |
|---|-----------------|----------------|
|   | -----           | -----          |
| Tax effect of net operating loss carryforwards          | \$ 14,875,732   | \$ 9,100,463   |
| Accrued expenses that are deductible in future periods  | 1,479,268       | 57,304         |
| Bad debt reserves that are deductible in future periods | 130,550         | 33,718         |
| Debt discounts that affect the timing of our interest   | 25,477          | 405,805        |
| Depreciation and amortization method differences        | 1,645           | (37,102)       |
|   | -----           | -----          |
| Net deferred tax assets                                 | \$ 16,512,672   | \$ 9,560,188   |
|   | =====           | =====          |
| Valuation allowances                                    | \$ (16,512,672) | \$ (9,560,188) |
|   | =====           | =====          |

Our valuation allowances increased by \$6,952,484 and \$1,934,561 during the years ended December 31, 2005 and 2004, respectively.

As of December 31, 2005, we have a net tax operating loss of \$39,881,318 that will be available to offset future taxable income, if any. The use of net operating loss carryforwards to reduce future income tax liabilities is subject to limitation and these amounts will begin to expire in 2022.

The following table illustrates the reconciliation of the tax benefit at the federal statutory rate to our effective rate for each year ended December 31, 2005 and 2004:

|   | 2005     | 2004     |
|---|----------|----------|
|   | -----    | -----    |
| Benefit at federal statutory rate                       | (34.00)% | (34.00)% |
| Benefit at state rate, net of federal benefit           | (3.30)%  | (3.30)%  |
| Non-deductible derivative fair value losses             | 28.64%   | 20.43%   |
| Effect of changes in our valuation allowances           | 8.63%    | 16.80%   |
| Non-deductible travel expenses and charitable donations | 0.03%    | 0.07%    |
|   | -----    | -----    |

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Benefit at our effective rate (0.00)% (0.00)%  
 =====

We operate in certain foreign jurisdictions that are not reflected in the above rate reconciliation because these operations are insignificant. However, we plan to increase our foreign operations and, as a result, we may generate tax liabilities in these foreign operations in future periods.

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Note 11 - Commitments and Contingencies

Lease of Office

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We lease office space at our corporate office in Florida under an original operating lease that expired March 8, 2004. We have renewed the operating lease for an additional six-year period that will expire October 30, 2015.

Future minimum rental payments required under the operating lease as of December 31, 2005 are as follows:

| Years ending December 31,<br>----- | Amount<br>----- |
|------------------------------------|-----------------|
| 2006                               | \$92,868        |
| 2007                               | \$92,868        |
| 2008                               | \$92,868        |
| 2009                               | \$92,868        |
| 2010                               | \$81,140        |

Rental expense for the years ended December 31, 2005 and 2004 are \$90,000 and \$68,784, respectively.

Licenses

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Royalty advances are payable against earned royalties on a negotiated basis. The table below identifies each Licensor to which our licenses require advance payments and, in addition, reflects the term of the respective licenses as well as the advance royalties remaining to be paid on such negotiated advance royalty payments, as of September 25, 2006. We currently are in default of our guaranteed royalty payments to Marvel Enterprises on our license for the United Kingdom by the aggregate advance remaining listed below for Marvel (UK) .

| Licensor<br>-----           | Term<br>----- | Aggregate Advance<br>Remaining<br>----- |
|-----------------------------|---------------|---|
| Marvel (UK)                 | Two years     | \$120,960                               |
| Masterfoods                 | Three years   | \$2,430,000                             |
| Diabetes Research Institute | One year      | \$2,500                                 |

Marvel Enterprises, Inc. (Super Heroes(R) and Marvel Heroes(R))

On February 4, 2005, we entered into a two-year license agreement for the utilization of Marvel Heroes characters on our flavored milks in the United Kingdom and Ireland. We agreed to a royalty rate of 4% of net wholesale sales

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in the territory as the cost of the license. We have adopted the unit sales model currently used in the United States. We have outsourced the infrastructure required for the production, promotion, marketing, distribution and sale of our products through a production agreement with Waterfront Corporation in the UK and through an exclusive sales agency agreement with Drinks Brokers, Ltd., a UK registered company responsible for the launch and growth of several major beverage brands in the licensed territory.

In March 2005, we entered into a new one-year license agreement with Marvel Enterprises, Inc. to use its Super Heroes(R) properties to promote our branded milk products in the United States, Canada and

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Mexico. Under the terms of the license agreement, we agreed to a royalty rate of 5% of net wholesale sales in the United States, 4% for school lunch channels and 2.5% for school hot lunch programs. We also agreed to a 11% royalty on the amount invoiced to dairy processors for "kits" in Canada and Mexico.

On February 4, 2005, we entered into an eighteen month license agreement for the utilization of Marvel Heroes characters on our flavored milks in nine Middle East Countries. We agreed to a 11% royalty on the amount invoiced to third party dairy processors for "kits" in the territory against the prepayment of a guaranteed minimum royalty amount of \$75,600.

Chattanooga Bakery, Inc. ( Moon Pie(R) )

In October 2003, we executed a two-year license agreement with MD Enterprises, Inc. on behalf of Chattanooga Bakery. Under the terms of the license agreement, we have the exclusive right to manufacture, distribute, market and sell Moon Pie(R) flavored milk products in the United States. We agreed to a variable royalty rate of 2% to 3% of net wholesale sales, depending upon volume, as the cost of the license. This license has been extended verbally.

Masterfoods USA (Starburst(R), Milky Way(R), 3 Musketeers(R))

On September 21, 2004, we entered into a licensing agreement with Masterfoods USA, a division of Mars, Incorporated, for the use of Masterfood's Milky Way(R), Starburst(R) and 3 Musketeers(R) trademarks in connection with the manufacture, marketing and sale of single serve flavored milk drinks in the United States, its Possessions and Territories and US Military installations worldwide. The license limits the relationship of the parties to separate independent entities. The amended term of the license agreement expires December 31, 2012. We have agreed to pay a 5% to 7% royalty based upon the total net sales value of the licensed products sold as the cost of the license. Ownership of the licensed marks and the specific milk flavors to be utilized with the marks remains with Masterfoods. We have a right of first refusal for other milk beverage products utilizing the Masterfoods marks within the licensed territory.

Diabetes Research Institute

In June 2005, we agreed to extend our licensing agreement with Diabetes Research Institute for a term beyond the original June 30, 2006 termination date.. We agreed to a variable royalty rate of 0.25% of net sales as the cost of the license . We use this intellectual property, which consists of a logo plus design on the labels of our Slim Slammers(TM) product line.

Employment Contracts

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Mr. Warren has an employment contract effective October 1, 2005, having an annual base salary of \$300,000, plus a bonus of .25% of top line net sales revenue and normal corporate benefits. This contract has minimum two-year terms plus a severance package upon change of control based on base salary.

Messrs. Toulan, Patipa, Edwards and Kee have employment contracts effective January 1, 2006, having annual base salaries aggregating \$710,000, plus discretionary bonuses and normal corporate benefits. These contracts have minimum two-year terms plus severance packages upon change of control based on base salary.

Mr. Kaplan has an employment contract effective November 1, 2005, having an annual base salary of \$180,000 for year one, \$200,000 for year two and \$220,000 for year three, plus discretionary

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bonuses and normal corporate benefits. This contract has a minimum three-year terms plus a severance package upon change of control based on base salary

### Marketing Commitments

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Coca-Cola Enterprises. We are obligated to spend an aggregate of \$5,000,000 on marketing activities in 2005 and 2006 and thereafter, beginning in 2007, an amount per year in each country in the defined territory equal or greater than 3% of our total revenue in such defined territory (on a country by country basis). Such national and local advertising for our defined products includes actively marketing the Slammers mark, based on a plan to be mutually agreed each year. We are required to maintain our intellectual property rights necessary for the production, marketing and distribution of our products by CCE.

Marvel UK. We are obligated to contribute to a discretionary marketing fund at the rate of 3% of royalties payable to Marvel for our sales in the UK, if requested by Marvel. We satisfied this obligation with a lump-sum payment of \$1,000 at the inception of the license.

### Note 12 - Master Distribution Agreement

On August 31, 2005, we entered into a Master Distribution Agreement with Coca-Cola Enterprises, Inc., which included the attendant grant of three year warrants to CCE for the right to purchase 30 million shares of the Company's common stock at an exercise price of \$0.36 per share. The fair value of the warrants has been recorded as deferred distribution costs and is being amortized over the life of the distribution agreement.

Under the terms of the agreement, Coca-Cola Enterprises is obligated to use all commercially reasonable efforts to solicit, procure and obtain orders for our products and merchandise and actively promote the sale of such products in the Territory, as defined in the agreement. The agreement establishes a comprehensive process for the phased transition from our existing system of distributors to Coca-Cola Enterprises, dependent upon distribution territory, product and sales channels. The parties have agreed that Coca-Cola Enterprises will implement its distribution on a ramp-up basis, with the initial distribution commencing in the United States on or about the October 31, 2005 effective distribution date. Coca-Cola Enterprises' distribution in other Territory areas will be dependent upon, among other things, third-party licensing considerations and compliance with the regulatory requirements for the products in foreign countries.

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### Note 13 - Restatements of Prior Financial Statements

We have restated our prior financial statements. This footnote is organized to reflect (i) our annual and quarterly statements of operations as reported and as restated, (ii) a tabular summary of the amounts of adjustments and descriptions of matters that gave rise to the restatements of our statements of operations and (iii) a tabular summary of the amounts of adjustments and the descriptions of matters that gave rise to the restatements of our balance sheets. See also Notes 1, 5, 6, 7, 8, 9 and 10 for additional disclosures.

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#### Condensed Consolidated Statements of Operations Years Ended December 31, 2005 and 2004

|                           | Year ended<br>December 31, 2005<br>(As Restated) | Year ended<br>December 31, 2005<br>(As Reported) |
|---------------------------|--|--|
| Revenues                  | \$ 11,948,921                                    | \$ 11,948,921                                    |
| Product costs             | (10,443,727)                                     | (8,938,692)                                      |
| Operating expenses        | (18,364,502)                                     | (17,209,180)                                     |
| Other income (expense)    | (62,669,345)                                     | (307,679)  |
| Net (loss)                | (79,528,653)                                     | (14,506,630)                                     |
| Loss applicable to common | (80,850,670)                                     | (14,842,933)                                     |
| Loss per common share     | (0.60)   | (0.11)   |
| Comprehensive loss        | \$ (79,559,412)                                  | \$ (14,537,389)                                  |

|                           | Year ended<br>December 31, 2004<br>(As Restated) | Year ended<br>December 31, 2004<br>(As Reported) |
|---------------------------|--|--|
| Revenues                  | \$ 3,344,699                                     | \$ 3,344,699                                     |
| Product costs             | (2,873,118)                                      | (2,374,805)                                      |
| Operating expenses        | (4,183,863)                                      | (4,529,373)                                      |
| Other income (expense)    | (7,805,338)                                      | (240,447)  |
| Net (loss)                | (11,517,620)                                     | (3,799,926)                                      |
| Loss applicable to common | (12,505,640)                                     | (4,188,558)                                      |
| Loss per common share     | (0.31)   | (0.10)   |
| Comprehensive loss        | \$ (11,518,309)                                  | \$ (3,800,615)                                   |

#### Condensed Consolidated Statements of Operations Three Months Ended March 31, 2005 and 2004

|               | Three months ended<br>March 31, 2005<br>(As Restated) | Three months ended<br>March 31, 2005<br>(As Reported) |
|---------------|---|---|
| Revenues      | \$ 897,770  | \$ 897,770  |
| Product costs | (816,113)   | (677,663)   |

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|                           |              |                |
|---------------------------|--------------|----------------|
| Operating expenses        | (1,282,309)  | (1,340,290)    |
| Other income (expense)    | 547,582      | (117,065)      |
| Net (loss)                | (653,070)    | (1,237,248)    |
| Loss applicable to common | (924,185)    | (1,332,308)    |
| Loss per common share     | (0.02)       | (0.02)         |
| Comprehensive loss        | \$ (661,093) | \$ (1,245,464) |

|                           | Three months ended<br>March 31, 2004<br>(As Restated) | Three months ended<br>March 31, 2004<br>(As Reported) |
|---------------------------|---|---|
| Revenues                  | \$ 438,206  | \$ 438,206  |
| Product costs             | (409,835)   | (330,121)   |
| Operating expenses        | (976,424)   | (957,649)   |
| Other income (expense)    | (3,524,664)   | (31,685)  |
| Net (loss)                | (4,472,717)   | (881,249)   |
| Loss applicable to common | (4,698,116)   | (974,717)   |
| Loss per common share     | (0.15)  | (0.03)  |
| Comprehensive loss        | \$ (4,472,717)  | \$ (881,249)  |

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Condensed Consolidated Statements of Operations  
Three and Six Months Ended June 30, 2005 and 2004

|                           | Three months<br>ended<br>June 30, 2005<br>(As Restated) | Three months<br>ended<br>June 30, 2005<br>(As Reported) | Six months<br>Ended<br>June 30, 2005<br>(As Restated) | Six months<br>ended<br>June 30, 2005<br>(As Reported) |
|---------------------------|---|---|---|---|
| Revenues                  | \$ 2,448,618  | \$ 2,448,618  | \$ 3,346,388  | \$ 3,346,388  |
| Product costs             | (1,972,850)   | (1,680,464)   | (2,788,963)   | (2,358,127)   |
| Operating expenses        | (2,696,152)   | (2,007,000)   | (3,978,461)   | (3,347,290)   |
| Other income (expense)    | (78,224,912)  | (103,181)   | (77,677,330)  | (220,246)   |
| Net (loss)                | (80,445,296)  | (1,342,027)   | (81,098,366)  | (2,579,275)   |
| Loss applicable to common | (81,038,891)  | (1,421,928)   | (81,963,076)  | (2,754,236)   |
| Loss per common share     | (1.12)  | (0.02)  | (1.24)  | (0.04)  |
| Comprehensive loss        | \$ (80,442,600)   | \$ (1,351,790)  | \$ (81,103,693)                                       | \$ (2,597,254)  |

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|                           | Three months<br>ended<br>June 30, 2004<br>(As Restated) | Three months<br>ended<br>June 30, 2004<br>(As Reported) | Six months<br>Ended<br>June 30, 2004<br>(As Restated) | Six months<br>ended<br>June 30, 2004<br>(As Reported) |
|---------------------------|---|---|---|---|
| Revenues                  | \$ 1,441,356  | \$ 1,441,356  | \$ 1,879,562  | \$ 1,879,562  |
| Product costs             | (1,051,120)   | (934,966)   | (1,460,955)   | (1,265,087)   |
| Operating expenses        | (1,198,967)   | (1,342,970)   | (2,175,391)   | (2,300,619)   |
| Other income (expense)    | (9,376,541)   | (43,310)  | (12,901,205)  | (74,995)  |
| Net (loss)                | (10,185,272)  | (879,890)   | (14,657,989)  | (1,761,139)   |
| Loss applicable to common | (10,431,608)  | (980,710)   | (15,129,724)  | (1,955,427)   |
| Loss per common share     | (0.26)  | (0.02)  | (0.43)  | (0.06)  |
| Comprehensive loss        | \$ (10,185,272)   | \$ (879,890)  | \$ (14,657,989)                                       | \$ (1,761,139)  |

Condensed Consolidated Statements of Operations  
Three and Nine Months Ended September 30, 2005 and 2004

|                           | Three months<br>ended<br>Sept. 30, 2005<br>(As Restated) | Three months<br>ended<br>Sept. 30, 2005<br>(As Reported) | Nine months<br>Ended<br>Sept. 30, 2005<br>(As Restated) | Nine months<br>ended<br>Sept. 30, 2005<br>(As Reported) |
|---------------------------|--|--|---|---|
| Revenues                  | \$ 3,245,305   | \$ 3,245,305   | \$ 6,591,693  | \$ 6,591,693  |
| Product costs             | (2,755,957)  | (2,360,884)  | (5,544,920)   | (4,719,011)   |
| Operating expenses        | (2,439,020)  | (2,717,708)  | (6,417,482)   | (6,064,998)   |
| Other income (expense)    | 19,628,825   | (3,073,169)  | (58,048,505)  | (3,293,415)   |
| Net (loss)                | 17,679,153   | (4,906,456)  | (63,419,214)  | (7,485,371)   |
| Loss applicable to common | 17,463,463   | (4,994,496)  | (64,499,613)  | (7,748,732)   |
| Loss per common share     | 0.15   | (0.04)   | (0.79)  | (0.09)  |
| Comprehensive loss        | \$ 17,660,830  | \$ (4,912,126)   | \$ (63,442,863)   | \$ (7,509,380)  |

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|                        | Three months<br>ended<br>Sept. 30, 2004<br>(As Restated) | Three months<br>ended<br>Sept. 30, 2004<br>(As Reported) | Nine months<br>Ended<br>Sept. 30, 2004<br>(As Restated) | Nine months<br>ended<br>Sept. 30, 2004<br>(As Reported) |
|------------------------|--|--|---|---|
| Revenues               | \$ 825,430   | \$ 825,430   | \$ 2,704,992  | \$ 2,704,992  |
| Product costs          | (781,856)  | (628,747)  | (2,242,811)   | (1,893,834)   |
| Operating expenses     | (1,182,112)  | (1,237,853)  | (3,357,503)   | (3,538,472)   |
| Other income (expense) | 7,436,020  | (79,822)   | (5,465,185)   | (154,817)   |
| Net (loss)             | 6,297,482  | (1,120,992)  | (8,360,507)   | (2,882,131)   |

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|                           |              |                |                |                |
|---------------------------|--------------|----------------|----------------|----------------|
| Loss applicable to common | 6,043,897    | (1,218,164)    | (9,085,827)    | (3,173,591)    |
| Loss per common share     | 0.14         | (0.03)         | (0.24)         | (0.08)         |
| Comprehensive loss        | \$ 6,297,482 | \$ (1,120,992) | \$ (8,360,507) | \$ (2,882,131) |

The following tables reflect the individual components of our restatements and a description of the nature of the adjustment:

|                                | Quarter ended<br>March 31, 2005 | Quarter ended<br>June 30, 2005 | Quarter ended<br>Sept. 30, 2005 | Quart<br>Dec. |
|--------------------------------|---------------------------------|--------------------------------|---------------------------------|---------------|
| Net income (loss), as reported | \$ (1,237,248)                  | \$ (1,342,027)                 | \$ (4,906,456)                  | \$ (7,        |
| Share-based payments           | -                               | (551,810)                      | (102,782)                       |               |
| Deferred development costs     | (12,586)                        | (94,768)                       | (128,711)                       |               |
| Derivative income (expense)    | 1,471,743                       | (77,311,393)                   | 23,321,020                      | (8,           |
| Amortization of debt discount  | (772,181)                       | (489,633)                      | (73,864)                        |               |
| Liquidated damages expense     | -                               | -                              | -                               | (             |
| Investor relations charges     | (30,000)                        | (332,954)                      | (634,541)                       | (             |
| Other                          | (72,798)                        | (322,711)                      | 204,487                         | (             |
| Net income (loss), as restated | \$ (653,070)                    | \$ (80,445,296)                | \$17,679,153                    | \$ (16,       |

Share-based payments: We improperly measured and deferred share-based payment expense related to employee stock options that were issued commencing in the second quarter of the year ended December 31, 2005. These adjustments, which are reflected in operating expenses, reflect the effects of re-measurement of the stock options and the elimination of previously deferred compensation amounts.

Deferred development costs: We improperly capitalized development costs on our balance sheet. These adjustments reflect our revised policy that requires development costs to be expensed as they are incurred. We record development costs as a component of operating expenses.

Derivative income (expense): Derivative income (expense) arises from adjustments to our derivative liabilities to carry these instruments at fair value at the end of each reporting period. Our derivative financial instruments consist of compound and freestanding instruments. These derivative financial instruments arose from (i) our notes payable, convertible notes payable and preferred stock financing transactions and (ii) the reclassification of non-exempt warrants from stockholders' equity to derivative liabilities because share settlement is presumed not to be within our control. We previously did not properly allocate proceeds from our financing transactions to derivative liabilities where applicable; nor did we reclassify our other warrants to derivative liabilities when we presumably lost our ability to share settle such instruments.

Amortization of debt discounts and other charges: We have adjusted our notes payable and convertible notes payable to reflect the allocation of proceeds to derivative liabilities. These allocations have resulted in discounts to the face value of the debt, and we are required to amortize these discounts through periodic charges to interest expense using the effective method. The adjustments reflect the difference between our previous method of recognizing



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interest expense based upon the stated interest rate and amounts derived from the application of the effective interest method. Other charges include gains and losses on extinguishments of our debt instruments that have arisen when modifications to such instruments were considered to be significant.

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### Liquidated Damages

Liquidated damages: We have restated our consolidated financial statements to record estimated liquidated damages that arose in connection with a registration rights agreement, pursuant to financial accounting standard No. 5, Accounting for Contingencies. In our previous filing, we recorded these amounts as incurred. During the years ended December 31, 2005 and December 31, 2004, we recorded liquidated damages expense of \$303,750 and \$0, respectively.

Investor relations charges: We entered into a contract with an investor relations firm during 2005 that required payment in our equity securities. We incorrectly did not recognize the value of these services until the securities were issued. This adjustment reflects the proper recognition of the consulting cost in general and administrative expenses and a reciprocal amount in accrued liabilities.

|   | Quarter ended<br>March 31, 2005 | Quarter ended<br>June 30, 2005 | Quarter ended<br>Sept. 30, 2005 | Quart<br>Dec. |
|---|---------------------------------|--------------------------------|---------------------------------|---------------|
| Loss applicable to common stockholders, as reported | \$(1,332,308)                   | \$ (1,421,928)                 | \$(4,994,496)                   | \$ (7,        |
| Adjustments to net loss                             | 584,178                         | (78,927,214)                   | 23,275,357                      | (8,           |
| Preferred stock accretion                           | (176,055)                       | (689,749)                      | (817,398)                       | (             |
| <hr style="border-top: 1px dashed black;"/>         |                                 |                                |                                 |               |
| Loss applicable to common stockholders, as restated | \$ (924,185)                    | \$(81,038,891)                 | \$17,463,463                    | \$(16,        |

Preferred stock accretions: We did not allocate proceeds from certain of our preferred stock financings to derivative financial instruments (warrants and compound derivatives) and stockholders' equity (beneficial conversion features). These adjustments reflect the accretion of discounts to the preferred stock carrying values, which are reductions to net income (loss) to arrive at income (loss) applicable to common shareholders. We have accreted these discounts in our restated financial statements through periodic charges to retained earnings using the effective method.

|                                    | Quarter ended<br>March 31, 2005 | Quarter ended<br>June 30, 2005 | Quarter ended<br>Sept. 30, 2005 | Quart<br>Dec. |
|------------------------------------|---------------------------------|--------------------------------|---------------------------------|---------------|
| Loss per common share, as reported | \$(0.02)                        | \$(0.02)                       | \$(0.04)                        | \$(           |
| Share-based payments               | -                               | (0.01)                         | (0.00)                          | (             |
| Deferred development costs         | (0.00)                          | (0.00)                         | (0.00)                          |               |

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|                                |           |           |         |      |
|--------------------------------|-----------|-----------|---------|------|
| Derivative income (expense)    | 0.02      | (1.07)    | 0.21    | (    |
| Amortization of debt discount  | (0.01)    | (0.01)    | (0.00)  | (    |
| Liquidated damages expense     | -         | -         | -       | (    |
| Investor relations charges     | (0.00)    | (0.00)    | (0.01)  | (    |
| Net income (loss), as restated | \$ (0.02) | \$ (1.12) | \$ 0.15 | \$ ( |
| Diluted income, as restated    | \$ (0.02) | \$ (1.12) | \$ 0.00 | \$ ( |

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See descriptions that we have provided under the tables for net income (loss) and income (loss) applicable to common stockholders. Our restated income (loss) per common share reflects the application of the treasury stock method and the if-converted methods where those methods are appropriate.

|                                    | Quarter ended<br>March 31, 2005 | Quarter ended<br>June 30, 2005 | Quarter ended<br>Sept. 30, 2005 | Quart<br>Dec. |
|------------------------------------|---------------------------------|--------------------------------|---------------------------------|---------------|
| Comprehensive loss,<br>as reported | \$ (1,245,464)                  | \$ (1,351,790)                 | \$ (4,912,126)                  | \$ (7,        |
| Comprehensive loss,<br>as restated | \$ (661,093)                    | \$ (80,442,600)                | \$17,660,830                    | \$ (16,       |

Our restated comprehensive income (loss) reflects the adjustments attributable to net income (loss), above.

|                                | Quarter ended<br>March 31, 2004 | Quarter ended<br>June 30, 2004 | Quarter ended<br>Sept. 30, 2004 | Quart<br>Dec. |
|--------------------------------|---------------------------------|--------------------------------|---------------------------------|---------------|
| Net income (loss), as reported | \$ (881,249)                    | \$ (879,890)                   | \$ (1,120,992)                  | \$ (          |
| Deferred development costs     | (102,951)                       | (28,790)                       | (1,089)                         | (             |
| Derivative income (expense)    | (3,430,564)                     | (9,105,816)                    | 8,005,711                       | (1,           |
| Amortization of debt discount  | (57,500)                        | (162,500)                      | (484,901)                       | (             |
| Other                          | (453)                           | (8,276)                        | (101,247)                       | (             |
| Net income (loss), as restated | \$ (4,472,717)                  | \$ (10,185,272)                | \$ 6,297,482                    | \$ (3,        |

Deferred development costs: We improperly capitalized development costs on our balance sheet. These adjustments reflect our revised policy that requires development costs to be expensed as they are incurred. We record development costs as a component of operating expenses.

Derivative income (expense): Derivative income (expense) arises from adjustments to our derivative liabilities to carry these instruments at fair value at the end of each reporting period. Our derivative financial instruments

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consist of compound and freestanding instruments. These derivative financial instruments arose from (i) our notes payable, convertible notes payable and preferred stock financing

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transactions and (ii) the reclassification of non-exempt warrants from stockholders' equity to derivative liabilities because share settlement is presumed not to be within our control. We previously did not properly allocate proceeds from our financing transactions to derivative liabilities where applicable; nor did we reclassify our other warrants to derivative liabilities when we presumably lost our ability to share settle such instruments.

**Amortization of debt discounts and other charges:** We have adjusted our notes payable and convertible notes payable to reflect the allocation of proceeds to derivative liabilities. These allocations have resulted in discounts to the face value of the debt, and we are required to amortize these discounts through periodic charges to interest expense using the effective method. The adjustments reflect the difference between our previous method of recognizing interest expense based upon the stated interest rate and amounts derived from the application of the effective interest method. Other charges include gains and losses on extinguishments of our debt instruments that have arisen when modifications to such instruments were considered to be significant.

**Investor relations charges:** We entered into a contract with an investor relations firm during 2005 that required payment in our equity securities. We incorrectly did not recognize the value of these services until the securities were issued. This adjustment reflects the proper recognition of the consulting cost in general and administrative expenses and a reciprocal amount in accrued liabilities.

See descriptions that we have provided under the tables for net income (loss) and income (loss) applicable to common stockholders. Our restated income (loss) per common share reflects the application of the treasury stock method and the if-converted methods where those methods are appropriate.

|   | Quarter ended<br>March 31, 2004 | Quarter ended<br>June 30, 2004 | Quarter ended<br>Sept. 30, 2004 | Quart<br>Dec. |
|---|---------------------------------|--------------------------------|---------------------------------|---------------|
| Loss applicable to common stockholders, as reported | \$ (974,717)                    | \$ (980,710)                   | \$ (1,218,164)                  | \$ (1,        |
| Adjustments to net loss                             | (3,591,468)                     | (9,173,421)                    | 7,695,921                       | (1,           |
| Preferred stock accretion                           | (131,931)                       | (277,477)                      | (433,860)                       | (59           |
| Loss applicable to common stockholders, as restated | \$ (4,698,116)                  | \$ (10,431,608)                | \$ 6,043,897                    | \$ (3,        |

**Preferred stock accretions:** We did not allocate proceeds from certain of our preferred stock financings to derivative financial instruments (warrants and compound derivatives) and stockholders' equity (beneficial conversion features). These adjustments reflect the accretion of discounts to the preferred stock carrying values, which are reductions to net income (loss) to arrive at income (loss) applicable to common shareholders. We have accreted these discounts in our restated financial statements through periodic charges

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to retained earnings using the effective method.

|                                       | Quarter ended<br>March 31, 2004 | Quarter ended<br>June 30, 2004 | Quarter ended<br>Sept. 30, 2004 | Quart<br>Dec. |
|---------------------------------------|---------------------------------|--------------------------------|---------------------------------|---------------|
| Loss per common share,<br>as reported | \$ (0.03)                       | \$ (0.02)                      | \$ (0.03)                       | \$ (          |
| Deferred development costs            | (0.00)                          | (0.00)                         | (0.00)                          |               |
| Derivative income (expense)           | (0.12)                          | (0.24)                         | 0.18                            | (             |
| Amortization of debt discount         | (0.00)                          | (0.00)                         | (0.01)                          | (             |
| Investor relations charges            | (0.00)                          | (0.00)                         | (0.00)                          | (             |
| Net income (loss), as restated        | \$ (0.15)                       | \$ (0.26)                      | \$ 0.14                         | \$ (          |
| Diluted income, as restated           | \$ (0.15)                       | \$ (0.26)                      | \$ 0.01                         | \$ (          |

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See descriptions that we have provided under the tables for net income (loss) and income (loss) applicable to common stockholders. Our restated income (loss) per common share reflects the application of the treasury stock method and the if-converted methods where those methods are appropriate.

|                                    | Quarter ended<br>March 31, 2004 | Quarter ended<br>June 30, 2004 | Quarter ended<br>Sept. 30, 2004 | Quart<br>Dec. |
|------------------------------------|---------------------------------|--------------------------------|---------------------------------|---------------|
| Comprehensive loss,<br>as reported | \$ (881,249)                    | \$ (879,890)                   | \$ (1,120,992)                  | \$ (          |
| Comprehensive loss,<br>as restated | \$ (4,472,717)                  | \$ (10,185,272)                | \$ 6,297,482                    | \$ (3,        |

Our consolidated balance sheets as of December 31, 2005 and 2004 have been restated as illustrated in the following table:

|                                 | Total<br>Assets | Total<br>Liabilities | Redeemable<br>Preferred<br>Stock |
|---------------------------------|-----------------|----------------------|----------------------------------|
| As reported (December 31, 2005) | \$24,284,806    | \$ (10,793,837)      | \$ (3,153,316)                   |
| Adjustments:                    |                 |                      |                                  |
| Intangible assets               | 4,073,314       | -                    | -                                |
| Accrued liabilities             | -               | (1,656,988)          | -                                |
| Dividends payable               | -               | 1,240,682            | -                                |
| Derivative liabilities          | -               | (35,939,235)         | -                                |

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|                                     |              |                 |                |
|-------------------------------------|--------------|-----------------|----------------|
| Notes payable and convertible notes | -            | (1,599,876)     | -              |
| Paid in capital                     | -            | -               | -              |
| Preferred stock adjustments         | -            | -               | 1,048,816      |
| Accumulated Deficit                 | -            | -               | -              |
| Deferred compensation               | -            | -               | -              |
| As restated (December 31, 2005)     | \$28,358,120 | \$ (48,749,254) | \$ (2,104,500) |

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|                                     | Total<br>Assets | Total<br>Liabilities | Redeemable<br>Preferred<br>Stock |
|-------------------------------------|-----------------|----------------------|----------------------------------|
| As reported (December 31, 2004)     | \$ 1,093,847    | \$ (4,123,541)       | \$ (4,284,802)                   |
| Adjustments:                        |                 |                      |                                  |
| Prepaid Expenses                    | (163,644)       | -                    | -                                |
| Intangible assets                   | 165,605         | -                    | -                                |
| Accrued liabilities                 | -               | (69,024)             | -                                |
| Dividends payable                   | -               | 928,379              | -                                |
| Derivative liabilities              | -               | (10,835,629)         | -                                |
| Notes payable and convertible notes | -               | (1,228,228)          | -                                |
| Common Stock                        | -               | -                    | -                                |
| Paid in Capital                     | -               | -                    | -                                |
| Preferred stock adjustments         | -               | -                    | 1,353,347                        |
| Accumulated Deficit                 | -               | -                    | -                                |
| As restated (December 31, 2004)     | \$ 1,095,808    | \$ (15,328,043)      | \$ (2,931,455)                   |

Intangible assets: We entered into a Master Distribution Agreement with Coca Cola Enterprises on August 31, 2005 that provided for the issuance of 30,000,000 warrants to purchase our common stock. We originally did not value these warrants using a proper valuation method. We have restated the intangible asset to reflect its proper valuation. In addition, the warrants did not meet all of the criteria for equity classification and are carried as derivative liabilities at fair value in the amount of \$14,220,657 as of December 31, 2005. Stockholders' equity (deficit) reflects the reclassification of the original value, the adjustments to fair value and adjusted amortization for the revised intangible asset carrying value.

Accrued liabilities: We entered into a contract with an investor relations firm during 2005 that required payment in our equity securities. We incorrectly did not recognize the value of these services until the securities were issued. This adjustment reflects the proper recognition of the consulting cost in general and administrative expenses and a reciprocal amount in accrued liabilities.

Dividends payable: We originally reported dividends payable of \$1,240,682 on certain series of our preferred stock; it was the only non-current liability at December 31, 2005. These dividends were not declared and, therefore, they have been reversed against the related charges in retained earnings. In the future we will accrue preferred stock dividends when they have been declared.

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Derivative liabilities: We issued certain debt and preferred stock that embody variable conversion rates having the effect of extending share settlement of our share obligations beyond our control. As a result, we reclassified our other warrants to derivative liabilities and carry them at fair value in our revised balance sheet. Derivative financial instruments are initially and subsequently measured at fair values using techniques consistent with the risks associated with the derivative financial instruments. Stockholders' equity (deficit) reflects the reclassification of the original equity related to these warrants and fair value adjustments.

Notes payable and convertible notes payable: We have allocated proceeds from our note payable, convertible note payable and preferred stock financing transactions, where applicable, to compound and freestanding derivative financial instruments in our restated financial statements. As noted above, we

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have also re-classed certain non-exempt warrants from stockholders' equity to derivative liabilities because share settlement is presumed not to be within our control. In addition to the adjustments to notes payable described under derivative financial instruments above, we have restated other notes payable to properly reflect discounts and their carrying amounts. These adjustments generally were made through charges to interest expense using the effective interest method over the periods such notes were outstanding.

Preferred Stock Adjustments: We previously reported the aggregate carrying value of \$3,153,316 related to our Series F, H, J and K Preferred Stock in stockholders' equity. We are required to carry these instruments outside of stockholders' equity, under the caption redeemable preferred stock, because these instruments have features where the investors' could require us to redeem them for cash. As of December 31, 2005 the carrying value of these series of preferred stock amounted to \$2,104,500. See also Note 7.

The financial instruments issued in the original preferred stock financing transactions included both freestanding derivatives (principally warrants) and compound embedded derivatives (principally conversion and default put features) that we are required to carry as derivative liabilities, and at fair values. As of December 31, 2005, these derivative liabilities had a fair value of \$36,868,468.

The allocation of proceeds from our preferred stock financing transactions resulted in discounts to the carrying values of the preferred stock. The restated financial statements reflect periodic accretions of these discounts, through charges to retained earnings, using the effective method. We also incorrectly accrued undeclared dividends and have reversed those provisions.

The aggregate of our adjustments to preferred stock, including the periodic (charges) and credits to derivative income (expense), resulted in a decrease in our stockholders' equity of \$1,048,816. The effects on income (loss) attributable to these adjustments are reflected in the tables, above.

Deferred Compensation: We previously reported deferred compensation as a component of stockholders' equity of \$475,933. We have restated our balance sheet to revalue the underlying options and properly recognize the compensation expense amounting to \$560,904 and paid in capital of \$84,972.

### Note 14 - Subsequent Events (UNAUDITED)

On April 13, 2006, we issued 457,125 shares of common stock pursuant to a notice of conversion of interest and premium associated with our June 2004

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convertible note. The common stock underlying this note was registered pursuant to a registration statement declared effective on April 18, 2005.

On April 17, 2006, we issued 807,692 shares of common stock underlying our Series F Warrant for 1,000,000 shares to an accredited investor. The shares of common stock underlying the Warrant were issued pursuant Regulation D.

On April 21, 2006, we issued 437,500 shares of common stock to an accredited investor pursuant to notices of conversion of our April, June and October 2004 convertible notes. The common stock underlying these notes was registered pursuant to a registration statement declared effective on August 3, 2004 and April 18, 2005, respectively.

On April 28, 2006 we issued 1,500,000 shares of common stock underlying our April 2004 Warrant. The shares of common stock underlying the Warrant were registered pursuant to a registration statement declared effective on August 3, 2004.

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On April 28, 2006, we issued 196,078 shares of our common stock in a private placement, pursuant to Section 4(2) of the Securities Act of 1933, to an accredited investor.

On May 12, 2006, we issued \$2,500,000, six-month-term, 10% notes payable plus detachable warrants to purchase 1,500,000 shares of our common stock with a strike price of \$0.80 for a period of five-years. Net proceeds from this financing transaction amounted to \$2,235,000. The holder has the option to redeem the notes for cash in the event of defaults and certain other contingent events, including events related to the common stock into which the instrument is convertible, registration and listing (and maintenance thereof) of our common stock and filing of reports with the Securities and Exchange Commission (the "Default Put"). We evaluated the terms and conditions of the notes and warrants and determined that (i) the Default Put required bifurcation because it did not meet the "clearly and closely related" criteria of FAS 133 and (ii) the warrants did not meet all of the requisite conditions for equity classification under FAS 133. As a result, the net proceeds from the arrangement were first allocated to the Default Put (\$87,146) and the warrants (\$901,665) based upon their fair values, because these instruments are required to be initially and subsequently carried at fair values. These instruments will be carried in our balance sheet following the financing under the classification, Derivative Liabilities and adjusted to fair value. The warrants and shares of common stock underlying the warrants and notes were issued to two accredited investors in a private placement exempt from registration under the Securities Act of 1933 pursuant Regulation D.

On May 16, 2006, we issued 2,000,000 shares of common stock pursuant to an exercise of a warrant associated with our November 2003 convertible note financing. The common stock underlying these notes was registered pursuant to a registration statement declared effective by the Securities and Exchange Commission in 2004.

On June 7, 2006, we issued 101,100 shares of common stock pursuant to a conversion of our May 2005 convertible note. The shares of common stock underlying the preferred were issued pursuant to a registration statement declared effective by the Securities and Exchange Commission in 2004.

On July, 6, 2006, we issued 83,121 shares of our common stock in a private placement, pursuant to Section 4(2) of the Securities Act of 1933, to an accredited investor.

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On July, 14, 2006, we issued 436,388 shares of common stock upon the cashless exercise of a warrant associated with our Series D convertible preferred stock. These shares were issued to an accredited investor pursuant to Regulation D and Section 4(2) of the Securities Act of 1933.

On July 14, August 14 and August 31, 2006, we issued, in the aggregate, 250,000 shares of common stock pursuant to a conversion of our Series H preferred stock. The shares of common stock underlying the preferred were issued pursuant to Regulation D.

On July, 19, 2006, we issued 1,008,065 shares of common stock upon the cashless exercise of a warrant associated with our Series H convertible preferred stock. These shares were issued to an accredited investor pursuant to Regulation D and Section 4(2) of the Securities Act of 1933.

On August 24, 2006, we issued 168,937 shares of common stock pursuant to a conversion of our May 2005 convertible note. The shares of common stock underlying the preferred were issued pursuant to a registration statement declared effective by the Securities and Exchange Commission in 2004.

On July 27, 2006, we entered into definitive agreements to sell \$30 million senior convertible notes that are due in 2010 to several institutional and accredited investors in a private placement exempt from

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registration under the Securities Act of 1933. The notes initially carry a 9% coupon, payable quarterly and are convertible into shares of common stock at \$0.70 per share. In 2007, the coupon may decline to LIBOR upon the Company achieving certain financial milestones. The notes will begin to amortize in equal, bi-monthly payments beginning in mid-2007. We concurrently issued warrants to purchase 12,857,143 shares of common stock at \$0.73 per share that expire in July 2011 to the investors in the private placement. Under the terms of the financing, we will sell \$30 million notes, of which \$15.0 million of the notes will be held in escrow. The release of the escrowed funds will be subject to stockholder approval. We intend to file a proxy statement seeking such shareholder approval as soon as practical. As a result of our failure to file our March 31, 2006 Form 10QSB timely, an event of default has occurred under the terms of the Notes, and the interest rate on the Notes, payable quarterly, was increased from 9% to 14% per annum. Pursuant to the terms of the Notes, upon the occurrence of an event of default, holders of the Notes may, upon written notice to the Company, each require the Company to redeem all or any portion of their Notes, at a default redemption price calculated pursuant to the terms of the Notes. We have entered into an Amendment Agreement with the holders of the Notes to amend the Notes in certain respects as consideration for the holders' release of the Company's default resulting from its delay in the filing of this quarterly report.

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### ITEM 8A. CONTROLS AND PROCEDURES

#### Evaluation of Disclosure Controls and Procedures

We maintain "disclosure controls and procedures," as such term is defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act"), which are designed to ensure information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules, regulations, and forms, and that



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such information is accumulated and communicated to our management, including our chief executive officer and chief accounting officer, as appropriate, to allow timely and appropriate decisions regarding required disclosure to be made.

We carried out an evaluation, under the supervision and with the participation of our audit committee and senior management, including our chief executive officer and chief accounting officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rules 13a-15(b) and 15d-15(b). During this evaluation, management considered the impact any material weaknesses and other deficiencies in our internal control over financial reporting might have on our disclosure controls and procedures.

Based upon this evaluation, in July 2006 we determined that the following material weakness existed:

Inadequate controls over the process for the identification and implementation of the proper accounting for complex and non-routine transactions, particularly as they relate to accounting for derivatives, which resulted in the Company restating its consolidated financial statements for each of the two years ended December 31, 2004 and 2005 (collectively, the "financial statements") in order to properly present those financial statements;

Because the material weakness identified in connection with the assessment of our internal control over financial reporting had not been fully remedied as of July 2006, our Chief Executive Officer and our Chief Accounting Officer have concluded that our disclosure controls and procedures were not effective as of December 31, 2005. To address the issues raised by these control weaknesses, the Company engaged advisory accountants, who performed additional analysis and performed other procedures in order to prepare the restated condensed consolidated financial statements appearing in this Amendment No. 1 to Form 10-KSB in accordance with generally accepted accounting principles in the United States of America.

In addition, we have added or are initiating the following additional controls to the Company's internal control over financial reporting which we expect will improve such internal control subsequent to the date of the evaluation. These changes are:

- o We have restructured certain departmental responsibilities as they relate to the financial reporting function.
- o We have added one more experienced full-time accountant to our accounting staff, whose responsibilities will include the identification and implementation of proper accounting procedures relating to guidance on financial reporting issues which apply to the Company.
- o We have commenced a search for a consultant to perform a review for the purpose of evaluating the Company's internal control over financial reporting on an ongoing basis.

### ITEM 8B. OTHER INFORMATION

None

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### ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS

The directors, executive officers and significant employees/advisors as of December 31, 2005, are as follows. Our directors serve for staggered terms of two years, or until their successors are elected.

| Name of Officer and Age<br>----- | Position with the Company<br>-----                   | Year Appoi<br>----- |
|----------------------------------|--|---------------------|
| Stanley A. Hirschman 59          | Chairman and Director                                | 2000                |
| Roy G. Warren 50                 | Director, Chief Executive Officer                    | 1997/1999           |
| Jeffrey J. Kaplan 57             | Chief Financial Officer                              | 2005                |
| Tommy E. Kee 57                  | Chief Accounting Officer                             | 2003                |
| Roy D. Toulan, Jr. 60            | Vice President, Corporate Secretary, General Counsel | 2003                |
| Michael Edwards 45               | Chief Revenue Officer                                | 2000                |
| Benjamin Patipa 49               | Chief Operating Officer                              | 2002                |
| Arthur W. Blanding 77            | Director   | 1999                |
| Robert Cummings 63               | Director   | 1997                |
| John McCormack 47                | Director   | 1997                |
| Phillip Pearce 78                | Director   | 1997                |

The experience and background of the Company's executive officers follow:

Mr. Stanley A. Hirschman - Chairman and Director since September 2000

Mr. Hirschman is president of CPointe Associates, Inc., an executive management and consulting firm specializing in solutions for emerging companies with technology-based products. CPointe was formed in 1996. In addition, he is a director of Energy & Engine Technology, 5 G Wireless Communications, Bronco Energy Fund and GoldSpring, Inc. Prior to establishing CPointe Associates, Mr. Hirschman was vice president of operations of Software, Etc., Inc., a retail software chain, from 1989 until 1996. Mr. Hirschman has also held senior management positions with retailers T.J. Maxx, Gap Stores and Banana Republic. Mr. Hirschman currently serves on the Audit Committee of the Company's board of directors.

Mr. Roy G. Warren - Chief Executive Officer since May 1999; Director since 1997

Mr. Warren serves as our Chief Executive Officer and as a director. As Chief Executive Officer, Mr. Warren continues to develop strategy for our growth and external financial matters.

For 15 years from 1981 through 1996, Mr. Warren was in the securities brokerage industry. During those years, Mr. Warren acted as executive officer, principal, securities broker and partner with brokerage firms in Florida, most notably Kemper Financial Companies, Alex Brown & Sons and Laffer Warren & Company. Mr. Warren currently serves on the Executive Committee of the Company's board of directors.

Mr. Warren also serves as a director of our wholly owned U.K. subsidiary, Bravo! Brands (UK) Ltd.

Mr. Tommy E. Kee -Chief Financial Officer 2003 - 2005; Chief Accounting Officer since 2005

Tommy Kee joined our company in March 2003 as Chief Financial Officer. Mr. Kee currently serves as our Chief Accounting Officer for our company. He

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graduated with an MBA from the University of Memphis and a BS degree in accounting from the University of Tennessee. Before joining us, he served for several years as CFO for Allied Interstate, Inc. in the West Palm Beach area. Prior to that, Mr.

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Kee served as CFO and Treasurer for Hearx Ltd. a West Palm Beach, Florida public company. He also served 18 years as International Controller and Financial Director with the Holiday Inns Inc. organization in Memphis and Orlando. Mr. Kee handles all financial management and reporting for our company and works closely with our external auditors and general counsel for financial reporting and SEC compliance.

Mr. Jeffrey Kaplan - Chief Financial Officer since 2005

Mr. Kaplan joined Bravo! in October 2005 as Chief Financial Officer. Mr. Kaplan served as Executive Vice President and Chief Financial Officer of BIB Holdings, Ltd. and then its private company spin-off, Elk Canyon Ltd., designers of jeanswear and loungewear, from October 2003 to September 2005. He served as Executive Vice President of Business Affairs of Viewpoint Corporation, a graphics software company, from November 2001 to September 2003 and its Executive Vice President and Chief Financial Officer from February 2001 to October 2001. Mr. Kaplan served as Executive Vice President and Chief Financial Officer of Rare Medium Group Inc., an IT professional services company, from October 1999 to February 2001. Mr. Kaplan received his Bachelor of Arts degree in political science from Brown University in 1970 and his Masters of Business Administration in finance from New York University in 1972.

Mr. Roy D. Toulan, Jr. - Vice President, Corporate Secretary, General Counsel since 2003

Roy Toulan began with the original founders as outside corporate counsel in 1997 and has been responsible for all of our corporate and business legal work, including securities matters. Mr. Toulan became Corporate Counsel in October 2002, when he left his private legal practice in Boston, and Vice President in January 2003. He received his law degree from Catholic University in Washington D.C., and for the first 15 years of his career practiced corporate and securities litigation with large law firms in New York and Boston. Before joining our company full time, he spent the last 18 years of his private practice in Boston, Massachusetts, engaged in general corporate and securities law helping companies with corporate structure and funding, both domestically and internationally. Mr. Toulan also serves as a director of our wholly owned U.K. subsidiary, Bravo! Brands (UK) Ltd.

Mr. Michael Edwards - Chief Revenue Officer since 2003

Mr. Edwards has been with our company in a sales and marketing capacity since 2000. Prior to that time, he worked for 5 years in beverage marketing research for Message Factors, Inc., a Memphis, Tennessee marketing research firm. Mr. Edwards has a BS degree from Florida State University in Management and Marketing and spent 13 years in the banking industry, leaving CitiBank to join Message Factors in 1995.

Dr. Benjamin Patipa - Chief Operating Officer since 2004

Dr. Patipa is a pediatrician with over fifteen years of experience in directing operations, marketing, sales and facilitating growth in both public and private companies. In 1987, Dr. Patipa founded and served as the chairman and CEO of Weight For Me, Inc., a company that developed a proprietary program which pioneered the delivery of weight control and nutrition services to the

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over 12 million obese children and adolescents in America. Weight For Me earned national and international recognition as the premier program for the control of obesity in children and adolescents. Dr. Patipa also served at HEARx Ltd. as a member of the Executive Operating Committee and Sonus USA, Inc., where he lead the company's franchise licensing and buying group business in the Southeast United States. Most recently, Dr. Patipa served as Senior Vice President and Operational Head of eHDL/HealthNet Data Link, Inc., a national electronic healthcare information company.

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Mr. Arthur W. Blanding - Director Since November 1999

Mr. Blanding is president of The Omega Company, an international dairy industry consulting company. Mr. Blanding has over 50 years experience in management of dairy processing, sales and strategic planning consulting. He graduated from Michigan State University in 1956, with a degree in food science, and in 1964 from Oregon State University with a degree in Food Microbiology and attended Harvard Business School.

As President of The Omega Company for the past 20 years, Mr. Blanding has completed over 200 projects successfully, both in the U.S. and abroad. Clients of The Omega Company include Abbott International, Cumberland Farms, Dairy Gold, Farm Fresh, Inc., Haagen Dazs, Labatt, Ross Laboratories and Stop & Shop Company, among others. Mr. Blanding was a consultant for the design and construction of the dairy processing facility built in Shanghai by Green Food Peregrine. The Omega Company is a party to a consulting contract with the Company concerning technical and production issues.

Mr. Robert J. Cummings - Director Since 1997

Mr. Cummings' work experience includes ten years in purchasing at Ford Motor Company. In 1975, he founded and currently operates J & J Production Service, Inc., a manufacturing representative business, which is currently responsible for over \$300 million in annual sales.

Mr. Phillip Pearce - Director Since 1997

Mr. Pearce is a "retired" member of the securities industry. Mr. Pearce served as Chairman of the NASD during which time he was instrumental in the founding of NASDAQ. Additionally, Mr. Pearce was a former Director of E.F. Hutton and has served as Governor of the New York Stock Exchange. Since his retirement in 1988, Mr. Pearce has remained active in the securities industry as a corporate financial consultant. Mr. Pearce serves on the compensation committee of our board of directors. Mr. Pearce also serves on our audit committee.

Mr. John McCormack - Director since 1997

From December 2000 to March 2003, Mr. McCormack served as our President and Chief Operating Officer. Prior to his employment with the Company, Mr. McCormack served as an executive with Dean Foods Co. for over 15 years. As a Vice President of Dean Foods, he was in charge of Dean Food's mid-western division out of Chicago, Illinois. Mr. McCormack currently is employed by Coca-Cola Enterprises Inc. as a Regional Sales Manager for the supermarket channel in Wisconsin, Minnesota and Northern Illinois.

Compliance With Section 16(A) of the Exchange Act  
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Based upon a review of the appropriate Forms 3, 4 and 5 and any

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amendments to such forms filed pursuant to Section 16(a), we report the following: during 2005, our directors and executive officers did not file Form 4s for options that were authorized pursuant to an incentive stock option compensation plan until issued.

### ITEM 10. EXECUTIVE COMPENSATION

#### Compensation of directors

We compensated Directors for their travel expenses to and from board of directors' meetings in 2002, 2003, 2004 and, in 2005, an additional \$1,000 per personal attendance and \$500 for a telephonic attendance. In 2004, there were three in person meetings and four telephonic board meetings. In 2005, there were three in person meetings and four telephonic board meetings. Directors received

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options for 35,000 shares of common stock for each year as a director through 2001. Each member of the executive committee has received options for an additional 40,000 shares of common stock for their services from 1998 through 2001. Directors received additional options for 25,000 shares for 2002 and 2003. Mr. Hirschman, our Chairman, received total compensation of \$48,000 for the year ended December 31, 2005 for his services as Chairman of both our Board of Directors and Audit Committee. On January 13, 2004, the Directors unanimously voted to convert the options to common stock on a one for one basis. The common shares so converted were issued pursuant to a Form S-8 registration statement filed December 23, 2004.

On January 13, 2004, the Board of Directors adopted a plan to convert on a one for one basis the options granted to our present employees and the directors currently serving on the Board into a like number of our restricted shares of common stock at the discounted value of \$0.05 per share. The conversion of the options to common stock for any individual director or employee was conditioned upon a "lockup" agreement by such director or employee, pursuant to which the recipients of such common stock could not sell, transfer, pledge or hypothecate such common stock for a six-month period.

On April 6, 2005, our Directors voted to adopt a Stock Option Incentive Plan for the grant of options to directors, employees and consultants for the purchase of up to 10,397,745 shares of our common stock. On May 12, 2005, the Board of Directors accepted and adopted the determination of the Compensation Committee to grant 3,572,744 of the authorized options to our directors.

#### Compensation of executive officers

The following table sets forth the compensation paid during the last three fiscal years to our Chief Executive Officer and our other executive officers:

| Name & Position | Year | Annual Compensation |       |       | Long-Term                                 |
|-----------------|------|---------------------|-------|-------|---|
|                 |      | Base<br>Salary      | Bonus | Other | Restricted Stock<br>Awards and<br>Options |
| Roy G. Warren   | 2003 | \$220,000           |       |       | 2005 Ten Year                             |

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|   |      |           |                                      |                           |   |
|---|------|-----------|--------------------------------------|---------------------------|---|
| President & CEO<br>Director                 | 2004 | 220,000   | \$137,750 (1)<br>\$8,462 bonus (3)   |                           | Options for<br>2,500,000<br>common valued<br>at \$300,000;<br>vested over 18<br>months            |
|   | 2005 | 240,000   | 156,538 bonus (4)                    | \$42,000 (5)              |   |
| Roy D. Toulan, Jr.<br>Vice President        | 2003 | \$180,000 | \$28,000 (2)                         | \$5,841                   | 2005 Ten Year<br>Options for  |
| Secretary                                   | 2004 | 180,000   | 15,000(1)                            | Life &<br>disability      | 600,000 common<br>valued at   |
| Corporate Counsel                           | 2005 | 182,231   | 6,923 (bonus (3))<br>7,308 bonus (3) | insurance<br>\$38,552 (5) | \$72,000; vested<br>over 18 months  |
| Michael Edwards<br>Chief Revenue<br>Officer | 2005 | \$162,923 | \$6,923 bonus (3)                    | \$34,161 (5)              | 2005 Ten Year<br>Options for<br>600,000 common<br>valued at<br>\$72,000; vested<br>over 18 months |

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|   |      |           |                                       |              |   |
|---|------|-----------|---------------------------------------|--------------|---|
| Benjamin Patipa<br>Chief Operating<br>Officer | 2005 | \$142,615 | \$6,923 bonus (3)<br>11,000 bonus (4) | \$32,107 (3) | 2005 Ten Year<br>Options for<br>600,000 common<br>valued at<br>\$72,000; vested<br>over 18 months |
| Tommy E. Kee<br>Chief Accounting;<br>Officer  | 2003 | \$120,000 |                                       |              | 2005 Ten Year<br>Options for  |
|   | 2004 | 120,000   | \$15,000(1)<br>4,615 bonus (3)        |              | 600,000 common<br>valued at   |
|   | 2005 | 140,923   | 6,154 bonus (3)<br>10,000 bonus (4)   | \$31,415 (3) | \$72,000; vested<br>over 18 months  |

(1) The reported values of options converted in 2004 are pursuant to a January 13, 2004 vote of Directors authorizing conversion, and are valued \$0.05 per share.

(2) 100,000 shares of common stock in 2003 as a signing bonus, valued at \$28,000.

(3) Year end bonus

(4) Special performance based bonus

(5) SEP/IRA Bonus, 2005

(6) Amount paid for termination of employment owing to change of control, based on base salary for 2006

Option Grants 2005

On April 6, 2005, our Directors voted to adopt a Stock Option Incentive Plan for the grant of options to directors, employees and consultants for the purchase of up to 10,397,745 shares of our common stock. On May 12, 2005, the Board of Directors accepted and adopted the determination of the Compensation Committee to grant 3,572,744 of the authorized options to our directors and

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4,900,000 to our senior management.

Aggregated Options Exercised in Last Fiscal Year And Fiscal Year-End Option Values

None

Compensation Plans

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Senior Management

On April 6, 2005, our Directors voted to adopt a Stock Option Incentive Plan for the grant of options to directors, employees and consultants for the purchase of up to 10,397,745 shares of our common stock. On May 12, 2005, the Board of Directors accepted and adopted the determination of the Compensation Committee to grant 4,900,000 of the authorized option to our senior management.

Employment contracts

Roy G. Warren Chief Executive Officer

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On September 14, 2005, the Compensation Committee of the Board of Directors recommended a new compensation package for Mr. Warren in recognition of his work to expand our business and in light of the then recent execution of a ten-year Master distribution Agreement with Coca-Cola Enterprises Inc. The basic compensation package adopted by the Company for Mr. Warren provides, as follows:

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- o Annual base salary of \$300,000 paid in accordance with established Company payment procedures.
- o Quarterly bonus of one-quarter of one percent (.0025) of top-line net sales revenue.
- o Company benefits as customarily awarded to executive members of management.
- o Participation in Employee and Director Stock Option programs.
- o A "Special Circumstances" bonus of \$500,000 to be awarded upon the signing of a Master Distribution Agreement with CCE. Bonus to be paid in the following manner:
  - o One-half paid as a cash award or, at the awardees option, in Company stock.
  - o One-half paid in Company stock, with the issuance of such being in the form of S-8 or other method as determined by counsel.
- o Effective October 1, 2005, and for a period of not less than 24 months

Roy D. Toulan, Jr., Vice President, General Counsel and Corporate

-----  
Secretary

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A new compensation package became effective for Mr. Toulan on January 1, 2006. The basic compensation package adopted by the Company for Mr. Toulan provides, as follows:

- o Annual base salary of \$190,000 paid in accordance with established Company payment procedures.

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- o Quarterly bonus at discretion of management based upon meeting performance goals.
- o Company benefits as customarily awarded to executive members of management.
- o Participation in Employee and Director Stock Option programs.
- o Effective January 1, 2006, and for a period of not less than 24 months

Jeffrey J. Kaplan, Chief Financial Officer  
-----

Mr. Kaplan's employment contract provides, as follows:

- o Annual base salary of \$180,000 in year one paid in accordance with established Company payment procedures; \$200,000 in year two and \$220,000 in year three.
- o Quarterly bonus at discretion of management based upon meeting performance goals.
- o Company benefits as customarily awarded to executive members of management.
- o Participation in Employee and Director Stock Option programs.
- o Options for 200,000 common shares at market on November 1, 2005 as signing bonus
- o Effective November 1, 2005, and for a period of not less than 36 months

Benjamin Patipa, Chief Operating Officer  
-----

A new compensation package became effective for Dr. Patipa on January 1, 2006. The basic compensation package adopted by the Company for Dr. Patipa provides, as follows:

- o Annual base salary of \$180,000 paid in accordance with established Company payment procedures.
- o Quarterly bonus at discretion of management based upon meeting performance goals.
- o Company benefits as customarily awarded to executive members of management.
- o Participation in Employee and Director Stock Option programs.
- o Effective January 1, 2006, and for a period of not less than 24 months

Michael Edwards, Chief Revenue Officer  
-----

A new compensation package became effective for Mr. Edwards on January 1, 2006. The basic compensation package adopted by the Company for Mr. Edwards provides, as follows:

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- o Annual base salary of \$180,000 paid in accordance with established Company payment procedures.
- o Quarterly bonus at discretion of management based upon meeting performance goals.
- o Company benefits as customarily awarded to executive members of management.
- o Participation in Employee and Director Stock Option programs.
- o Effective January 1, 2006, and for a period of not less than 24 months



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Tommy E. Kee, Chief Accounting Officer  
-----

A new compensation package became effective for Mr. Kee on January 1, 2006. The basic compensation package adopted by the Company for Mr. Kee provides, as follows:

- o Annual base salary of \$160,000 paid in accordance with established Company payment procedures.
- o Quarterly bonus at discretion of management based upon meeting performance goals.
- o Company benefits as customarily awarded to executive members of management.
- o Participation in Employee and Director Stock Option programs.
- o Effective January 1, 2006, and for a period of not less than 24 months

Securities authorized for issuance under equity compensation plans  
-----

The equity compensation reported in this section has been a issued pursuant to individual compensation contracts and arrangements with employees, directors, consultants, advisors, vendors, suppliers, lenders and service providers. The equity is reported on an aggregate basis as of December 31, 2005. Our security holders have not approved the compensation contracts and arrangements underlying the equity reported.

| Compensation Plan Category       | Number of securities to be issued upon exercise of options, warrants and rights | Weighted average price of outstanding options, warrants and rights | Number of securities for future issuance compensation plans |            |
|----------------------------------|---|--|---|------------|
| Directors (former)               | 325,000   | \$0.71   | 0   | indiv      |
| Employees (former)               | 650,000   | \$0.87   | 60,000  | indiv      |
| Directors/Management & Employees | 8,872,745   | \$0.245  | 1,475,000   | 2005 Incen |
| Consultants                      | 510,714   | \$0.30   | 0   | indiv      |
| <b>Total</b>                     | <b>10,358,459</b>   | <b>\$0.77</b>  | <b>1,535,000</b>  |            |

On April 6, 2005, our Directors voted to adopt a Stock Option Incentive Plan for the grant of option to directors, employees and consultants for the purchase of up to 10,397,745 shares of our common stock. On May 12, 2005, the Board of Directors accepted and adopted the determination of the Compensation Committee to grant 8,922,745 of the authorized option to our employees, directors and certain consultants. The ten-year options vest over a period of eighteen months and have exercise prices varying from \$0.20 per share to \$0.30 per share, with a weighted average exercise price of \$0.24 per share.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

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The following table sets forth the beneficial ownership of our company's common stock as of December 31, 2005 as to

- o each person known to beneficially own more than 5% of the Company's common stock

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- o each of our directors
- o each executive officer
- o all directors and officers as a group

The following conditions apply to all of the following tables:

- o except as otherwise noted, the named beneficial owners have direct ownership of the stock and have sole voting and investment power with respect to the shares shown
- o the class listed as "common" includes the shares of common stock underlying the Company's issued convertible preferred stock, options and warrants

### Beneficial Owners

| Title of Class | Name and Address of Beneficial Owner (1)   | Amount and Nature of Beneficial Ownership | Percent of Class |
|----------------|--|---|------------------|
| Common         | Coca-Cola Enterprises Inc.<br>2500 Windy Ridge Parkway<br>Atlanta, GA 30339                              | 30,000,000                                | 16.28%           |
| Common         | Mid-Am Capital, L.L.C. (3)<br>Northpointe Tower<br>10220 North Ambassador Drive<br>Kansas City, MO 64190 | 19,970,723                                | 9.99%            |
| Common         | Lombard Odier Darier<br>Hentsch & Cie (4)<br>Rue de la Corraterie 11<br>1204 Geneva                      | 16,500,000                                | 8.95%            |
| Common         | Magnetar Capital Master<br>Fund, Ltd (4)<br>1603 Orrington Avenue<br>13th Floor<br>Evanston, IL 60201    | 13,750,000                                | 7.46%            |

- (1) Beneficial Ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Shares of common stock subject to options or warrants currently exercisable or convertible, or exercisable or convertible within 60 days of December 31, 2005 are deemed outstanding for computing the percentage of the person holding such option or warrant but are not deemed outstanding for computing the

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percentage of any other person.

- (2) Percentage calculated from base of 184,253,753 shares of common stock issued and outstanding.
- (3) This owner is contractually limited to a beneficial ownership of our equity not to exceed 9.99%. Equity listed consists of convertible preferred, convertible debentures and/or warrants.
- (4) Equity listed consists of common stock and warrants to purchase common stock

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Management Owners

| Title of Class | Name and Address of Management Owner   | Amount and Nature of Ownership (1) | Percent of Class |
|----------------|--|------------------------------------|------------------|
| Common         | Roy G. Warren<br>11300 US Highway No.1<br>N. Palm Beach, FL                            | 5,781,765 (3)                      | 3                |
| Common         | Robert Cummings<br>2829 N.E. 44th Street<br>Lighthouse Point, FL                       | 1,130,038 (4)                      | Less than        |
| Common         | John McCormack<br>8750 South Grant<br>Burr Ridge, IL 60521                             | 1,312,538 (4)                      | Less than        |
| Common         | Mr. Arthur W. Blanding<br>Janesville, WI 53545   | 947,297 (5)                        | Less than        |
| Common         | Phillip Pearce<br>6624 Glenleaf Court<br>Charlotte, NC 28270                           | 962,297 (6)                        | Less than        |
| Common         | Stanley Hirschman<br>2600 Rutgers Court<br>Plano, Texas 75093                          | 1,040,652 (7)                      | Less than        |
| Common         | Roy D. Toulon, Jr.<br>VP, General Counsel<br>6 Wheelers Pt. Rd<br>Gloucester, MA 01930 | 1,615,121 (8)                      | Less than        |
| Common         | Tommy Kee<br>Chief Accounting Officer<br>11300 US Highway 1<br>N. Palm Beach, FL 33408 | 1,042,385 (8)                      | Less than        |
| Common         | Benjamin Patipa<br>Chief Operating Officer<br>6139 Indian Forest Circle                | 1,358,700 (8)                      | Less than        |

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Lake Worth, FL 33463

|        |  |               |   |
|--------|--|---------------|---|
| Common | Michael Edwards<br>Vice President Sales<br>4140 S.E. Old St. Lucie Blvd.<br>Stuart, FL 34996 | 2,000,000 (8) | 1 |
| Common | Executive officers and<br>directors as a group   | 17,190,793    | 9 |

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- (1) Beneficial Ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Shares of common stock subject to options or warrants currently exercisable or convertible, or exercisable or convertible within 60 days of December 31, 2005 are deemed outstanding for computing the percentage of the person holding such option or warrant but are not deemed outstanding for computing the percentage of any other person.
- (2) Percentage calculated from base of 184,253,753 shares of common stock issued and outstanding.
- (3) Includes options to purchase 2,500,00 shares of our common stock pursuant to a 2005 Incentive Stock Option Plan adopted by the Board of Directors on May 12, 2005.
- (4) Includes options to purchase 565,038 shares of our common stock pursuant to a 2005 Incentive Stock Option Plan adopted by the Board of Directors on May 12, 2005.
- (5) Includes options to purchase 494,408 shares of our common stock pursuant to a 2005 Incentive Stock Option Plan adopted by the Board of Directors on May 12, 2005.
- (6) Includes options to purchase 706,297 shares of our common stock pursuant to a 2005 Incentive Stock Option Plan adopted by the Board of Directors on May 12, 2005.
- (7) Includes options to purchase 670,982 shares of our common stock pursuant to a 2005 Incentive Stock Option Plan adopted by the Board of Directors on May 12, 2005.
- (8) Includes options to purchase 600,000 shares of our common stock pursuant to a 2005 Incentive Stock Option Plan adopted by the Board of Directors on May 12, 2005.

There currently are no arrangements that may result in a change of ownership or control.

## ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

John Mc McCormack has been a director of the Company since 1997 and was our Chief Operating Officer from December 2000 to March 2003. Since December 2005, Mr. McCormack has been employed by Coca-Cola Enterprises Inc. as a Regional Sales Manager for the supermarket channel, in Wisconsin, Minnesota and Northern Illinois.

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ITEM 13. EXHIBITS

| Exhibit No. | Document Description  | Incorporated<br>by Reference | Fi<br>He |
|-------------|---|------------------------------|----------|
| 3.1         | Articles of Incorporation   | (1)                          |          |
| 3.2         | Amended Articles (name change)  | (1)                          |          |
| 3.4         | Restated Bylaws   | (1)                          |          |
| 4           | Rights of Equity Holders  |                              |          |
| 4.1         | Preferred, Series B Designation   | (1)                          |          |
| 4.2         | Preferred, Series F Designation   | (2)                          |          |
| 4.3         | Preferred, Series G Designation   | (3)                          |          |
| 4.4         | Preferred, Series H Designation   | (6)                          |          |
| 4.5         | Preferred, Series I Designation   | (7)                          |          |
| 4.6         | Preferred, Series J Designation   | (8)                          |          |
| 4.7         | Preferred, Series K Designation   | (10)                         |          |
| 4.8         | Subscription Agreement dated November 2003 entered with Gamma Opportunity Capital Partners, LP                | (11)                         |          |
| 4.9         | Class A Common Stock Purchase Warrant issued to Gamma Opportunity Capital Partners, LP                        | (11)                         |          |
| 33          |   |                              |          |
| 4.10        | Class B Common Stock Purchase Warrant issued to Gamma Opportunity Capital Partners, LP                        | (11)                         |          |
| 4.11        | Convertible Note issued to Gamma Opportunity Capital Partners, LP dated November 2003                         | (11)                         |          |
| 4.12        | Class A Common Stock Purchase Warrant issued to Libra Finance, S.A.   | (11)                         |          |
| 4.13        | Subscription Agreement dated November 2003 entered with MID-AM CAPITAL, L.L.C                                 | (11)                         |          |
| 4.14        | Class A Common Stock Purchase Warrant issued to MID-AM CAPITAL, L.L.C.  | (11)                         |          |
| 4.15        | Class B Common Stock Purchase Warrant issued to MID-AM CAPITAL, L.L.C   | (11)                         |          |
| 4.16        | Convertible Note issued to MID-AM CAPITAL, L.L.C. dated November 2003   | (11)                         |          |
| 4.17        | Subscription Agreement dated April 2, 2004 entered with Alpha Capital Aktiengesellschaft and Longview Fund LP | (11)                         |          |
| 4.18        | Convertible Note issued to Alpha Capital Aktiengesellschaft dated April 2004                                  | (11)                         |          |
| 4.19        | Convertible Note issued to Longview Fund LP dated April 2004  | (11)                         |          |
| 4.20        | Common Stock Purchase Warrant issued to Alpha Capital Aktiengesellschaft dated April 2004                     | (11)                         |          |
| 4.21        | Common Stock Purchase Warrant issued to Longview Fund LP dated April 2004                                     | (11)                         |          |
| 4.22        | Subscription Agreement entered by and between the Company and Mid-AM Capital LLC dated June 2004              | (12)                         |          |
| 4.23        | Convertible Note issued to Mid-AM Capital LLC dated June 2004   | (12)                         |          |
| 4.24        | Common Stock Purchase Warrant A issued to Mid-AM Capital LLC dated June 2004                                  | (12)                         |          |
| 4.25        | Common Stock Purchase Warrant B issued to Mid-AM Capital LLC dated June 2004                                  | (12)                         |          |
| 4.26        | Subscription Agreement entered by and between the   | (12)                         |          |



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|       |   |      |
|-------|---|------|
| 10.5  | Warner Bros. Canada. License Agreement              | (6)  |
| 10.6  | MoonPie License Agreement                           | (10) |
| 10.7  | Marvel License Agreement (US)                       | (10) |
| 10.8  | SADAFCO Production Agreement                        | (10) |
| 10.9  | Real Estate Lease Amendment Extending Term          | (10) |
| 10.10 | Masterfoods License                                 | (13) |
|       | Marvel Enterprises License (UK)                     | (13) |
|       | Coca-Cola Enterprises Master Distribution Agreement | (15) |
| 16.1  | Letter on change or certifying accountant           | (9)  |
| 21.1  | Subsidiary Articles of Association                  | (4)  |
| 31.1  | Certification of CEO, Rules 13a-14(a) & 15d-14(a)   |      |
| 31.2  | Certification of CFO, Rules 13a-14(a) & 15d-14(a)   |      |
| 32.1  | Certifications of CEO & CFO, 18 U.S.C. Sec. 1350    |      |

- (1) Filed with Form 10SB/A First Amendment
- (2) Filed with Form 10K-SB for 12-31-99
- (3) Filed with Form 10QSB for 6-30-00
- (4) Filed with Form SB-2/A Second Amendment
- (5) Filed with Form SB-2/A Third Amendment
- (6) Filed with Form 10K-SB 2001

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- (7) Filed with Form 10QSB for 6-30-02
- (8) Filed with Form 8-K for 10-02-02
- (9) Filed with Form 8-K for 3-26-04
- (10) Filed with Form 10K-SB 2003
- (11) Filed with Form SB-2 June 4, 2004
- (12) Filed with Form SB-2 January 21, 2005
- (13) Filed with Form 10K-SB 2004
- (14) Filed with Form 8-K for 11-28-05
- (15) Filed with Form 10QSB for 9-30-05

### ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

#### Audit Fees

The aggregated fees billed for each of the last two fiscal years for professional services rendered by the principal accountant for the audit of our annual financial statements and review of financial statements included in our Forms 10-QSB were \$109,279 and \$86,493 respectively for 2005 and 2004.

#### Audit Related Fees

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None

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Tax Fees

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In 2005, we paid an aggregate of \$37,000 for the preparation of 2004 and prior years' tax returns.

All Other Fees

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During 2005, we paid \$3,522 to the principal accountant for services performed in connection with the implementation of Sarbanes Oxley Section 404.

Audit Committee Pre-Approval Policies

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The audit committee makes reasonable inquiry as to the independence of our principal auditors based upon the considerations set forth in Rule 2-01 of Regulation S-X, including the examination of representation letters furnished by the principal accountant. The audit committee has not approved any services beyond those required for the audit of our annual financial statements, review of financial statements included in our Forms 10-KSB and preparation of corporate tax returns.

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SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, Bravo! Foods International Corp. has caused this report to be signed on its behalf by the undersigned, thereunder duly authorized.

BRAVO! FOODS INTERNATIONAL CORP.  
(Formerly China Premium Food Corporation)

By: /S/ Roy G. Warren, Chief Executive Officer

In accordance with the Securities Exchange Act of 1934, Bravo Foods International Corp. has caused this report to be signed on its behalf by the undersigned in the capacities and on the dates stated.

| Signature         | Title                               | Date            |
|-------------------|-------------------------------------|-----------------|
| -----             | -----                               | ----            |
| /S/ Roy G. Warren | Chief Executive Officer             | October 2, 2006 |
| /S/ Tommy E. Kee  | Chief Accounting Officer, Treasurer | October 2, 2006 |

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