

Lifevantage Corp
Form 10-Q
May 16, 2011

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q**

**▶ QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2011**

**○ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM _____ TO _____
Commission file number 000-30489
LIFEVANTAGE CORPORATION
(Exact name of Registrant as specified in its charter)**

COLORADO

90-0224471

(State or other jurisdiction of incorporation or organization)

(IRS Employer Identification No.)

11545 W. Bernardo Court, Suite 301, San Diego, California 92127

(Address of principal executive offices)

(858) 312-8000

(Registrant's telephone number)

(Former name, former address and former fiscal year, if changed since last report)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller reporting company)

Smaller reporting company

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

The number of shares outstanding of the issuer's common stock, par value \$0.001 per share, as of May 12, 2011 was 79,173,522.

Table of Contents

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements contained in this report and the information incorporated by reference herein may contain forward-looking statements (as such term is defined in Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended). These statements, which involve risks and uncertainties, reflect our current expectations, intentions, or strategies regarding our possible future results of operations, performance, and achievements. Forward-looking statements include, without limitation: statements regarding future products or product development; statements regarding future selling, general and administrative costs and research and development spending; statements regarding our product development strategy; statements regarding the future performance of our network marketing sales channel; and statements regarding future financial performance, results of operations, capital expenditures and sufficiency of capital resources to fund our operating requirements. These forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and applicable rules of the Securities and Exchange Commission and common law.

These forward-looking statements may be identified in this report and the information incorporated by reference by words such as anticipate, believe, could, estimate, expect, intend, plan, predict, project, should and expressions, including references to assumptions and strategies. These statements reflect our current beliefs and are based on information currently available to us. Accordingly, these statements are subject to certain risks, uncertainties, and contingencies, which could cause our actual results, performance, or achievements to differ materially from those expressed in, or implied by, such statements.

The following factors are among those that may cause actual results to differ materially from our forward-looking statements:

Limited operating history in new business model;

Our ability to successfully expand our operations and manage our future growth;

Difficulty in managing growth and expansion;

Dilutive effects of any potential need to raise additional capital;

The deterioration of global economic conditions and the decline of consumer confidence and spending;

Material weaknesses reported in our internal control over financial reporting;

Environmental liabilities stemming from past operations and property ownership;

Significant dependence upon a single product;

Competition in the dietary supplement market;

The potential failure or unintended negative consequences of our network marketing sales channel;

Our ability to retain independent distributors or to hire new independent distributors on an ongoing basis;

The potential for government or third party actions against us resulting from independent distributor activities that violate applicable laws or regulations;

The potential for third party and governmental actions involving our network marketing sales channel;

Our ability to protect our intellectual property rights and the value of our product;

Our ability to continue to innovate and provide products that are useful to consumers;

The effect of current and future government regulations of the network marketing and dietary supplement industries on our business;

Table of Contents

The effect of unfavorable publicity on our business;

The potential for product liability claims against us;

Our dependence on third party manufacturers to manufacture our product;

The ability to obtain raw material for our product;

Our common stock is currently classified as a penny stock;

Our stock price may experience future volatility;

The illiquidity of our common stock;

Substantial sales of shares of our common stock;

Other factors not specifically described above, including the other risks, uncertainties, and contingencies described under Description of Business , Risk Factors and Management s Discussion and Analysis of Financial Condition and Results of Operations in Items 1 and 7 of our Annual Report on Form 10-K for the year ended June 30, 2010.

When considering these forward-looking statements, you should keep in mind the cautionary statements in this report and the documents incorporated by reference. We have no obligation and do not undertake to update or revise any such forward-looking statements to reflect events or circumstances after the date of this report.

LIFEVANTAGE CORPORATION
INDEX

	<u>PAGE</u>
<u>PART I. Financial Information</u>	
<u>Item 1. Financial Statements:</u>	
<u>Condensed Consolidated Balance Sheets (unaudited) -March 31, 2011 and June 30, 2010</u>	5
<u>Condensed Consolidated Statements of Operations (unaudited) For the Three and Nine Month Periods Ended March 31, 2011 and 2010</u>	6
<u>Condensed Consolidated Statements of Cash Flows (unaudited) For the Nine Month Periods Ended March 31, 2011 and 2010</u>	8
<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	9
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	17
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	21
<u>Item 4. Controls and Procedures</u>	21
<u>PART II. Other Information</u>	23
<u>Item 1. Legal Proceedings</u>	23
<u>Item 1A. Risk Factors</u>	23
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	23
<u>Item 3. Defaults Upon Senior Securities</u>	23
<u>Item 4. (Removed and Reserved)</u>	23
<u>Item 5. Other Information</u>	23
<u>Item 6. Exhibits</u>	23
<u>Signatures</u>	24
<u>EX-10.1</u>	
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-32.1</u>	
<u>EX-32.2</u>	

Table of Contents**PART I Financial Information****Item 1. Financial Statements**

LIFEVANTAGE CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	March 31,	As of,
	2011	June 30, 2010
ASSETS		
Current assets		
Cash and cash equivalents	\$ 4,094,051	\$ 1,637,676
Investments, available for sale	280,000	340,000
Accounts receivable, net	803,987	401,597
Inventory	1,471,738	493,858
Short-term deferred debt offering costs, net	261,054	
Prepaid expenses and deposits	385,704	153,864
Total current assets	7,296,534	3,026,995
Long-term assets		
Investments, available for sale	70,000	85,000
Property and equipment, net	196,007	196,353
Intangible assets, net	1,976,785	2,045,471
Deferred debt offering costs, net		844,792
Deposits	27,673	28,613
TOTAL ASSETS	\$ 9,566,999	\$ 6,227,224
LIABILITIES AND STOCKHOLDERS DEFICIT		
Current liabilities		
Accounts payable	\$ 875,042	\$ 770,941
Commissions payable	1,370,556	591,035
Reserve for sales returns	737,495	343,937
Other accrued expenses	1,618,210	809,507
Customer deposits		34,797
Revolving line of credit and accrued interest	433,984	433,985
Short-term derivative liabilities	7,573,109	1,444,331
Short-term convertible debt, net of discount	138,168	702,361
Total current liabilities	12,746,564	5,130,894
Long-term liabilities		
Deferred rent	22,560	27,191
Derivative liabilities	9,967,357	17,123,119
Convertible debt, net of discount		121,014
Total liabilities	22,736,481	22,402,218
Commitments and contingencies		
Stockholders deficit		

Edgar Filing: Lifevantage Corp - Form 10-Q

Preferred stock par value \$0.001 per share, 50,000,000 shares authorized, no shares issued or outstanding		
Common stock par value \$0.001 per share, 250,000,000 shares authorized and 73,677,540 and 61,494,849 issued and outstanding as of March 31, 2011 and June 30, 2010, respectively	73,678	61,495
Additional paid-in capital	28,080,043	21,457,145
Accumulated deficit	(41,266,601)	(37,661,857)
Accumulated other comprehensive loss	(56,602)	(31,777)
Total stockholders deficit	(13,169,482)	(16,174,994)
TOTAL LIABILITIES AND STOCKHOLDERS DEFICIT	\$ 9,566,999	\$ 6,227,224

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

Table of Contents

LIFEVANTAGE CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	For the three months ended		For the nine months ended	
	March 31,		March 31,	
	2011	2010	2011	2010
Sales, net	\$ 9,975,224	\$ 2,723,807	\$ 23,878,662	\$ 7,037,450
Cost of sales	1,581,866	447,797	3,793,535	1,172,595
Gross profit	8,393,358	2,276,010	20,085,127	5,864,855
Operating expenses:				
Sales and marketing	5,350,388	1,877,073	12,781,834	5,852,268
General and administrative	2,081,108	1,618,591	5,084,270	6,548,199
Research and development	115,515	69,863	315,025	295,277
Depreciation and amortization	54,084	53,960	157,984	200,733
Total operating expenses	7,601,095	3,619,487	18,339,113	12,896,477
Operating income (loss)	792,263	(1,343,477)	1,746,014	(7,031,622)
Other income (expense):				
Interest expense	(468,900)	(5,483,245)	(2,477,805)	(6,378,735)
Change in fair value of derivative liabilities	(10,090,924)	(1,422,894)	(2,777,953)	7,345,657
Total other income (expense)	(10,559,824)	(6,906,139)	(5,255,758)	966,922
Net income (loss) before income taxes	(9,767,561)	(8,249,616)	(3,509,744)	(6,064,700)
Income tax expense			(95,000)	
Net income (loss)	(9,767,561)	(8,249,616)	(3,604,744)	(6,064,700)
Net income (loss) per share, basic and diluted	\$ (0.13)	\$ (0.14)	\$ (0.05)	\$ (0.11)
Weighted average shares, basic and diluted	73,181,511	57,117,710	69,281,640	57,353,428

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

Table of Contents

LIFEVANTAGE CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS DEFICIT AND COMPREHENSIVE
INCOME
(UNAUDITED)

	Common Stock		Additional Paid In Capital	Accumulated Deficit	Accumulated Other Comprehensive	Total
	Shares	Amount			Loss	
Balances, June 30, 2010	61,494,849	\$ 61,495	\$ 21,457,145	\$ (37,661,857)	\$ (31,777)	\$ (16,174,994)
Conversion of debt to equity	11,646,825	11,647	6,122,654			6,134,301
Options/Warrants issued for services			450,780			450,780
Exercise of options and warrants	535,866	536	49,464			50,000
Currency translation adjustment					(24,825)	(24,825)
Net loss				(3,604,744)		(3,604,744)
Other comprehensive income						(3,629,569)
Balances, March 31, 2011	73,677,540	\$ 73,678	\$ 28,080,043	\$ (41,266,601)	\$ (56,602)	\$ (13,169,482)

Table of Contents

LIFEVANTAGE CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	For the nine months ended March 31,	
	2011	2010
Cash Flows from Operating Activities:		
Net income (loss)	\$ (3,604,744)	\$ (6,064,700)
Adjustments to reconcile net loss to net cash provided (used) by operating activities:		
Depreciation and amortization	157,984	200,733
Stock based compensation to employees	397,183	973,455
Stock based compensation to non-employees	53,597	1,097,917
Amortization of debt discount		956,633
Amortization of deferred offering costs	583,738	165,051
Non-cash interest expense	1,644,158	5,094,905
Change in fair value of derivative liabilities	2,777,953	(7,345,657)
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	(402,390)	544,231
(Increase) decrease in inventory	(977,880)	144,929
Increase in prepaid expenses	(266,637)	(46,010)
Decrease in deposits and other assets	940	32,182
Increase (decrease) in accounts payable	104,101	(876,844)
Increase in accrued expenses	1,977,148	607,016
Net Cash Provided (Used) by Operating Activities	2,445,151	(4,516,159)
Cash Flows from Investing Activities:		
Redemption of marketable securities	75,000	200,000
Purchase of intangible assets	(24,208)	(30,251)
Purchase of equipment	(64,743)	(2,965)
Net Cash (Used) Provided by Investing Activities	(13,951)	166,784
Cash Flows from Financing Activities:		
Net (payments) on proceeds from revolving line of credit and accrued interest		(147,459)
Issuance of convertible debt and warrants		5,000,000
Principal payments under capital lease obligation		(41,491)
Issuance of common stock and warrants	50,000	946,139
Exercise of options and warrants		7,477
Private placement fees		(464,313)
Net Cash Provided by Financing Activities	50,000	5,300,353
Foreign Currency Effect on Cash	(24,825)	(33,448)
Increase (Decrease) in Cash and Cash Equivalents:	2,456,375	917,530
Cash and Cash Equivalents beginning of period	1,637,676	608,795
Cash and Cash Equivalents end of period	\$ 4,094,051	\$ 1,526,325
Non Cash Investing and Financing Activities:		

Edgar Filing: Lifevantage Corp - Form 10-Q

Warrants issued for agent fees and reclassification of warrants to a derivative liability	\$	\$ 674,347
Conversion of debt to common stock	\$ 2,329,365	\$ 239,940
Conversion of derivative to common stock	\$ 3,804,936	\$
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for interest expense	\$ 276,625	\$ 68,198
Cash paid for income taxes	\$ 56,000	\$

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

Table of Contents

LIFEVANTAGE CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THREE AND NINE MONTHS ENDED MARCH 31, 2011 AND 2010
(UNAUDITED)

These unaudited Condensed Consolidated Financial Statements and Notes should be read in conjunction with the audited financial statements and notes of LifeVantage Corporation as of and for the year ended June 30, 2010 included in our annual report on Form 10-K.

Note 1 Organization and Basis of Presentation:

The condensed consolidated financial statements included herein have been prepared by us, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). In the opinion of the management of LifeVantage Corporation (LifeVantage or the Company), these interim Financial Statements include all adjustments, consisting of normal recurring adjustments, that are considered necessary for a fair presentation of our financial position as of March 31, 2011, and the results of operations for the three and nine month periods ended March 31, 2011 and 2010 and the cash flows for the nine month periods ended March 31, 2011 and 2010. Interim results are not necessarily indicative of results for a full year or for any future period. Certain prior period amounts have been reclassified to conform to our current period presentation.

The condensed consolidated financial statements and notes included herein are presented as required by Form 10-Q, and do not contain certain information included in our audited financial statements and notes for the fiscal year ended June 30, 2010 pursuant to the rules and regulations of the SEC. For further information, refer to the financial statements and notes thereto as of and for the year ended June 30, 2010, and included in the Annual report on Form 10-K on file with the SEC.

Note 2 Summary of Significant Accounting Policies:

Consolidation

The accompanying financial statements include the accounts of LifeVantage Corporation and our wholly-owned subsidiaries Lifeline Nutraceuticals Corporation (LNC), LifeVantage de México, S. de R.L. de C.V. (Limited Liability Company), Importadora LifeVantage, S. de R.L. de C.V. (Limited Liability Company), and Servicios Administrativos para la Importación de Productos Body & Skin, S.C. All inter-company accounts and transactions between the entities have been eliminated in consolidation.

Translation of Foreign Currency Statements

We translate the financial statements of our foreign entities by using the current exchange rate. For assets and liabilities, the exchange rate at the balance sheet date is used. For any investment in subsidiaries and retained earnings, the historical exchange rate is used. For revenue, expenses, gains, and losses, an appropriately weighted average exchange rate for the period is used.

Use of Estimates

Management has made a number of estimates and assumptions relating to the reporting of revenues, expenses, assets and liabilities and the disclosure of contingent assets and liabilities to prepare these consolidated financial statements. Actual results could differ from those estimates.

Fair Value Measurements

Fair value measurement requirements are embodied in certain accounting standards applied in the preparation of our financial statements. Significant fair value measurements include our embedded derivative liabilities. See Notes 4 and 6 Convertible Debentures and Stockholders Equity for disclosures related to our convertible debentures and common stock and warrant financing arrangements. The fair value hierarchy is defined below:

Fair value hierarchy:

(1) Level 1 inputs are quoted prices in active markets for identical assets and liabilities.

Table of Contents

(2) Level 2 inputs are inputs which include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the assets or liabilities, either directly or indirectly, for substantially the full term of the financial instrument.

(3) Level 3 inputs are unobservable inputs and significant to the fair value measurement. The financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

The summary of fair values of financial instruments is as follows at March 31, 2011:

Instrument:	Fair value	Carrying Value	Level	Valuation Methodology
Investments	\$ 350,000	\$ 350,000	2	Market price
Derivative warrant liabilities	\$ 11,681,218	\$ 11,681,217	3	Black-Scholes Lattice model
Embedded conversion liability	\$ 5,859,248	\$ 5,859,248	3	

The summary of fair values of financial instruments is as follows at June 30, 2010:

Instrument:	Fair value	Carrying Value	Level	Valuation Methodology
Investments	\$ 425,000	\$ 425,000	2	Market price
Derivative warrant liabilities	\$ 10,573,084	\$ 10,573,084	3	Black-Scholes Lattice model
Embedded conversion liability	\$ 7,994,366	\$ 7,994,366	3	

The following represents a reconciliation of the changes in fair value of financial instruments measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the nine months ended March 31, 2011 and the year ended June 30, 2010:

	March 31, 2011	June 30, 2010
Beginning balance: Derivative liabilities	\$ 18,567,450	\$ 8,429,710
Total (gains) losses	2,777,953	(3,101,673)
Adoption of change in accounting principle		3,267,253
Purchases, sales, issuances and settlements, net	(3,804,937)	9,972,160
Ending balance: Derivative liabilities	\$ 17,540,466	\$ 18,567,450

Cash and Cash Equivalents

We consider only our monetary liquid assets with original maturities of three months or less as cash and cash equivalents.

Accounts Receivable

Accounts receivable at March 31, 2011 consist primarily of credit card receivables including a percentage holdback by the credit card processor. The holdback balance at March 31, 2011 was \$539,374. Based on the Company's verification process for customer credit cards and historical information available, management has determined that an allowance for doubtful accounts on credit card sales related to its direct and independent distributor sales as of March 31, 2011 is not necessary. No bad debt expense has been recorded for the nine months ended March 31, 2011 or the year ended June 30, 2010.

Investments

In 2008 we invested in auction rate preferred securities of closed-end funds (ARPS) to maximize interest income. We have classified these investments as available for sale in the balance sheet.

Table of Contents**Inventory**

Inventory is stated at the lower of cost or market value. Cost is determined using the first-in, first-out method. We have capitalized payments to our contract product manufacturer for the acquisition of raw materials and commencement of the manufacturing, bottling and labeling of our product. As of March 31, 2011 and June 30, 2010, inventory consisted of:

	March 31, 2011	June 30, 2010
Finished goods	\$ 629,789	\$ 326,095
Raw materials	841,949	167,763
Total inventory	\$ 1,471,738	\$ 493,858

Deferred Offering Costs

Deferred offering costs consist of cash paid to and the fair value of warrants issued to placement agents in conjunction with our convertible debenture financings. Amortization of these costs commence upon the closing date and continue for the life of the convertible debenture instruments.

As of March 31, 2011 and June 30, 2010, deferred offering costs consisted of:

	March 31, 2011	June 30, 2010
Deferred offering costs	\$ 1,370,212	\$ 1,370,212
Amortization of deferred offering costs	(1,109,158)	(525,420)
Deferred offering costs, net	\$ 261,054	\$ 844,792

Revenue Recognition

We ship the majority of our product directly to the consumer via UPS and receive substantially all payment for these sales in the form of credit card charges. Revenue from direct product sales to customers is recognized upon passage of title and risk of loss to customers when product is shipped from the fulfillment facility. Sales revenue and estimated returns are recorded when product is shipped. Our return policy is to provide a 30-day money back guarantee on orders placed by customers. After 30 days, we do not issue refunds to direct sales customers for returned product. In the network marketing sales channel, we allow terminating distributors to return unopened unexpired product that they have purchased within the prior twelve months, subject to certain consumption limitations. To date, returns from terminating distributors have been negligible. Our return rate for sales directly to consumers and sales through our network channel are based on our historical experience which we analyze on a regular basis. As a result of our analysis during the three months ended March 31, 2011 we adjusted our reserve estimate which resulted in an increase to revenue and operating income and a decrease to net loss of approximately \$137,000. As of March 31, 2011 and June 30, 2010, our reserve balance for returns and allowances was \$737,495 and \$343,937, respectively.

Income/(Loss) per share

Basic income or loss per share is computed by dividing the net income or loss by the weighted average number of common shares outstanding during the period. Diluted earnings per common share are computed by dividing net income by the weighted average common shares and potentially dilutive common share equivalents. For the three and nine month periods ended March 31, 2011 the effects of approximately 62 million common shares, respectively, issuable upon exercise of warrants issued in our private placement offerings, compensation based warrants issued and options granted through our 2007 and 2010 Long-Term Incentive Plans are not included in computations because their effect was anti-dilutive. For the three month and nine month periods ended March 31, 2010 the basic and diluted average outstanding shares are the same since including the additional potential common share equivalents would have an antidilutive effect on the loss per share calculation.

Table of Contents**Segment Information**

Our operations are aggregated into a single reportable operating segment based upon similar economic and operating characteristics as well as similar markets. Our operations are also subject to similar regulatory environments. We conduct our operations in the U.S., Japan and Mexico. Substantially all long-lived assets are located in the U.S. Revenues by geographic area are as follows:

	Three months ended March		Nine months ended March	
	2011	2010	2011	2010
Revenues from unaffiliated customers				
U.S. operations	\$ 8,098,007	\$ 2,678,501	\$ 20,867,657	\$ 6,925,335
Japan operations	1,824,588		2,830,797	
Mexico operations	52,629	45,306	180,208	108,115
Total revenues	\$ 9,975,224	\$ 2,723,807	\$ 23,878,662	\$ 7,037,450

Research and Development Costs

We expense all costs related to research and development activities as incurred. Research and development expenses for the nine month periods ended March 31, 2011 and 2010 were \$315,025 and \$295,277, respectively.

Shipping and Handling

Shipping and handling costs associated with inbound freight and freight out to customers, including independent distributors, are included in cost of sales. Shipping and handling fees charged to all customers are included in sales.

Stock-Based Compensation

In certain circumstances, we issued common stock for invoiced services and in other similar situations to pay contractors and vendors. Payments in equity instruments to non-employees for goods or services are accounted for using the fair value of whichever is more reliably measurable: (a) the goods or services received; or (b) the equity instruments issued.

Derivative Financial Instruments

We do not use derivative 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 freestanding warrants and embedded conversion features on convertible debt instruments that are not afforded equity classification. These instruments are required to be carried as derivative liabilities, at fair value, in our consolidated financial statements.

Derivative financial instruments consist of financial instruments or other contracts that contain a notional amount and one or more underlying variables (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 estimate fair values of derivative financial instruments using various techniques that are considered to be consistent with the objective measurement of 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, adjusted for the effect of dilution, because it embodies all of the requisite assumptions (including trading volatility, estimated terms, and risk free rates) necessary to fair value these instruments. For embedded conversion features we generally use a lattice technique because it contains all the requisite assumptions to value these features. 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 the trading market price of our common stock. Since derivative financial instruments are initially and subsequently carried at fair values, our income or loss will reflect the volatility in changes to these estimates and assumptions.

Table of Contents**Convertible Debt Instruments**

We issued convertible debt in September and October 2007, November and December 2009 and January and February 2010. We review the terms of convertible debt and equity instruments that we issue to determine whether there are embedded derivative instruments, including the embedded conversion options that are required to be bifurcated and accounted for separately as derivative instrument liabilities. Also, in connection with the sale of convertible debt and equity instruments, we may issue freestanding options or warrants that may, depending on their terms, be accounted for as derivative instrument liabilities, rather than as equity. For option-based derivative financial instruments, we use the Black-Scholes option pricing model to value the derivative instruments. For embedded conversion derivatives we use a lattice model to value the derivative.

When the embedded conversion option in a convertible debt instrument is not required to be bifurcated and accounted for separately as a derivative instrument, we review the terms of the instrument to determine whether it is necessary to record a beneficial conversion feature. When the effective conversion rate of the instrument at the time it is issued is less than the fair value of the common stock into which it is convertible, we recognize a beneficial conversion feature, which is credited to equity and reduces the initial carrying value of the instrument.

When convertible debt is initially recorded at less than its face value as a result of allocating some or all of the proceeds received to derivative instrument liabilities, to a beneficial conversion feature or to other instruments, the discount from the face amount, together with the stated interest on the convertible debt, is amortized over the life of the instrument through periodic charges to income, using the effective interest method.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry-forwards. Deferred tax assets and liabilities are measured using statutory tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities from a change in tax rates is recognized in income in the period that includes the effective date of the change. As of March 31, 2011 we have recognized income tax expense of \$95,000 which is our estimated state income tax liability for the nine months ended March 31, 2011. Realization of our deferred tax asset is dependent upon future earnings in specific tax jurisdictions, the timing and amount of which are uncertain. We continue to evaluate the realizability of the deferred tax asset, based upon achieved and estimated future results. If it is determined that it is more likely than not that the deferred tax asset will be realized, we will reverse all or a portion of the allowance as deemed appropriate. The difference between the effective rate of 2.7% and the Federal statutory rate of 34% is due to the change in our valuation allowance account, state income taxes (net of federal benefit), and certain permanent differences between our taxable and book income.

Effective January 1, 2009, we account for any uncertainty in income taxes by recognizing the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. We measure the tax benefits recognized in the financial statements from such a position based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate resolution. The application of income tax law is inherently complex. As such, we are required to make certain subjective assumptions and judgments regarding income tax exposures. The result of the reassessment of our tax positions did not have an impact on the consolidated financial statements.

Concentration of Credit Risk

We disclose significant concentrations of credit risk regardless of the degree of such risk. Financial instruments with significant credit risk include cash and investments. At March 31, 2011, we had \$3,664,717 in cash accounts at one financial institution, approximately \$197,978 in foreign bank accounts and \$231,356 in an investment management account at another financial institution. The maximum loss that would have resulted from concentration risk totaled \$803,701 at March 31, 2011 and \$717,618 at June 30, 2010 for the excess of the deposit liabilities reported by the banks over the amounts that would have been covered by federal insurance.

Effect of New Accounting Pronouncements

We have reviewed recently issued, but not yet effective, accounting pronouncements and do not believe any such pronouncements will have a material impact on our financial statements.

Table of Contents**Note 3 Investments**

In 2008 we invested in auction rate preferred securities of closed-end funds (ARPS) to maximize interest income. We considered investments in these instruments as available for sale in accordance with relevant accounting guidance.

ARPS have historically been liquid but have been adversely affected by the broader national liquidity crisis. We entered into an agreement with our investment advisor, Stifel Nicolaus, to repurchase 100% of the remaining ARPS at par on or prior to June 30, 2012. The schedule for repurchase of remaining ARPS by Stifel Nicolaus over the next three years is as follows:

- (a) The greater of 10 percent or \$25,000 to be completed by June 30, 2011;
- (b) The balance of outstanding ARPS, if any, to be repurchased by June 30, 2012.

We have established a line of credit to borrow against 80% of these investments so that sales of these securities would not have to occur in order to fund our operating needs. Management classified 80% or \$280,000 of our investments as short term. The remaining 20% or \$70,000 of our investments that may not be available in the current year are classified as long-term.

As of March 31, 2011, in light of the plan for repurchase and the repurchases made during the year, management has determined that there has not been a change in the fair value of the securities owned. We have not recorded any impairment related to these investments, as management does not believe that the underlying credit quality of the assets has been impacted by the reduced liquidity of these investments. In addition, no unrealized gain or loss has been recorded on these assets. We consider the inputs to valuation of these securities as level 2 inputs in the fair value hierarchy.

Note 4 Convertible Debentures**2007**

On September 26, 2007 and October 31, 2007, we issued convertible debentures in a private placement offering that had an interest rate of 8 percent per annum and had a term of three years. The convertible debentures were convertible into common stock at \$0.20 per share during their term and at maturity, at our option, were repayable in full or convertible into common stock at the lower of \$0.20 per share or the average trading price for the 10 days immediately prior to the maturity dates on September 26, 2010 and October 31, 2010. We also issued warrants to purchase shares of our common stock at \$0.30 per share in the private placement offering. We allocated the proceeds received in the private placement to the convertible debentures and warrants to purchase common stock based on their relative estimated fair values. The discount from the face amount of the convertible debentures represented by the value initially assigned to any associated warrants and derivative liabilities was amortized over the period to the due date of each convertible debenture, using the effective interest method. We redeemed all warrants issued in the offering in fiscal 2009.

Details of the issuances are in the table below:

	Face				Discount Amortized at	Net Value at March
Date Issued	Value Issued	Debt Discount	Face Value Converted	Discount Converted	March 31, 2011	31, 2011
September 26, 2007	\$ 1,075,000	\$ (937,510)	\$(1,075,000)	\$ 242,173	\$ 695,337	\$
October 31, 2007	415,000	(378,235)	(415,000)	139,624	238,611	
Totals	\$ 1,490,000	\$ (1,315,745)	\$(1,490,000)	\$ 381,797	\$ 933,948	\$

As of December 31, 2010 all the convertible debentures issued in September and October of 2007 were converted.

We determined that the conversion option in the convertible debentures did not satisfy the definition of being indexed to our own stock, as an anti-dilution provision in the convertible debentures would have reduced the

conversion price dollar for dollar if we were to have issued common stock with a price lower than the conversion price of the convertible debentures. Based on authoritative guidance effective on July 1, 2009 the embedded conversion option in the convertible debentures was a liability as of July 1, 2009. We have bifurcated the embedded conversion option from the host contract and accounted for this feature as a separate derivative liability. As of December 31, 2010 the embedded conversion option had a zero value because all debentures have been converted.

Table of Contents

Effective interest associated with the convertible debentures totaled none and \$240,684 for the three and nine months ended March 31, 2011, respectively. Effective interest associated with the convertible debentures totaled \$148,953 and \$377,866 for the three and nine months ended March 31, 2010, respectively. Effective interest is accreted to the balance of convertible debt until maturity. Simple interest paid totaled none and \$18,046 for the three and nine months ended March 31, 2011, respectively. Simple interest paid totaled \$21,734 and \$67,939 for the three and nine months ended March 31, 2010, respectively. A total of \$256,568 was paid for commissions and expenses incurred in the 2007 private placement offering which was amortized into interest expense over the term of the convertible debentures on a straight-line basis. As of March 31, 2011 we have recorded accumulated amortization of 2007 deferred offering costs of \$231,552.

2009 and 2010

Between November 2009 and February 2010, we issued convertible debentures with an aggregate principal amount of \$4,995,000 that bear interest at 8 percent per annum and have a term of two years. Accordingly, as of March 31, 2011, these amounts are recorded as short-term convertible debt on the accompanying balance sheet. We received aggregate net cash proceeds of \$4,035,687, after deducting placement fees of \$464,313 and taking into account the conversion of an outstanding note payable as described below. The convertible debentures are convertible into common stock at \$0.20 per share during their term. Subject to meeting certain equity conditions, we have the option to redeem the outstanding principal plus accrued interest for cash at any time during the term of the debentures. If we offer to redeem, the holders of the debentures have 20 days to convert to common stock. In conjunction with these convertible debentures we issued warrants to purchase an aggregate of 14,997,449 shares of common stock with an exercise price of \$0.50 per share and warrants to purchase an aggregate of 2,035,860 shares of common stock with an exercise price of \$0.20 per share. In addition, a note payable to a related party in the amount of \$500,000 was converted to a convertible debenture. We allocated the proceeds received in the private placements to the embedded derivative and warrants based on their estimated fair values. Details of the issuances are in the table below:

Date Issued	Face Value Issued	Debt Discount	Face Value Converted	Discount Converted	Discount Amortized at March 31, 2011	Net Value at March 31, 2011
November 18, 2009	\$ 246,896	\$ (246,896)	\$ (169,830)	\$ 168,578	\$ 5,559	\$ 4,307
December 11, 2009	874,125	(874,125)	(199,800)	198,354	31,362	29,916
December 31, 2009	254,745	(254,745)			11,374	11,374
January 20, 2010	1,255,743	(1,255,743)	(289,690)	287,043	51,467	48,820
February 4, 2010	1,849,149	(1,849,149)	(763,240)	758,888	40,719	36,367
February 25, 2010	514,342	(514,342)	(331,525)	327,548	11,361	7,384
Totals	\$ 4,995,000	\$ (4,995,000)	\$ (1,754,085)	\$ 1,740,411	\$ 151,842	\$ 138,168

As of March 31, 2011 the convertible debentures are convertible into an aggregate of 16,204,575 shares with a value as of March 31, 2011 of \$11,505,248 which exceeds the principal value by \$8,264,333.

Based on authoritative guidance effective on July 1, 2009 we have concluded that the embedded conversion option in the convertible debentures is required to be bifurcated from the host contract and have accounted for this feature as a separate derivative liability, at fair value, in our financial statements. In addition, we determined that the warrants issued in conjunction with the convertible debentures are required to be carried as derivative liabilities, at fair value, in our financial statements, due to certain anti-dilution provisions. As of March 31, 2011, the embedded conversion option is estimated to be \$5,859,248 and the warrant derivative is estimated to be \$9,324,029. In addition, we have reviewed the terms of the convertible debentures to determine whether there are any other embedded derivative instruments that may be required to be bifurcated and accounted for separately as derivative instrument liabilities and have determined that either they did not meet the criteria or were immaterial in amount.

Edgar Filing: Lifevantage Corp - Form 10-Q

Effective interest associated with the convertible debentures totaled \$342,740 and \$1,680,097 for the three and nine month periods ended March 31, 2011, respectively. Effective interest associated with the convertible debentures totaled \$537,832 and \$578,747 for the three and nine month periods ended March 31, 2010, respectively. Effective interest is accreted to the balance of convertible debt until maturity. Simple interest paid was \$73,653 and \$258,578 for the three and nine month periods ended March 31, 2011, respectively. We incurred an aggregate of \$1,138,660 in commissions and expenses in connection with the 2009 private placement offerings, \$464,313 of which was paid in cash and the balance of which was reflected in the issuance of warrants with a fair market value of \$674,347. The \$1,138,660 in commissions and expenses is being amortized into interest expense over the term of the convertible debentures. As of March 31, 2011 we have recorded accumulated amortization of deferred offering costs of \$877,606.

Table of Contents**Note 5 Line of Credit**

We established a line of credit to borrow up to 80% of our cash and investments. As of March 31, 2011, we can borrow up to \$600,000. The line is collateralized by our auction rate securities. The interest rate charged through March 31, 2011, 3.00 percent, is 0.25 percentage points below the published Wall Street Journal Prime Rate, which was 3.25 percent as of March 31, 2011. At March 31, 2011, we have borrowed approximately \$433,984 including accrued interest, from the line.

Note 6 Stockholders Equity

During the three and nine months ended March 31, 2011 we issued 1,193,725 and 11,646,825, respectively, shares of common stock as a result of conversions of convertible debentures.

Our Articles of Incorporation authorize the issuance of preferred shares. However, as of March 31, 2011, none have been issued nor have any rights or preferences been assigned to the preferred shares by our Board of Directors.

Note 7 Stock-based Compensation

We adopted and the shareholders approved the 2007 Long-Term Incentive Plan (the 2007 Plan), effective November 21, 2006, to provide incentives to certain eligible employees, directors and consultants. A maximum of 10,000,000 shares of our common stock can be issued under the 2007 Plan in connection with the grant of awards. Awards to purchase common stock have been granted pursuant to the 2007 Plan and are outstanding to various employees, officers, directors, independent distributors and Scientific Advisory Board (SAB) members at prices between \$0.21 and \$0.76 per share, vesting over one- to three-year periods. Awards expire in accordance with the terms of each award and the shares subject to the award are added back to the 2007 Plan upon expiration of the award. As of March 31, 2011, awards for the purchase of an aggregate of 8,137,731 shares of our common stock are outstanding under the 2007 Plan.

We adopted and the shareholders approved the 2010 Long-Term Incentive Plan (the 2010 Plan), effective September 27, 2010, to provide incentives to certain eligible employees, directors and consultants. A maximum of 3,500,000 shares of our common stock can be issued under the 2010 Plan in connection with the grant of awards. As of March 31, 2011 there were 2,412,000 awards outstanding under the 2010 Plan.

Payments in equity instruments for goods or services are accounted for under the guidance of share based payments, which require use of the fair value method. We have adjusted the expense for the anticipated forfeitures. Compensation based options totaling 44,000 and 102,000 were granted for the three and nine month periods ended March 31, 2011, respectively. Compensation based options totaling 360,000 and 1,737,500 were granted during the three and nine month periods ended March 31, 2010, respectively.

For the three and nine months ended March 31, 2011, stock based compensation of \$288,665 and \$450,780, respectively, was reflected as an increase to additional paid in capital. Of the stock based compensation for the three and nine months ended March 31, 2011, \$264,666 and \$397,183 respectively, was employee related and \$23,999 and \$53,597, respectively, was non-employee related. For the three and nine months ended March 31, 2010, stock based compensation of \$417,842 and \$2,071,372, respectively, was reflected as an increase to additional paid in capital. Of the stock based compensation for the three and nine months ended March 31, 2010, \$43,888 and \$973,455 respectively, was employee related and \$373,954 and \$1,097,917 respectively, was non-employee related.

Compensation expense was calculated using the fair value method during the three and nine month periods ended March 31, 2011 and 2010 using the Black-Scholes option pricing model. The following assumptions were used for options and warrants granted during the nine month periods ended March 31, 2011 and 2010:

1. risk-free interest rates of between 1.33 and 2.64 percent for the nine months ended March 31, 2011 and 2.01 and 3.52 percent for the nine months ended March 31, 2010;
2. dividend yield of -0- percent;
3. expected life of 3 to 6 years; and
4. a volatility factor of the expected market price of our common stock of between 125 and 129 percent for the nine months ended March 31, 2011 between 143 and 337 percent for the nine months ended March 31, 2010.

Table of Contents

Note 8 Subsequent Events

Between April 1, 2011 and May 12, 2011, 10,411,173 warrants were exercised by holders which will result in a net issuance of common shares of 7,176,436. Between April 1, 2011 and May 12, 2011 holders converted certain debentures issued between November of 2009 and February of 2010 into 1,198,825 shares of common stock. On May 3, 2011 a stock option for 500 shares was exercised. This activity will result in the issuance of an aggregate of 8,375,761 shares of common stock.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis contains forward-looking statements within the meaning of the federal securities laws. We urge you to carefully review our description and examples of forward-looking statements included in the section entitled "Cautionary Note Regarding Forward-Looking Statements" at the beginning of this report. Forward-looking statements speak only as of the date of this report and we undertake no obligation to publicly update any forward-looking statements to reflect new information, events or circumstances after the date of this report. Actual events or results may differ materially from such statements. In evaluating such statements, we urge you to specifically consider various factors identified in this report, including the matters set forth below in Part II, Item 1A of this report, any of which could cause actual results to differ materially from those indicated by such forward-looking statements. The following discussion and analysis should be read in conjunction with the accompanying financial statements and related notes, as well as the Financial Statements and related notes in our Annual report on Form 10-K for the fiscal year ended June 30, 2010 and the risk factors discussed therein.

Overview

The following discussion and analysis reviews the financial condition and results of operations of LifeVantage Corporation (the Company, LifeVantage, or we, us or our) and its wholly-owned subsidiaries Lifeline Nutraceutical Corporation (LNC), LifeVantage de México, S. de R.L. de C.V. (Limited Liability Company), Importadora LifeVantage, S. de R.L. de C.V. (Limited Liability Company), and Servicios Administrativos para la Importación de Productos Body & Skin, S.C.

We are a dietary supplement company that manufactures, markets, distributes, and sells Protandim, a patented dietary supplement intended to increase the body's natural antioxidant protection by inducing multiple protective enzymes including superoxide dismutase (SOD) and catalase (CAT) through network marketing and direct-to-consumer sales channels. We also sell our LifeVantage TrueScience Anti-Aging Cream, a skin care product, through the same channels.

Our revenue depends significantly upon the number and productivity of our independent distributors. Independent distributors market and sell our products and recruit new distributors based on the distinguishing benefits and innovative characteristics of our products. We have developed a distributor compensation plan and other incentives designed to motivate our independent distributors to market and sell our products and to build sales organizations. If we experience delays or difficulties in introducing compelling products or attractive initiatives to independent distributors, this can have a negative impact on our revenue and harm our business.

We primarily sell a single product, Protandim, and in June 2009 we began selling our LifeVantage TrueScience Anti-Aging Cream (LifeVantage TrueScience) which incorporates ingredients contained in Protandim and other proprietary ingredients. We developed Protandim, a proprietary blend of ingredients that combats oxidative stress by increasing the body's natural antioxidant protection at the genetic level, inducing the production of naturally occurring protective antioxidant enzymes including SOD, CAT, and glutathione synthase.

We sell Protandim and LifeVantage TrueScience through our network marketing sales channel utilizing independent distributors and directly to individuals through our preferred customer program.

To date, we have focused our research efforts on investigating various aspects and consequences of the imbalance of oxidants and antioxidants, an abnormality, which is a central underlying feature in many disorders. We intend to continue our research, development, and documentation of the efficacy of Protandim to provide credibility to the market. We also anticipate undertaking research, development, testing, and licensing activities in an effort to introduce additional products in the future, although we may not be successful in this endeavor.

Table of Contents

Ongoing research and development projects studying Protandim as a potent and effective Nrf2 activator are currently in various stages of completion with several institutions including the University of Colorado at Denver, University of Minnesota's Masonic Cancer Center, Northwestern University, Colorado State University and Louisiana State University. The studies relate to various conditions including non-alcoholic fatty liver disease, alcohol-related susceptibility to acute lung injury, breast cancer, allograft rejection, and multiple sclerosis. A recently completed and published peer-reviewed study from The Ohio State University examined the biochemical mechanisms that underlie the ability of Protandim® to suppress intimal hyperplasia (over-proliferation of cells that line the vessel wall), a common adverse event that limits the effectiveness of several types of vascular surgery. Coronary artery bypass graft (CABG) surgery is performed more than 400,000 times a year in the United States. Most procedures requiring multiple bypasses still utilize the saphenous vein (taken from the leg) for secondary grafts. Ten years after CABG surgery, roughly half of the saphenous vein grafts will have become largely, if not completely blocked by processes that may result from intimal hyperplasia. Previous studies concluded that a major factor causing this condition is the three-to-five-fold higher concentration of oxygen experienced by the graft in its new environment. This study showed that Protandim's ability to activate the signaling molecule Nrf2 significantly increased antioxidant enzyme activity in human saphenous veins cultured at high oxygen, while reducing free radical levels, lipid peroxidation, and, importantly, reducing intimal proliferation to the level seen in normal healthy saphenous vein.

Net revenue from Protandim(R), TrueScience(R) and related marketing materials totaled \$9,975,224 and \$23,878,662, respectively, for the three and nine months ended March 31, 2011, and \$2,723,807 and \$7,037,450, respectively, for the three and nine months ended March 31, 2010.

Three and Nine Months Ended March 31, 2011 Compared to Three and Nine Months Ended March 31, 2010

Revenue We generated net sales of \$9,975,224 during the three months ended March 31, 2011, and generated net sales of \$2,723,807 during the three months ended March 31, 2010. We generated net sales of \$23,878,662 during the nine months ended March 31, 2011 and \$7,037,450 during the nine months ended March 31, 2010. The increase in sales is due to increased volume through the network marketing or multi-level marketing sales channel. Our sales in Japan contributed \$1,824,588 and \$2,830,797 of this increase for the three and nine months ended March 31, 2011, respectively. As a result of an historical analysis of our return rate during the three months ended March 31, 2011 we adjusted our sales return reserve estimate which resulted in an increase to revenue of approximately \$137,000. During the three and nine month periods ended March 31, 2011, substantially all of our sales and marketing effort was directed toward building this channel.

Gross Margin Our gross profit percentage for the three month periods ended March 31, 2011 and 2010 was 84%. Our gross profit percentage for the nine months ended March 31, 2011 and 2010 was 84% and 83%, respectively. The slightly higher gross margins we have experienced are primarily due to efficiencies and cost reductions obtained through our contract manufacturer. We expect the gross margin percentages for this sales channel to remain in this range for the foreseeable future.

Operating Expenses Total operating expenses for the three months ended March 31, 2011 were \$7,601,095 as compared to operating expenses of \$3,619,487 for the three months ended March 31, 2010. Total operating expenses during the nine month period ended March 31, 2011 were \$18,339,113 as compared to operating expenses of \$12,896,477 during the nine month period ended March 31, 2010. Operating expenses consist of sales and marketing expenses, general and administrative expenses, research and development, and depreciation and amortization expenses.

Sales and Marketing Expenses Sales and marketing expense increased from \$1,877,073 for the three months ended March 31, 2010 to \$5,350,388 for the three months ended March 31, 2011. Sales and marketing expenses increased from \$5,852,268 for the nine months ended March 31, 2010 to \$12,781,834 for the nine months ended March 31, 2011. This increase was due primarily to commissions paid to distributors due to the higher sales volume. We expect continued increases in sales and marketing expenses as our sales increase.

General and Administrative Expenses Our general and administrative expense increased from \$1,618,591 for the three months ended March 31, 2010 to \$2,081,108 for the three months ended March 31, 2011. General and administrative expense decreased from \$6,548,199 for the nine months ended March 31, 2010 to \$5,084,270 for the nine months ended March 31, 2011. The increase for the three month period is primarily due to increased bonus

accruals and professional fees related to Sarbanes Oxley compliance, tax strategy and public reporting. The decrease for the nine month period is primarily due to decreased legal expenses and personnel related costs and are partially offset by increased bonus accruals and benefits costs. We expect general and administrative expenses to remain relatively stable, however there will be some periodic increases associated with additional personnel required to support our growth.

Research and Development Our research and development expenses increased from \$69,863 for the three months ended March 31, 2010 to \$115,515 for the three months ended March 31, 2011. Research and development expenses increased from \$295,277 for the nine months ended March 31, 2010 to \$315,025 for the nine months ended March 31, 2011. These increases are a result of increased fees paid to our Scientific Advisory Board. Continued investment in research and development is a company priority and we intend to commit up to approximately 2% of our total net sales in future periods for research and development efforts. The recognition and timing of these expenses will be dependent upon entry into specific research and development projects, which are still in the planning stages.

Table of Contents

Depreciation and Amortization Expense Depreciation and amortization expense increased from \$53,960 during the three months ended March 31, 2010 to \$54,084 during the three months ended March 31, 2011. Depreciation and amortization expense decreased from \$200,733 for the nine months ended March 31, 2010 to \$157,984 for the nine months ended March 31, 2011. The decrease for the nine month period was due primarily to assets being fully depreciated and is partially offset by depreciation associated with capital acquisitions made during the current fiscal year.

Net Other Income (Expense) We recognized net other expense of \$10,559,824 during the three months ended March 31, 2011 as compared to net other expense of \$6,906,139 during the three months ended March 31, 2010. During the nine months ended March 31, 2011 we recognized net other expense of \$5,255,758 as compared to net other income of \$966,922 for the nine months ended March 31, 2010. These fluctuations between periods are primarily the result of the change in fair value of the derivative liabilities during the three and nine months ended March 31, 2011 of \$10,090,924 and \$2,777,953, respectively. This expense was increased by interest expense related to convertible debentures and income tax expense.

Income Tax Expense We recognized no income tax expense for the three month periods ended March 31, 2011 and 2010, respectively. For the nine months ended March 31, 2011 we recognized tax expense of \$95,000 as compared to none for the nine months ended March 31, 2010. The income tax expense reflects our estimated liability for state income taxes for the three and nine months ended March 31, 2011.

Net Income/Loss We recorded net loss of \$9,767,561 for the three month period ended March 31, 2011 compared to a net loss of \$8,249,616 for the three month period ended March 31, 2010. As a result of an historical analysis of our return rate during the three months ended March 31, 2011 we adjusted our sales return reserve estimate which resulted in a decrease to net loss of approximately \$137,000. We recorded net loss of \$3,604,744 for the nine month period ended March 31, 2011 compared to a net loss of \$6,064,700 for the nine month period ended March 31, 2010.

Liquidity and Capital Resources

Our primary liquidity and capital resource requirements are to finance our continued expansion into the network marketing sales channel. This includes the costs associated with additional support personnel, compensating our distributors, the manufacture and sale of our products, capital investments in systems and infrastructure and general and administrative expenses. In order to remain cash flow positive from operations, we must maintain or continue to increase sales and maintain or limit expense increases.

Our primary source of liquidity is cash generated from the sales of our products. As of March 31, 2011, our available liquidity was \$4,094,051, including available cash, cash equivalents and marketable securities. This represented an increase of \$2,456,375 from the \$1,637,676 in cash, cash equivalents and marketable securities as of June 30, 2010. During the nine months ended March 31, 2011, our net cash provided by operating activities was \$2,445,151 as compared to net cash used by operating activities of \$4,516,159 during the nine months ended March 31, 2010. Our cash provided by operating activities during the nine month period ended March 31, 2011 increased primarily as a result of increased revenues.

During the nine months ended March 31, 2011, our net cash used by investing activities was \$13,951, due to the redemption of marketable securities less the purchase of fixed and intangible assets. During the nine months ended March 31, 2010, our net cash provided by investing activities was \$166,784 primarily due to the redemption of marketable securities less the purchase of intangible assets.

Cash provided by financing activities during the nine months ended March 31, 2011 was \$50,000 compared to cash provided by financing activities of \$5,300,353 during the nine months ended March 31, 2010. Cash provided by financing activities during the nine month period ended March 31, 2011 was related solely to proceeds from the exercise of warrants. Cash provided from financing activities during the nine months ended March 31, 2010 was due to proceeds from an equity offering of common stock and warrants and the issuance of convertible debentures and warrants.

We maintain an investment portfolio of marketable securities that is managed by a professional financial institution. The portfolio includes auction rate private securities, or ARPS, of AA and AAA rated closed-end funds. These marketable securities which historically have been extremely liquid have been adversely affected by the broader national liquidity crisis.

Edgar Filing: Lifevantage Corp - Form 10-Q

We have a line of credit that is secured by the marketable securities that we hold, which allows us to borrow against 80% of the par value of these marketable securities. Based upon this line of credit, we have classified 80% or \$280,000 of our marketable securities as short term. The remaining 20% or \$70,000 of our marketable securities that may not be available in the next twelve months is classified as long-term. However, future economic events could change the portion of these classified as long term.

Table of Contents

At March 31, 2011, we had negative working capital (current assets minus current liabilities) of \$5,450,030, compared to negative working capital of \$2,103,899 at June 30, 2010. The negative working capital at March 31, 2011 is due to the classification as short-term in the quarter ended March 31, 2011 of certain derivative liabilities related to the convertible debentures and warrants issued in our 2009 financing transactions.

Our ability to finance future operations will depend on our existing liquidity and on our ability to generate continued revenues and profits from operations. We believe that existing cash on hand and future cash flow will be sufficient to allow us to continue operations for at least the next 12 months. A shortfall from projected sales levels would likely result in expense reductions, which could have a material adverse effect on our ability to continue operations at current levels. If we are unable to generate cash from operations at projected or otherwise sufficient levels, we may be required to seek additional funds through debt, equity or equity-based financing (such as convertible debt); however financing may not be available on favorable terms or at all. If we raise additional funds by selling additional shares of our capital stock, or securities convertible into shares of our capital stock, the ownership interest of our existing shareholders will be diluted. The amount of dilution could be increased by the issuance of warrants or securities with other dilutive characteristics, such as anti-dilution clauses or price resets.

Off-Balance Sheet Arrangements

As of March 31, 2011, we did not have any off-balance sheet arrangements.

Critical Accounting Policies

We prepare our financial statements in conformity with accounting principles generally accepted in the United States of America. As such, we are required to make certain estimates, judgments, and assumptions that we believe are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented. Actual results could differ from these estimates. Our significant accounting policies are described in Note 2 to our financial statements. Certain of these significant accounting policies require us to make difficult, subjective, or complex judgments or estimates. We consider an accounting estimate to be critical if (1) the accounting estimate requires us to make assumptions about matters that were highly uncertain at the time the accounting estimate was made, and (2) changes in the estimate that are reasonably likely to occur from period to period, or use of different estimates that we reasonably could have used in the current period, would have a material impact on our financial condition or results of operations.

There are other items within our financial statements that require estimation, but are not deemed critical as defined above. Changes in estimates used in these and other items could have a material impact on our financial statements. Management has discussed the development and selection of these critical accounting estimates with our board of directors, and the audit committee has reviewed the foregoing disclosure.

Allowances for Product Returns We record allowances for product returns at the time we ship the product based on estimated return rates. We base these accruals on the historical return rate since the inception of our selling activities, and the specific historical return patterns of the product.

We offer a 30-day, money back unconditional guarantee to all direct customers. As of March 31, 2011, approximately \$3,668,019 of our sales were subject to the money back guarantee. We replace product returned due to damage during shipment wholly at our cost, the total of which historically has been negligible. In addition, we allow terminating distributors to return 30% of unopened unexpired product that they purchased during the prior twelve months, subject to certain consumption limitations.

We monitor our return estimate on an ongoing basis and may revise the allowances to reflect our experience. Our allowance for product returns was \$737,495 at March 31, 2011, compared with \$343,900 at June 30, 2010. As a result of an historical analysis of our return rate during the three months ended March 31, 2011 we adjusted our sales return reserve estimate which resulted in an increase to revenue and operating income and a decrease in our net loss of approximately \$137,000. To date, product expiration dates have not played any role in product returns, and we do not expect product expiration dates to affect product returns in the foreseeable future because it is unlikely that we will ship product with an expiration date earlier than the latest allowable product return date.

Inventory Valuation We state inventories at the lower of cost or market on a first-in first-out basis. From time to time we maintain a reserve for inventory obsolescence and we base this reserve on assumptions about current and

future product demand, inventory whose shelf life has expired and market conditions. From time to time, we may be required to make additional reserves in the event there is a change in any of these variables. We have recorded \$89,573 of reserve for obsolete inventory as of March 31, 2011 primarily for obsolete marketing materials.

Table of Contents

Revenue Recognition We ship the majority of our product directly to the consumer through the direct to consumer and network marketing sales channels via United Parcel Service, (UPS), and receive substantially all payment for these shipments in the form of credit card charges. We recognize revenue from direct product sales to customers upon passage of title and risk of loss to customers when product is shipped from the fulfillment facility. Sales revenue and estimated returns are recorded when product is shipped.

Derivative Instruments In connection with the sale of debt or equity instruments, we may sell options or warrants to purchase our common stock. In certain circumstances, these options or warrants may be classified as derivative liabilities, rather than as equity. Additionally, the debt or equity instruments may contain embedded derivative instruments, such as conversion options, which in certain circumstances may be required to be bifurcated from the associated host instrument and accounted for separately as a derivative instrument liability.

The identification of, and accounting for, derivative instruments is complex. For options, warrants and any bifurcated conversion options that are accounted for as derivative instrument liabilities, we determine the fair value of these instruments using the Black-Scholes option pricing model. That model requires assumptions related to the remaining term of the instruments and risk-free rates of return, our current common stock price and expected dividend yield, and the expected volatility of our common stock price over the life of the instruments. Because of the limited trading history for our common stock, we have estimated the future volatility of our common stock price based on not only the history of our stock price but also the experience of other entities considered comparable to us. The identification of, and accounting for, derivative instruments and the assumptions used to value them can significantly affect our financial statements.

Intangible Assets **Patent Costs** We review the carrying value of our patent costs and compare to fair value at least annually to determine whether the patents have continuing value. In determining fair value, we consider undiscounted future cash flows and market capitalization.

Stock-Based Compensation We use the fair value approach to account for stock-based compensation in accordance with the modified version of prospective application.

Research and Development Costs We have expensed all of our payments related to research and development activities.

Recently Issued Accounting Standards

We have reviewed recently issued, but not yet effective, accounting pronouncements and do not believe any such pronouncements will have a material impact on our financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Under the rules and regulations of the SEC, as a smaller reporting company we are not required to provide the information required by this Item.

Item 4. Controls and Procedures**Evaluation of Disclosure Controls and Procedures**

As of March 31, 2011, we conducted an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by the company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures also include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were not effective as of March 31, 2011 at the reasonable assurance level due to the material weaknesses in our internal control over financial reporting discussed immediately below.

Table of Contents

Identified Material Weaknesses

A material weakness is a control deficiency, or combination of deficiencies, that results in more than a remote likelihood that a material misstatement of our financial statements would not be prevented or detected on a timely basis by our employees in the normal course of performing their assigned functions. Management identified material weaknesses during our assessment of our internal control over financial reporting as of March 31, 2011. In particular, we concluded that we did not maintain:

1. Adequate oversight of certain accounting functions and did not maintain adequate documentation of management review and approval of accounting transactions and financial reporting processes; and
2. Formal policies governing certain accounting transactions and financial reporting processes.

In conclusion, our Chief Executive Officer and Chief Financial Officer determined that we did not maintain effective internal control over financial reporting as of March 31, 2011.

Management's Remediation Initiatives

We are in the process of evaluating our material weaknesses. In an effort to remediate the identified material weaknesses and other deficiencies and to enhance our internal control over financial reporting, we have initiated, or plan to initiate, the following series of measures:

- 1) Implement appropriate management oversight and approval activities; and
- 2) We have established comprehensive formal general accounting policies and procedures and are in the process of obtaining written confirmation from appropriate employees to document their understanding of and compliance with company policies and procedures.

We plan to test our updated controls and remediate our material weaknesses by June 30, 2011.

In our Annual Report on Form 10-K for the year ended June 30, 2010 (filed with the SEC on September 15, 2010) in addition to the material weaknesses discussed above, we identified two other material weaknesses in our internal controls related to the lack of: (i) sufficient personnel with an appropriate level of accounting knowledge, experience and training in the selection and application of technical accounting principles in accordance with GAAP to support our financial accounting and reporting functions; and (ii) a whistleblower hotline. During the quarter ended September 30, 2010 we hired additional staff with experience managing and working in the corporate accounting department of a publicly traded company and established a whistleblower hotline.

Conclusion

The above identified material weaknesses resulted in material audit adjustments to our 2010 financial statements. If the identified material weaknesses are not remediated, one or more of the identified material weaknesses noted above could result in a material misstatement in our reported financial statements in a future interim or annual period.

In light of the identified material weaknesses, management performed (1) significant additional substantive review of those areas described above, and (2) additional analyses, including but not limited to a detailed balance sheet and statement of operations analytical review that compared changes from the prior period's financial statements and analyzed all significant differences. These procedures were completed so management could gain assurance that the financial statements included in this report fairly present in all material respects our financial position, results of operations and cash flows for the periods presented.

Changes in Internal Control over Financial Reporting

During the quarter ended March 31, 2011, we implemented the following changes that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act: we established comprehensive formal general accounting policies and procedures.

Table of Contents

PART II Other Information

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the risk factors discussed in Part I. Item 1A Risk Factors in our Annual Report on Form 10-K for the fiscal year ended June 30, 2010. The risks and uncertainties described in such risk factors and elsewhere in this report have the potential to materially affect our business, financial condition, results of operations, cash flows, projected results and future prospects. As of the date of this report, we do not believe that there have been any material changes to the risk factors previously disclosed in our Annual Report on Form 10-K for the fiscal year ended June 30, 2010.

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

During the period covered by this report, we issued 1,193,725 unregistered shares of our common stock upon the conversion of convertible debentures originally acquired from us in January and February of 2010. The shares issued were exempt from registration under the Securities Act of 1933 pursuant to Section 3(a)(9) thereof. The shares were exchanged for outstanding debentures exclusively with the holder thereof and no commission or other remuneration was paid or given directly or indirectly for soliciting such exchange.

Item 3. Defaults Upon Senior Securities

None.

Item 4. (Removed and Reserved)

None.

Item 5. Other Information

None.

Item 6. Exhibits

See the exhibit index immediately following the signature page of this report.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

LIFEVANTAGE CORPORATION

Date: May 16, 2011

/s/ Douglas C. Robinson
Douglas C. Robinson
President and Chief Executive Officer
(Principal Executive Officer)

Date: May 16, 2011

/s/ Carrie E. McQueen
Carrie E. McQueen
Chief Financial Officer
(Principal Financial Officer)
24

Table of Contents

Exhibit Index

Exhibit	Document Description	Incorporation by Reference
10.1#	Employment Agreement between Lifevantage Corporation and Douglas C. Robinson, dated March 11, 2011 and effective as of March 15, 2011	Filed herewith.
31.1	Certification of principal executive officer pursuant to Rule 13a-14(a)/15d-14(a)	Filed herewith.
31.2	Certification of principal financial officer pursuant to Rule 13a-14(a)/15d-14(a)	Filed herewith.
32.1*	Certification of principal executive officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith.
32.2*	Certification of principal financial officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith.

Management contract or compensatory plan.

* This certification is being furnished solely to accompany this report pursuant to 18 U.S.C. 1350, and is not being filed for purposes of Section 18 of the Securities Exchange Act of 1934 and is not to be incorporated by reference into any filing of the registrant, whether made before or after the date hereof, regardless of any general incorporation language in such filing