

MusclePharm Corp  
Form 10-Q  
November 14, 2013

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

**FORM 10-Q**

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

For the quarterly period ended: **September 30, 2013**

OR

**“ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: **000-53166**

**MUSCLEPHARM CORPORATION**

(Exact name of registrant as specified in its charter)

**Nevada**

(State or other jurisdiction of  
incorporation or organization)

**77-0664193**

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

**4721 Ironton Street, Building A  
Denver, Colorado 80239**

(Address of principal executive offices and zip code)

**(303) 396-6100**

(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months, 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, or 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:

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

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

As of November 14, 2013, there were 8,865,990 shares outstanding of the registrant's common stock.

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**Part I FINANCIAL INFORMATION****Item 1. Financial Statements****MusclePharm Corporation and Subsidiary****Consolidated Balance Sheets**

	September 30, 2013 (unaudited)	December 31, 2012 (audited)
Assets		
Current Assets:		
Cash	\$ 5,683,656	\$ -
Cash restricted	-	9,148
Debt Securities	925,574	-
Accounts receivable net	10,911,439	3,302,344
Derivative instrument	1,692,351	-
Inventory	9,633,164	257,975
Prepaid giveaways	592,422	358,800
Prepaid stock compensation	3,368,692	44,748
Prepaid sponsorship fees	692,536	6,249
Deferred equity costs	-	698,500
Other assets	907,881	272,117
Total current assets	34,407,715	4,949,881
Property and equipment net	1,668,944	1,356,364
Debt issue costs net	-	335,433
Prepaid stock compensation	5,171,400	-
Other assets	299,404	125,049
Total Assets	\$ 41,547,463	\$ 6,766,727
Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts payable and accrued liabilities	\$ 16,543,261	\$ 11,721,205
Customer deposits	356,469	336,211
Debt net	70,456	4,463,040
Derivative liabilities	1,895,085	-
Total current liabilities	18,865,271	16,520,456
Long Term Liabilities:		
Debt net	-	4,523
Other	7,554	-
Total Liabilities	18,872,825	16,524,979
Commitments and Contingencies		
Stockholders' Equity:		
Series A, Convertible Preferred Stock, \$0.001 par value; 5,000,000 shares authorized, none issued and outstanding	-	-
Series B, Preferred Stock, \$0.001 par value; 0 and 51 shares authorized, 51 issued and none and 51 outstanding	-	-
Series C, Convertible Preferred Stock, \$0.001 par value; 500 shares authorized, 190 and none issued and outstanding	-	-

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Series D, Convertible Preferred Stock, \$0.001 par value; 1,600,000 shares authorized, 1,500,000 and none issued and 144,000 and none outstanding	144	-
Common Stock, \$0.001 par value; 100,000,000 shares authorized, 8,915,911 and 2,778,404 issued and 8,865,990 and 2,747,308 outstanding	8,916	2,778
Treasury Stock, at cost; 49,921 and 31,096 shares	(564,515)	(460,978)
Additional paid-in capital	101,025,625	54,817,341
Accumulated deficit	(77,839,103)	(64,109,476)
Accumulated other comprehensive income (loss)	43,571	(7,917)
Total Stockholders' Equity	22,674,638	(9,758,252)
Total Liabilities and Stockholders' Equity	\$ 41,547,463	\$ 6,766,727

See accompanying notes to unaudited financial statements.

**MusclePharm Corporation and Subsidiary**  
**Consolidated Statements of Operations**  
**(unaudited)**

	For the Three Months Ended		For the Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Sales - gross	\$ 31,080,225	\$ 20,627,691	\$ 84,519,744	\$ 58,799,563
Discounts and sales allowances	(5,736,257)	(2,053,965)	(11,134,551)	(8,235,817)
Sales - net	25,343,968	18,573,726	73,385,193	50,563,746
Cost of sales	17,937,768	14,507,761	49,900,891	40,345,528
Gross profit	7,406,200	4,065,965	23,484,302	10,218,218
Advertising and promotion	4,043,064	2,599,691	9,635,642	6,576,531
General and administrative	1,936,610	1,141,435	5,000,831	3,146,029
Professional and R&D fees	2,429,361	2,881,235	10,452,208	3,776,033
Salaries and benefits	3,869,945	1,254,417	6,730,813	2,922,072
Total operating expenses	12,278,980	7,876,778	31,819,494	16,420,665
Loss from operations	(4,872,780)	(3,810,813)	(8,335,192)	(6,202,447)
Other income (expense)				
Derivative expense	-	(1,922,763)	(96,913)	(4,409,214)
Change in fair value of derivative liabilities	305,421	4,403,875	(5,466,542)	5,900,749
Gain (loss) on settlement of accounts payable and debt	67,489	(1,510,613)	392,144	(4,452,439)
Gain on derivative instrument	444,059	-	444,059	-
Accretion of note discount	115,429	-	115,429	-
Interest expense	(1,302)	(3,265,053)	(782,747)	(6,812,255)
Foreign currency transaction (gain) loss	(4,152)	14,342	(9,865)	12,769
Other income	-	16,988	10,000	35,411
Total other income (expense) - net	926,944	(2,263,224)	(5,394,435)	(9,724,979)
Net loss	(3,945,836)	(6,074,037)	(13,729,627)	(15,927,426)
Other comprehensive income				
Net change in foreign currency translation	(13,027)	(33,163)	(6,950)	7,556
Net change in debt securities	58,438	-	58,438	-
Total other comprehensive (loss) income	45,411	(33,163)	51,488	7,556
Total comprehensive loss	\$ (3,900,425)	\$ (6,107,200)	\$ (13,678,139)	\$ (15,919,870)
Net loss per share available to common stockholders - basic and diluted	\$ (0.47)	\$ (3.21)	\$ (2.07)	\$ (9.62)
Weighted average number of common shares outstanding during the period - basic and diluted	8,475,084	1,894,202	6,626,125	1,656,218

See accompanying notes to unaudited financial statements.

**MusclePharm Corporation and Subsidiary**  
**Consolidated Statements of Cash Flows**  
**(unaudited)**

	Nine Months Ended September 30,	
	2013	2012
Cash Flows From Operating Activities:		
Net loss	\$ (13,729,627)	\$ (15,927,426)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation	510,890	325,185
Bad debt	158,578	9,490
Amortization of prepaid stock and deferred compensation	9,828,760	718,173
Amortization of debt discount	-	6,086,521
Amortization of debt issue costs	335,433	286,523
Accretion of note discount	(115,429)	-
(Gain) loss on settlement of accounts payable, debt and conversion of Series C preferred stock	(392,144)	3,261,897
Derivative expense	96,913	4,409,214
Change in fair value of derivative liabilities	5,466,541	(5,900,749)
Change in fair value of derivative assets	(444,059)	
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Restricted cash balance	9,148	(74,202)
Accounts receivable	(7,767,673)	(1,478,270)
Prepaid and other	(3,549,221)	(339,088)
Inventory	(9,608,811)	(396,873)
Increase (decrease) in:		
Accounts payable and accrued liabilities	11,127,500	8,384,755
Customer deposits	20,258	921,675
Other	7,554	-
Net Cash (Used In) Provided by Operating Activities	(8,045,389)	286,825
Cash Flows From Investing Activities:		
Purchase of convertible promissory note and warrant	(2,000,000)	-
Purchase of property and equipment	(825,164)	(899,823)
Proceeds from disposal of property and equipment	1,694	-
Purchase of trademark	(104,725)	(35,000)
Net Cash Used In Investing Activities	(2,928,195)	(934,823)
Cash Flows From Financing Activities:		
Proceeds from issuance of debt	-	4,823,950
Debt issue costs	-	(166,950)
Repayment of debt	(4,397,107)	(5,241,234)
Repurchase of common stock (treasury stock)	(103,537)	(460,978)
Proceeds from issuance of preferred stock	12,000,000	-
Proceeds from issuance of common stock and warrants	10,827,501	1,660,760
Stock issuance costs	(1,662,667)	-
Net Cash Provided Financing Activities	16,664,190	615,548

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Cash Flows From Equity Activities:		
Effect of exchange rates on cash and cash equivalents	(6,950)	7,556
Net Cash (Used In) Provided by Equity Activities	(6,950)	7,556
Net increase (decrease) in cash	5,683,656	(24,894)
Cash at beginning of period	-	659,764
Cash at end of period	\$ 5,683,656	\$ 634,870
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$ 410,846	\$ 423,705
Cash paid for taxes	\$ -	\$ -
Supplemental disclosure of non-cash investing and financing activities:		
Stock issued for future services - third parties	\$ 13,879,997	\$ 1,001,519
Warrants issued in conjunction with equity issuances	\$ 8,175,459	\$ 427,759
Debt discount recorded on convertible and unsecured debt accounted for as a derivative liability	\$ -	\$ 3,554,672
Stock issued to settle accounts payable and accrued expenses third parties	\$ 5,760,887	\$ 1,392,143
Conversion of convertible debt and accrued interest for common stock	\$ -	\$ 1,069,402
Stock issued for executive and board compensation	\$ 152,412	\$ 4,667,764
Reclassification of derivative liability to additional paid in capital	\$ 11,688,463	\$ 9,759,079
Stock issued to settle accrued liabilities	\$ -	\$ 384,500
Change in fair value of debt securities in other comprehensive income	\$ 58,438	\$ -
Stock issued to settle contracts	\$ 155,365	\$ 3,932

See accompanying notes to unaudited financial statements.



**MusclePharm Corporation and Subsidiary**  
**Notes to Consolidated Financial Statements**  
**(September 30, 2013)**  
**(Unaudited)**

**Note 1: Nature of Operations and Basis of Presentation**

**Nature of Operations**

MusclePharm Corporation (the “Company”, “we”, “our”, or “MusclePharm”), was incorporated in the state of Nevada on August 4, 2006 under the name Tone in Twenty for the purpose of engaging in the business of providing personal fitness training using isometric techniques. The Company is headquartered in Denver, Colorado.

MusclePharm currently manufactures and markets a wide-ranging variety of high-quality sports nutrition products.

**Basis of Presentation**

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and the rules and regulations of the U.S. Securities and Exchange Commission (“SEC”), as amended for interim financial information.

The financial information as of December 31, 2012 is derived from the audited financial statements presented in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012 and filed with the SEC on April 1, 2013. The unaudited interim consolidated financial statements should be read in conjunction with the Company’s Annual Report on Form 10-K, which contains the audited financial statements and notes thereto, together with Management’s Discussion and Analysis of Financial Condition and Results of Operations, for the years ended December 31, 2012 and 2011.

Certain information or footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted, pursuant to the rules and regulations of the SEC for interim financial reporting. Accordingly, they do not include all the information and footnotes necessary for a comprehensive presentation of financial position, results of operations, or cash flows. It is management’s opinion, however, that all material adjustments (consisting of normal recurring adjustments) have been made which are necessary for a fair financial statement presentation. The interim results for the nine months ended September 30, 2013 are not necessarily indicative of results for the full fiscal year.

**Note 2: Summary of Significant Accounting Policies**

**Principles of Consolidation**

The consolidated financial statements include the accounts of MusclePharm Corporation and its wholly-owned subsidiary MusclePharm Canada Enterprises Corp (“MusclePharm Canada”). MusclePharm Canada began operations in April of 2012. All intercompany accounts and transactions between MusclePharm Corporation and MusclePharm Canada have been eliminated upon consolidation.

**Use of Estimates**

The preparation of financial statements in conformity with GAAP 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.

Making estimates requires management to exercise significant judgment. It is reasonably possible that the estimate of the effect of a condition, situation or set of circumstances that existed at the date of the financial statements, which management considered in formulating its estimate could change in the near term due to one or more future non-conforming events. Accordingly, the actual results could differ significantly from estimates.

**Risks and Uncertainties**

The Company operates in an industry that is subject to rapid change and intense competition. The Company's operations will be subject to significant risk and uncertainties including financial, operational, technological, regulatory, industry adverse publicity and other risks, including the potential risk of business failure.

**MusclePharm Corporation and Subsidiary**  
**Notes to Consolidated Financial Statements**  
**(September 30, 2013)**  
**(Unaudited)**

**Cash and Cash Equivalents**

The Company considers all highly liquid instruments purchased with an original maturity of three months or less and money market accounts to be cash equivalents. At September 30, 2013 and December 31, 2012, respectively, the Company had no cash equivalents.

**Accounts Receivable and Allowance for Doubtful Accounts**

Accounts receivable represents trade obligations from customers that are subject to normal trade collection terms. Prior to July 1, the accounts receivable were sent directly to the Company's third party manufacturer and netted with any outstanding liabilities to the manufacturer. Subsequent to July 1, the Company took over the receipt and processing of accounts receivable. The Company periodically evaluates the collectability of its accounts receivable and considers the need to establish an allowance for doubtful accounts based upon historical collection experience and specific customer information. Accordingly, the actual amounts could vary from the recorded allowances. There is also a review of customer discounts at the period end and an accrual made for discounts earned but not yet received by quarter end.

Management reserves for bad debt expense based on the aging of accounts receivable. Bad debt expense is classified under general & administrative expense in the Consolidated Statement of Operations.

The Company does not charge interest on past due receivables. Receivables are determined to be past due based on the payment terms of the original invoices. Accounts receivable consisted of the following at September 30, 2013 and December 31, 2012:

	As of September 30, 2013	As of December 31, 2012
Accounts receivable	\$ 11,833,677	\$ 4,416,193
Less: allowance for discounts	(750,000)	(1,088,720)
Less: allowance for doubtful accounts	(172,238)	(25,129)
Accounts receivable net	\$ 10,911,439	\$ 3,302,344

At September 30, 2013 and December 31, 2012, the Company had the following concentrations of accounts receivable with significant customers:

Customer	As of September 30, 2013		As of December 31, 2012	
A	20	%	24	%
B	16	%	6	%
C	15	%	20	%

**Inventory**

Inventory is valued at the lower of cost or market value. Product-related inventories are primarily maintained using the First-In First-Out method.

**Prepaid Giveaways**

Prepaid giveaways represent non-inventory sample items, which are given away to aid in promotion of the brand.

**Prepaid Sponsorship Fees**

Prepaid sponsorship fees represents fees paid in connection with future advertising to be received.

**Property and Equipment**

Property and equipment are stated at cost and depreciated to their estimated residual value over their estimated useful lives. When assets are retired or otherwise disposed of, the assets and related accumulated depreciation are relieved from the accounts and the resulting gains or losses are included in operating income in the Consolidated Statements of Operations. Repairs and maintenance costs are expensed as incurred. Depreciation is provided using the straight-line method for all property and equipment.

**MusclePharm Corporation and Subsidiary**  
**Notes to Consolidated Financial Statements**  
**(September 30, 2013)**  
**(Unaudited)**

**Website Development Costs**

Costs incurred in the planning stage of a website are expensed, while costs incurred in the development stage are capitalized and amortized over the estimated useful life of the asset.

**Long-Lived Assets**

The Company reviews long-lived assets for impairment whenever events or changes in circumstances, such as service discontinuance or technological obsolescence, indicate that the carrying amount of the long-lived asset may not be recoverable. When such events occur, the Company compares the carrying amount of the asset to the undiscounted expected future cash flows related to the asset. If the comparison indicates that impairment is present, the amount of the impairment is calculated as the difference between the excess of the carrying amount over the fair value of the asset. If a readily determinable market price does not exist, fair value is estimated using discounted expected cash flows attributable to the asset. During the nine months ended September 30, 2013 and 2012, the Company recorded no impairment expense.

**Fair Value of Financial Instruments**

The Company measures assets and liabilities at fair value based on an expected exit price which represents the amount that would be received on the sale of an asset or paid to transfer a liability, as the case may be, in an orderly transaction between market participants. As such, fair value may be based on assumptions that market participants would use in pricing an asset or liability. The authoritative guidance on fair value measurements contains a consistent framework for measuring fair value on either a recurring or nonrecurring basis whereby inputs, used in valuation techniques, are assigned a hierarchical level.

The following are the hierarchical levels of inputs to measure fair value:

Level 1: Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2: Inputs reflect quoted prices for identical assets or liabilities in markets that are not active; quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the assets or liabilities; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3: Unobservable inputs reflecting the Company's assumptions incorporated in valuation techniques used to determine fair value. These assumptions are required to be consistent with market participant assumptions that are reasonably available.

The determination of where assets and liabilities fall within this hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The following are the major categories of assets and liabilities measured at fair value on a recurring basis as of September 30, 2013 and December 31, 2012, using quoted prices in active markets for identical liabilities (Level 1); significant other observable inputs (Level 2); and significant unobservable inputs (Level 3):

	As of September 30, 2013	As of December 31, 2012
Assets		
Debt securities (Level 2)	\$ 925,574	\$ -

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Derivative instruments	Biozone warrants (Level 2)	1,692,351	-
		2,617,925	-

Liabilities

Derivative liabilities (Level 2)	\$	1,895,085	\$	-
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The Company's financial instruments consisted primarily of marketable securities, accounts receivable, notes receivable, accounts payable and accrued liabilities, and debt. The Company's debt approximates fair value based upon current borrowing rates available to the Company for debt with similar maturities. The carrying amounts of the Company's financial instruments generally approximated their fair values as of September 30, 2013 and December 31, 2012, respectively, due to the short-term nature of these instruments.

**MusclePharm Corporation and Subsidiary**  
**Notes to Consolidated Financial Statements**  
**(September 30, 2013)**  
**(Unaudited)**

Due to the thinly traded nature of the underlying stock of the debt securities and derivative instrument above, the Company has classified them as Level 2 inputs, and has employed a lattice pricing model for valuation purposes. Refer to Notes 5 and 6 for further details of the valuation.

### Debt Securities

The Company classifies its investment securities as either held-to-maturity, available-for-sale or trading. The Company's debt securities are classified as available-for-sale and are carried at fair value, with the unrealized gains and losses reported in shareholders' equity under accumulated other comprehensive income (loss). See Note 5 for further discussion of the Company's debt securities.

### Revenue Recognition

The Company records revenue when all of the following have occurred: (1) persuasive evidence of an arrangement exists, (2) product has been shipped or delivered, (3) the sales price to the customer is fixed or determinable, and (4) collectability is reasonably assured.

Depending on individual customer agreements, sales are recognized either upon shipment of products to customers or upon delivery. For all of our Canadian sales, which represent 3% of total sales, recognition occurs upon shipment.

The Company has determined that advertising related credits that are granted to customers fall within the guidance of ASC No. 605-50-55 ("*Revenue Recognition*" *Customer Payments and Incentives Implementation Guidance and Illustrations*). The guidance indicates that, absent evidence of benefit to the vendor, appropriate treatment requires netting these types of payments against revenues and not expensing as advertising expense.

The Company records sales allowances and discounts as a direct reduction of sales.

Sales for the three and nine months ended September 30, 2013 and 2012 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Sales	\$ 31,080,225	\$ 20,627,691	\$ 84,519,744	\$ 58,799,563
Discounts	(5,736,257)	(2,053,965)	(11,134,551)	(8,235,817)
Sales - Net	\$ 25,343,968	\$ 18,573,726	\$ 73,385,193	\$ 50,563,746

The Company has an informal seven day right of return for products. There were nominal returns for the three and nine months ended September 30, 2013 and 2012.

For the nine months ended September 30, 2013 and 2012, the Company had the following concentrations of revenues with significant customers:

Customer	Nine Months Ended September 30,			
	2013	%	2012	%
A	28	%	39	%

B	9	%	8	%
C	5	%	10	%

**Licensing Income and Royalty Revenue**

On May 5, 2011, the Company granted an exclusive indefinite license to market, manufacture, design and sell the Company's existing apparel line. The licensee paid an initial fee of \$250,000 in June 2011, and will pay the Company a 10% net royalty based on its net income at the end of each fiscal year. To date, no royalty revenue has been earned by the Company.



**MusclePharm Corporation and Subsidiary**  
**Notes to Consolidated Financial Statements**  
**(September 30, 2013)**  
**(Unaudited)**

**Cost of Sales**

Cost of sales represents costs directly related to the production, manufacturing and freight of the Company's products.

**Shipping and Handling**

Prior to March 1, 2013 MusclePharm used a manufacturer from Tennessee to ship directly to our customers. After that date, MusclePharm took control of the shipping and began shipping products from a previously leased, 152,000 square foot distribution center in Franklin, Tennessee.

Prior to June 30, 2013, our products were transported from our manufacturer to the MusclePharm distribution center, but title did not pass from the manufacturer until loaded on the truck for shipment to the customer. As a result, MusclePharm did not take title to our products.

On July 1, 2013, the Company terminated a distribution agreement dated November 17, 2010 with one of our key product manufacturers in which the manufacturer received and fulfilled customer sales orders for a majority of our products. In connection with the termination of the agreement, the Company took control of customer order fulfillment through our Franklin, Tennessee warehouse. The facility is operated with the Company's equipment and employees.

The Company also uses a manufacturer in New York for the manufacture of one of the Company's products. These orders are typically large and heavy and are drop shipped directly to our customers at the time of order. Costs associated with these shipments are recorded in cost of sales.

For Canadian sales, the product is shipped from our Canadian warehouse to our customers. Costs associated with the shipments are recorded in cost of sales.

**Advertising and Promotion Expenses**

Advertising and promotion expenses include digital and print advertising, trade show events, athletic endorsements and sponsorships, and promotional giveaways. Advertising expenses are recognized in the month that the advertising appears while costs associated with trade show events are expensed when the event occurs. Costs related to promotional giveaways are expensed when the product is either given out at a promotional event or shipped to the customer.

A significant amount of the Company's promotional expenses results from payments under endorsement and sponsorship contracts. Accounting treatment for endorsement and sponsorship payments is based upon specific contract provisions. Generally, endorsement payments are expensed straight-line over the term of the contract after giving recognition to periodic performance compliance provisions of the contract. Prepayments made under the contracts are included in either current or long-term prepaid expenses depending on the period to which the prepayment applies.

Some of the contracts provide for contingent payments to endorsers or athletes based upon specific achievement in their sports (e.g. winning a championship). The Company records expense for these payments when the endorser achieves the specific achievement.

Advertising and promotion expense for the three and nine months ended September 30, 2013 and 2012 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Advertising	\$ 4,043,064	\$ 2,599,691	\$ 9,635,642	\$ 6,576,531

**Beneficial Conversion Feature**

For conventional convertible debt where the rate of conversion is below market value, the Company records a “beneficial conversion feature” (“BCF”) and related debt discount.

When the Company records a BCF, the relative fair value of the BCF is recorded as a debt discount against the face amount of the respective debt instrument. The discount is amortized to interest expense over the life of the debt.

**MusclePharm Corporation and Subsidiary**  
**Notes to Consolidated Financial Statements**  
**(September 30, 2013)**  
**(Unaudited)**

**Accounts payable and Accrued Liabilities**

Accounts payable and accrued liabilities consist of the Company's trade payables as well as amounts estimated by management for future liability payments that relate to the current accounting period. Management reviews these estimates periodically to determine their reasonableness and fair presentation.

**Debt**

The Company defines short term debt as any debt payment due less than one year from the date of the financial statements. Long term debt is defined as any debt payment due more than one year from the date of the financial statements. Refer to Note 7 for further disclosure of debt liabilities.

**Derivative Instruments**

Fair value accounting requires bifurcation of embedded derivative instruments such as conversion features in equity instruments and warrants granted, and measurement of their fair value. In determining the appropriate fair value, the Company uses Black-Scholes or lattice option-valuation models. In assessing the convertible equity instruments, management determines if the convertible equity instrument is conventional convertible equity and further if the beneficial conversion feature requires separate measurement.

Once derivative instruments are determined, they are adjusted to reflect fair value at the end of each reporting period. Any increase or decrease in the fair value is recorded in results of operations as an adjustment to fair value of derivatives. In addition, the fair value of freestanding derivative instruments such as warrants, are also valued using a Black-Scholes or lattice option-pricing model. Once a derivative liability ceases to exist any remaining fair value is reclassified to additional paid-in capital if redeemed or through earnings if forfeited or expired.

**Deferred Equity Costs**

The Company may pay costs related to the underwriting and offering of equity securities. These costs are treated as a reduction to equity capital raised and recorded in equity when the share issuances are recorded. Until the shares are recorded or until offering is aborted, these costs will be held on the balance sheet as a deferred asset.

**Debt Issue Costs and Debt Discount**

The Company may pay debt issue costs, and record debt discounts in connection with raising funds through the issuance of debt. These costs are amortized over the life of the debt to interest expense. If a conversion of the underlying debt occurs, a proportionate share of the unamortized amounts is immediately expensed.

**Original Issue Discount**

For certain convertible debt issued, the Company provides the debt holder with an original issue discount. The original issue discount is recorded to debt discount and additional paid-in capital at an amount not to exceed gross proceeds raised, reducing the face amount of the debt, and is amortized to interest expense over the life of the debt.

**Share-Based Payments**

Generally, all forms of share-based payments, including stock option grants, warrants and restricted stock grants and stock appreciation rights are measured at their fair value on the awards' grant date, based on estimated number of awards that are ultimately expected to vest. Share-based compensation awards issued to non-employees for services rendered are recorded at either the fair value of the services rendered or the fair value of the share-based payment, whichever is more readily determinable.

### **Earnings (loss) Per Share**

Net earnings (loss) per share is computed by dividing net income (loss) for the period by the weighted average number of shares of common stock outstanding during each period. Diluted earnings (loss) per share is computed by dividing net income (loss) for the period by the weighted average number of shares of common stock, common stock equivalents and potentially dilutive securities outstanding during each period.

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The Company uses an “if converted” method to determine whether there is a dilutive effect of outstanding option and warrant contracts. For the three months and nine months ended September 30, 2013 and 2012 the Company reflected net loss and a dilutive net loss, respectively, and the effect of considering any common stock equivalents would have been anti-dilutive for these periods. Therefore, separate computation of diluted earnings (loss) per share is not presented.

The Company has the following common stock equivalents for the nine months ended September 30, 2013 and 2012, respectively:

	Nine Months Ended September 30,	
	2013	2012
Stock options (exercise price - \$425/share)	472	1,847
Warrants (exercise price \$4 - \$1,275/share)	288,089	4,990
Convertible debt (exercise price \$17/share)	-	2,471
Total common stock equivalents	288,561	9,308

In the above table, some of the outstanding instruments from 2013 and 2012 contain ratchet provisions that would cause variability in the exercise price at the balance sheet date. As a result, common stock equivalents could change at each reporting period.

### **Foreign Currency**

MusclePharm began operations in Canada in April of 2012. The Canadian Dollar was determined to be the functional currency as the majority of the transactions related to the day to day operations of the business are exchanged in Canadian Dollars. At the end of the period, the financial results of the Canadian operation are translated into United States Dollars, which is our reporting currency, and added to the U.S. operations for consolidated company financial results. The revenue and expense items are translated using the average rate for the period and the assets and liabilities at the end of period rate. Transactions that have completed the accounting cycle and resulted in a gain or loss related to translation are recorded in realized gain or loss due to foreign currency translation under other income expense on the income statement. Transactions that have not completed their accounting cycle but appear to have gain or loss due to the translation process are recorded as unrealized gain or loss due to translation and held in the equity section on the balance sheet until such date the accounting cycle of the transaction is complete and the actual realized gain or loss is recognized.

### **Reclassification**

The Company has reclassified certain prior period amounts to conform to the current period presentation. These reclassifications had no effect on the financial position, results of operations or cash flows for the periods presented.

### **Note 3: Property and Equipment**

Property and equipment consisted of the following at September 30, 2013 and December 31, 2012:

	As of September 30, 2013	As of December 31, 2012	Estimated Useful Life
Furniture, fixtures and gym equipment	\$ 1,666,922	\$ 1,323,998	From 36 to 60 months

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Leasehold improvements	752,968	563,204	From 20 to 66 months
Vehicles	391,365	100,584	5 years
Displays	32,057	32,057	5 years
Website	11,462	11,462	3 years
Total	2,854,774	2,031,305	
Less: Accumulated depreciation and amortization	(1,185,830)	(674,941)	
	\$ 1,668,944	\$ 1,356,364	

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**Note 4: Inventory**

On July 1, 2013, the Company terminated a Distribution Agreement dated November 17, 2010 with one of our key product manufacturers in which the manufacturer received and fulfilled customer sales orders for a majority of our products as more fully discussed in the “Shipping and Handling” section of Note 2 above. In connection with the termination of the agreement, we purchased an aggregate \$4,664,421 of product inventory, and the Company took over control of customer order fulfillment through our Franklin, Tennessee warehouse.

Inventory consisted of the following at September 30, 2013 and December 31, 2012:

	As of September 30, 2013	As of December 31, 2012
Product Inventory	9,633,164	257,975

The Company reserves for obsolete and slow moving inventory based on the age of the product as determined by the expiration date. Products within one year of their expiration dates are considered for reserve purposes. Historically, we have had minimal returns, and any damaged packaging is sent back to the manufacturer for replacement. The Company has determined that an inventory reserve was immaterial as of September 30, 2013.

**Note 5: Debt Securities**

On August 26, 2013, the Company purchased, for an aggregate \$2,000,000, a secured convertible promissory note from Biozone Pharmaceuticals, Inc. (“Biozone”) (OTC:BZNE) that matures one year from the date of issuance, and certain derivative instruments (Note 6), the value of which was recorded as a discount to the note to be accreted over the note’s term. In addition, a change of control put option was identified but is not recorded as a derivative because the value was determined to be de minimus. The promissory note bears interest at a rate of 10% per annum, is convertible at any time prior to the maturity date into 10,000,000 shares of Biozone common stock at the conversion rate of \$0.20 per share, and contains certain put and call features. The Company’s ability to convert into Biozone Common Stock is restricted by a beneficial ownership limitation of 4.99% of the number of the common stock outstanding after giving effect to the issuance of common stock issuable upon conversion. This conversion limit can be changed by the Company upon at least 60 days’ notice.

The Company has classified this note as a Level 2 available-for-sale security and has engaged an independent third party firm to value the note and its embedded conversion features each reporting period. Changes in the reported value of the note will be included as a component of other comprehensive income. The note had a fair value on the purchase date of \$1,955,462, which was purchased at a \$44,538 premium. The premium has been netted against the discount of \$1,248,292 attributable to the derivative instrument and will be accreted to interest income over the stated maturity of the note. The debt security is recorded at fair value net of any recorded discount not yet accreted. As of September 30, 2013, the portion of the discount not yet accreted was \$1,132,863.

The following table summarizes the Company’s marketable securities activity for the nine months ended September 30, 2013:

	Convertible Note
FV of debt security on 8/26/13	\$ 1,955,462

Premium on purchase date	44,538
Discount for value of derivative instrument	(1,248,292)
Accretion of net discount	115,428
Unrealized gain in OCI	58,438
Balance September 30, 2013	\$ 925,574

See Note 15(c) for subsequent event related to this debt security.

**Note 6: Derivative Instrument**

In conjunction with the purchase of the convertible promissory note discussed in Note 5, the Company received a callable warrant to purchase up to 10,000,000 shares of Biozone at an exercise price of \$0.40 with an expiration date of 10 years from the date of issuance. The initial value of the warrant was \$1,248,292 and was recorded as a discount against the note. The Company's ability to exercise the warrant is limited by a beneficial ownership limitation of 4.99% of the number of the common shares outstanding in Biozone after giving effect to the exercise of the warrant.



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The Company has classified the warrant as Level 2 inputs, and engaged an independent third party firm to value the warrant. The warrant was valued using a binomial lattice pricing model where the option value is calculated using a backward induction process.

This model considers price volatility, time, and dilutive effect of exercising. The pricing model assumes a volatility of 70% at the dates of purchase and period end.

The following table summarizes the Company's derivative asset activity for the nine months ended September 30, 2013:

Balance December 31, 2012	\$-
Purchases	1,248,292
Sales	-
Realized gain (loss)	-
Unrealized gain (loss)	444,059
Balance September 30, 2013	\$1,692,351

**Note 7: Debt**

At September 30, 2013 and December 31, 2012, debt consists of the following:

	As of September 30, 2013	As of December 31, 2012
Auto loan - secured	\$ 5,856	15,380
Unsecured debt	64,600	4,452,183
Less: debt discount	-	-
Unsecured debt - net	64,600	4,452,183
Total debt	70,456	4,467,563
Less: current portion	(70,456)	(4,463,040)
Long term debt	\$ -	\$ 4,523

Debt in default of \$64,600 at September 30, 2013 and December 31, 2012 is included as a component of short-term debt.

Future annual principal payments for the above debt are as follows:

Years Ending December 31,	
2013 (3 months)	\$66,967
2014	3,489
Total annual principal payments	\$70,456

**Convertible Debt Secured - Derivative Liabilities**

During the year ended December 31, 2012, the Company issued convertible debt totaling \$519,950. The convertible debt includes the following terms:

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	Year Ended December 31, 2012
Interest Rate	8% - 10%
Default interest rate	0% - 20%
Maturity	January 3, 2012 to October 11, 2014
Conversion terms 1	100,000
Conversion terms 2	19,950
Conversion terms 3	400,000
	\$ 519,950

The debt holders are entitled, at their option, to convert all or part of the principal and accrued interest into shares of the Company's common stock at the conversion prices and terms discussed above. The Company classifies embedded conversion features in these notes as a derivative liability due to management's assessment that the Company may not have sufficient authorized number of shares of common stock required to net-share settle or due to the existence of a ratchet due to an anti-dilution provision. See Note 8 regarding accounting for derivative liabilities.

**(A) Unsecured Debt**

Unsecured debt consisted of the following activity and terms:

Balance - December 31, 2012	\$4,452,183
Repayments	(4,387,583)
Balance September 30, 2013	\$64,600

**(B) Vehicle Loan**

Vehicle loan debt consisted of the following activity and terms:

	Interest Rate	Maturity
Balance - December 31, 2012	\$ 15,380	6.99 %
Repayments	(9,524)	26 payments of \$1,008
Balance September 30, 2013	\$5,856	

**(C) Debt Issue Costs**

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During the nine months ended September 30, 2013 and September 30, 2012, the Company paid debt issue costs totaling \$0 and \$166,950, respectively.

For the year ended December 31, 2012, the Company issued 22,633 warrants as cost associated with a debt raise. The initial derivative liability value of \$427,759 was recorded as debt issue costs and derivative liability.

The following is a summary of the Company's debt issue costs for the nine months ended September 30, 2013 and year ended December 31, 2012 as follows:

	2013	2012
Debt issue costs	\$ 335,433	\$ 851,923
Accumulated amortization of debt issue costs	(335,433)	(516,490)
Debt issue costs net	\$ -	\$ 335,433

During the nine months ended September 30, 2013 and 2012, the Company amortized \$335,433 and \$286,523, respectively, in debt issue costs.

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**Note 8: Derivative Liabilities**

The Company identified conversion features embedded within consulting agreements and Series D Preferred Stock issued in 2013. The Company has determined that the features associated with the embedded conversion option should be accounted for at fair value as a derivative liability as the Company could not determine if a sufficient number of shares would be available to settle all transactions.

The fair value of the conversion feature is summarized as follows:

Derivative liability - December 31, 2012	\$-
Fair value at the commitment date for equity instruments	8,175,459
Fair value at the commitment date for warrants issued	96,913
Fair value mark to market adjustment for equity instruments	5,408,089
Fair value mark to market adjustment for warrants	58,453
Conversion instruments exercised or settled	(11,843,829)
Derivative liability September 30, 2013	\$1,895,085

The Company recorded the day 1 value of derivative contracts associated with the Series D preferred stock issuance against gross proceeds raised, and expensed immediately the remaining value of the derivative as it exceeded the gross proceeds of the offering. The Company recorded a derivative expense of \$96,913 and \$4,409,214 for the nine months ended September 30, 2013 and 2012, respectively.

The fair value at the commitment and re-measurement dates for the Company's derivative liabilities were based upon the following management assumptions:

	Commitment Date		Re-measurement Date	
Expected dividends	0	%	0	%
Expected volatility	118% - 123	%	72	%
Expected term:	1 year		1 year	
Risk free interest rate	0.14% - 0.15	%	0.10	%

**Note 9: Restricted Stock**

In November 2012, the Company granted our former Executive Vice President and Co-Chairman, Mr. John H. Bluhner, 70,589 restricted stock units through a restricted stock unit agreement. Each restricted stock unit represents a contingent right to receive one share of the Company's common stock upon vesting. The value of this award at the grant date was \$245,400 and will be amortized over the vesting periods such that each tranche of restricted stock units will be fully amortized at the date of vesting. The restricted stock units vest in one tranche of 23,529 on January 1, 2013 and two tranches of 23,530 shares on January 1, 2014 and December 1, 2014. As of September 30, 2013, 23,529 restricted stock units have vested and the unamortized portion of this award is \$102,418. See Note 15(A) for further discussion on Mr. Bluhner's rights to receive restricted stock pursuant to his separation agreement.

In November 2012, the Company granted the Chief Financial Officer, Mr. L. Gary Davis, 58,824 restricted stock units through a restricted stock unit agreement. Each restricted stock unit represents a contingent right to receive one share of the Company's common stock upon vesting. The value of this award at the grant date was \$204,500 and will be

amortized over the vesting periods such that each tranche of restricted stock units will be fully amortized at the date of vesting. The restricted stock units vest in three tranches of 19,608 shares each on January 1, 2013 and 2014, and December 1, 2014. As of September 30, 2013, 19,608 restricted stock units have vested and the unamortized portion of this award is \$85,348.

In June 2013, the Company approved a restricted stock award to certain key employees, officers and directors for 1,550,000 cumulative shares. The awarded shares were issued upon the award's approval with ownership rights to be conveyed upon vesting. The value of this award at the grant date was \$17,065,500. Of these shares, the Company estimates that 1,500,200 shares will fully vest for a total value of \$16,517,202. This amount will be amortized over the vesting periods such that each tranche's estimated shares of restricted stock will be fully amortized at the dates of vesting. The Company will periodically review this estimate for reasonableness and make adjustments as appropriate. The award vests in two tranches with 17% vesting December 31, 2013 and the remaining 83% vesting December 31, 2015 with the exception of certain executives under employment agreements that terminate prior to December 31, 2015. These awards will be amortized over the remaining term of their employment agreements. As of September 30, 2013, zero shares have vested, 2,500 shares have been returned and the unamortized portion of this award is \$15,066,634.

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Total compensation expense for these awards recognized during the nine months ended September 30, 2013 was \$1,588,068 and is included in General and Administrative expenses.

**Note 10: Stockholders' Equity**

The Company has three and four separate series of authorized preferred stock at September 30, 2013 and December 31, 2012, respectively:

On November 26, 2012, the Company (i) effected a 1-for-850 reverse stock split of our common stock, including a proportionate reduction in the number of authorized shares of our common stock from 2.36 billion shares to 2.8 million shares of common stock, and (ii) amended our articles of incorporation to increase the number of authorized shares of common stock (post reverse stock split) from 2,941,177 to 100 million effective November 27, 2012. All share and per share amounts in this document have been changed to give effect to the reverse stock split.

**(A) Series A Convertible Preferred Stock**

This class of stock has the following provisions:

Non-voting,  
No rights to dividends,  
No liquidation value, and  
Convertible into 200 shares of common stock.

**(B) Series B Preferred Stock (Related Parties)**

In August 2011, the Company issued an aggregate of 51 shares of Series B Preferred Stock to two of its officers. The Company accounted for the share issuance at par value as there was no future economic value that could be associated with the issuance. In September 2013, the outstanding 51 shares of Series B Preferred Stock were returned to the Company and retired. Pursuant to the certificate of designation, these shares were added back to general preferred stock pool upon their surrender and are not available for reissuance as Series B Preferred Stock without a new designation.

This class of stock has the following provisions:

- Voting rights entitling the holders to an aggregate 51% voting control,
- No rights to dividends,
- Stated value of \$0.001 per share,
- Liquidation rights entitle the receipt of net assets on a pro-rata basis with the holders of our common stock, and
- Non-convertible.

**(C) Series C Convertible Preferred Stock**

In October 2011, the Company issued 190 shares of Series C Convertible Preferred Stock, having a fair value of \$190,000. Of the total shares issued, 100 shares were issued for \$100,000 (\$1,000 / share). The remaining 90 shares

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were issued for services rendered having a fair value of \$90,000 (\$1,000 / share), based upon the stated value per share. In March 2012, all 190 shares were converted into 22,353 shares of the Company's common stock at a conversion price of \$0.0085 per share and a loss of \$614,984.



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This class of stock has the following provisions:

- Stated Value - \$1,000 per share,
- Non-voting,
- Liquidation rights entitle an amount equal to the stated value, plus any accrued and unpaid dividends,
- As long as any Series C, Convertible Preferred Stock is outstanding, the Company is prohibited from executing various corporate actions without the majority consent of the holders of Series C, Convertible Preferred Stockholders authorization; and
- Convertible at the higher of (a) \$0.01 or (b) such price that is a 50% discount to market using the average of the low two closing bid prices, five days preceding conversion.

Due to the existence of an option to convert at a variable amount, the Company treated this series of preferred stock as a derivative liability due to the potential for settlement in a variable quantity of shares. Additionally, the Company computed the fair value of the derivative liability at the commitment date and re-measurement date, which was \$293 and \$175, respectively, using the Black-Scholes assumptions below. This transaction is analogous to a dividend with a direct charge to retained earnings.

**(D) Series D Convertible Preferred Stock**

In January 2013 the board of directors authorized 1,600,000 shares of Series D convertible preferred stock. Between January 16, 2013 and February 4, 2013, the Company entered into separate subscription agreements with certain investors in connection with the offering, pursuant to which the Company sold an aggregate of 1,500,000 shares of Preferred Stock for aggregate gross proceeds of approximately \$12 million. Pursuant to the Certificate of Designation of the Series D Convertible Preferred Stock filed with the Nevada Secretary of State on January 11, 2013 (the "Certificate of Designation"), each share of Preferred Stock is convertible into two shares of common stock, subject to adjustment as set forth in the Certificate of Designation.

The shares of Series D have the following provisions:

- Voting rights based on number of common shares of conversion option;
- Initially no rights to dividends;
- Liquidation rights entitle an amount equal to the stated value, plus any accrued and unpaid dividends; and
- Convertible into 2 shares of common stock, subject to adjustment.

**(E) Common Stock**

During the nine months ended September 30, 2013, the Company issued the following common stock:

Transaction Type	Quantity (#)	Valuation (\$)	Range of Value per Share (\$)	
Conversion of Series D preferred stock to common stock	2,712,000	11,688,642	2.80	7.54
Cash and warrants	1,191,332	10,559,332	8.26	10.50
Executive/Board of Director compensation	71,664	302,379	3.48	6.00

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Stock issued for services and to settle liabilities	2,162,511	19,796,250	4.02	12.99
Total	6,137,507	42,346,603	2.80	12.99

The fair value of all stock issuances above is based upon either the quoted closing trading price on the date of issuance, the value of derivative instrument at the date of conversion, contract value where the fair value was stated by the contract, or net proceeds from capital raised after giving effect to the cost of capital raised.

**(F) Stock Options**

The Company applied fair value accounting for all shares based payments awards. The fair value of each option granted is estimated on the date of grant using the Black-Scholes option-valuation model. The Black-Scholes assumptions used when the options were issued in the year ended December 31, 2010 are as follows:

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Exercise price	\$425	
Expected dividends	0	%
Expected volatility	74.8	%
Risk free interest rate	1.4	%
Expected life of option	5 years	
Expected forfeiture	0	%

The following is a summary of the Company's stock option activity:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Balance December 31, 2012	1,847	\$ 425.00	2.25 years	-
Granted	-			
Exercised	-			
Forfeited/Cancelled	(1,375)	\$ 425.00		
Balance September 30, 2013 outstanding	472	\$ 425.00	1.50 years	-
Balance September 30, 2013 exercisable	472	\$ 425.00	1.50 years	-
Outstanding options held by related parties 2013	-			
Exercisable options held by related parties 2013	-			

**(G) Stock Warrants**

All warrants issued during the nine months ended September 30, 2013 were accounted for as derivative liabilities. See Note 8.

During the nine months ended September 30, 2013, the Company entered into convertible equity agreements. As part of these agreements, the Company issued warrants to convert 1,500,000 shares of Series D preferred stock into 3,000,000 shares of common stock.

A summary of warrant activity for the Company for the nine months ended September 30, 2013 is as follows:

	Number of Warrants	Weighted Average Exercise Price
Outstanding December 31, 2012	89	\$ 1,275
Granted	3,040,000	4.09
Exercised/settled	(2,752,000)	4.09
Balance as September 30, 2013	288,089	\$ 4.39

Warrants Outstanding		Warrants Exercisable				
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price	Intrinsic Value
\$4 - \$1,275	288,089	1.00	\$ 4.39	288,089	\$ 4.39	1,726,845

**(H) Treasury Stock**

During the nine months ended September 30, 2013, the Company repurchased 18,825 shares of its common stock for the total sum of \$260,000 as part of a settlement. Of this amount, \$103,537 or \$5.50 per share was considered repurchase of securities and \$156,463 was recorded as a loss on settlement. The Company records the value of its common stock held in treasury at cost. The Company has not cancelled or retired these shares, and they remain available for reissuance. The Company has a stock repurchase plan in place but has suspended it indefinitely.

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**(I) Consulting Agreement**

On July 19, 2012, the Company entered into consulting agreements with two outside consulting firms to provide services related to the capital restructuring of the Company. These agreements were subsequently amended in March of 2013 and again in April of the same year. During the three and nine month period ended September 30, 2013, the Company recognized expense related to the GRQ and Melechdavid agreements of \$423,261 and \$7,015,076, respectively which are classified under Professional and R&D fees in the Consolidated Statement of Operations. The Company's obligations under the GRQ and Melechdavid agreements were completely satisfied as of July 12, 2013 and the agreements have not been renewed or extended.

**Note 11: Commitments, Contingencies and Other Matters**

**(A) Operating Lease**

The Company has various non-cancelable leases with terms expiring through 2017.

Future minimum annual lease payments for the above leases are approximately as follows:

Years Ending December 31,	
2013 (3 months)	\$ 130,987
2014	569,618
2015	391,069
2016	79,860
2017	19,965
Total minimum lease payments	\$ 1,191,499

Rent expense for the nine months ended September 30, 2013 and 2012, was \$446,943 and \$231,560, respectively.

**(B) Capital Leases**

In August 2013, Company entered into a lease agreement for the lease of certain equipment to be used by the Company. The agreement stipulates 36 monthly payments of \$410.24 and provides for an automatic transfer of ownership at lease end. The interest rate implicit in this lease is 9.5%.

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As of September 30, 2013 and December 31, 2012, the Company had an outstanding balance on capital leases of \$11,440, and \$0, respectively. Future minimum lease payments are as follows:

Years Ending December 31,	
2013 (3 months)	\$ 1,231
2014	4,923
2015	4,923
2016	3,282
Total minimum lease payments	\$ 14,359

**(C) Legal Matters**

From time to time, the Company is or may become involved in various legal proceedings that arise in the ordinary course of business or otherwise. Legal proceedings are subject to inherent uncertainties as to timing, outcomes, costs, expenses and time expenditures by the Company's management and others on behalf of the Company. Although there can be no assurance, based on information currently available the Company's management believes that the outcome of legal proceedings that are pending or threatened against the Company will not have a material effect on the Company's financial condition. However, the outcome of any of these matters is neither probable nor reasonably estimable.

As of September 30, 2013, the Company was a party defendant in the following legal proceedings, each of which the Company: (a) believes is without merit; and (b) intends to defend vigorously:

*The Tawnsaura Group, LLC v MusclePharm Corporation, Case No: 8:12-cv-01476-JVS-RNB in the United States District Court for the Central District of California.* Date instituted: September 12, 2012. Plaintiff alleges patent infringement for MusclePharm's use of Citrulline Malate in its products. To date, Plaintiff has filed against over 70 different manufacturers of dietary supplements and sports nutrition products. MusclePharm is part of a joint defense group and believes this case is without merit due to the existence of prior art. The Company reached a settlement with the Tawnsaura Group effective October 1, 2013 for \$5,000. This settlement is included in General and administrative expenses in the Consolidated Statement of Operations.

· *William Bossung and Bishop Equity Partners LLC v. MusclePharm Corporation,* Clark County, Nevada District Court. Date instituted: January 17, 2012. Plaintiff alleges that additional monetary payments are due in respect of a settlement for outstanding warrants. The Company reached a settlement with William Bossung and Bishop Equity Partners LLC effective September 30, 2013 for 25,000 shares of fully vested restricted shares of MusclePharm Common Stock. The full value of the settlement of \$255,500 is included in General and administrative expense in the Consolidated Statement of Operations.

*Nageen Dehesh v MusclePharm Corporation, Case No: SC120793 in the Superior Court of the State of California, County of Los Angeles West District.* Date instituted: May 30, 2012. Plaintiff alleges she is owed payment for introducing MusclePharm to investors and/or raising capital. Plaintiff is not a licensed broker dealer and there was no agreement between the parties.

In July 2013 Harcol sent written correspondence to MusclePharm alleging infringement of a certain patent by MusclePharm and was contemplating legal action against the Company. MusclePharm denies any infringement of the patent in question, and in an effort to avoid the risk and expense of litigation, reached a settlement with Harcol effective October 1, 2013. The settlement provided for a payment of \$65,000 in exchange for an exclusive, perpetual, irrevocable, fully-paid up, royalty free license under the patent in question. The payment of \$65,000 is included as a component of General and Administrative expenses in the Consolidated Statement of Operations.

**(D) Payroll Taxes**

As of September 30, 2013, accounts payable and accrued expenses included \$78,081 pertaining to accrued payroll taxes. The taxes represent employee withholdings that have yet to be remitted to the taxing agencies.

**(E) Product Liability**

As a manufacturer of nutritional supplements and other consumer products that are ingested by consumers, the Company may be subject to various product liability claims. Although we have not had any material claims to date, it is possible that current and future product liability claims could have a material adverse effect on our business or financial condition, results of operations or cash flows. The Company currently maintains product liability insurance with a deductible/retention of \$10,000 per claim with an aggregate cap on retained loss of \$5,000,000. At September 30, 2013, the Company had not recorded any accruals for product liability claims.

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**Notes to Consolidated Financial Statements**  
**(September 30, 2013)**  
**(Unaudited)**

**(F) Other Liabilities and Regulatory Matters**

Subsequent to December 31, 2012, the Company determined that it may have potential liabilities related to the filing of certain informational returns required by governmental authorities. Management has developed a plan to address these matters and does not currently expect a significant adverse impact on its financial position or results of operations.

**(G) W-2 Correction**

In 2012, the Company issued three executives stock as part of their performance based compensation. This compensation was not included in their 2012 earnings and the Company is now preparing to correct this matter by issuing revised Form W-2 earnings statements to each of these executives related to the 2012 stock compensation. No determination can be made as to the impact this will have on the Company, but is believed to be immaterial.

**(H) SEC Investigation**

The Company, following requests for information received by MusclePharm from the Denver Regional Office of the Securities and Exchange Commission (the "Staff"), is reviewing its reports for the 2010 and 2011 fiscal years, which were included in financial statements issued for the 2010 and 2011 fiscal years. The Company and its auditors for the fiscal years 2010 and 2011 have voluntarily provided information to the Staff and are cooperating with Staff requests. The principal areas of the Company's internal review relate to internal controls, disclosures of related party transactions, settlements of claims including share issuances, executive compensation, and disclosure of perquisites. The Company was recently informed that the Staff has issued a formal order of investigation of the Company. There can be no assurance that these are the only subject matters of concern, what the nature or amounts in question will be, or that these are the only periods under review.

**Note 12: Defined Contribution Plan**

The Company established a 401(k) Plan (the "401(k) Plan") for eligible employees of the Company. Generally, all employees of the Company who are at least twenty-one years of age and who have completed one year of entry service are eligible to participate in the 401(k) Plan. The 401(k) Plan is a defined contribution plan that provides that participants may make voluntary salary deferral contributions, on a pretax basis, of up to \$17,500 for 2013 (subject to make-up contributions) in the form of voluntary payroll deductions. The Company may make discretionary contributions. During the nine months ended September 30, 2013 and 2012 the Company's matching contribution was \$44,940 and \$34,313, respectively.

**Note 13: Related Party Transactions**

The Chief Executive Officer of one of our major customers is the brother of our President of Sales and Marketing. Our Chief Financial Officer also indirectly owns 1.75% of the Chief Executive Officer's equity interest in such customer. We do not offer preferential pricing of our products to this customer based on these relationships.

On August 26, 2013, we entered into a Securities Purchase Agreement with BioZone Pharmaceuticals, Inc. ("Biozone") pursuant to which we bought (i) \$2,000,000 of a 10% secured convertible promissory notes (the "Note") and (ii) a warrant to purchase 10,000,000 shares of the Seller's common stock, at an exercise price of \$0.40 per share, for an



aggregate purchase price of \$2,000,000. Dr. Phillip Frost, a significant investor in the Company and a member of its scientific advisory board, is the Chairman and CEO of OPKO Health, Inc. (“OPKO”), and is the trustee of Frost Gamma Investments Trust (“Frost Gamma”). Each of Dr. Frost, OPKO, and Frost Gamma are significant shareholders in Biozone.

**Note 14: Endorsement Agreement**

On July 26, 2013, the Company entered into an Endorsement Licensing and Co-Branding Agreement by and among, the Company, Arnold Schwarzenegger, Marine MP, LLC, and Fitness Publications, Inc. Under the terms of the Agreement, Mr. Arnold Schwarzenegger will endorse the Company’s products and a special Arnold Schwarzenegger product line of between 4 and 8 products will be marketed under Mr. Schwarzenegger’s name and likeness.

**MusclePharm Corporation and Subsidiary**  
**Notes to Consolidated Financial Statements**  
**(September 30, 2013)**  
**(Unaudited)**

As part of this agreement, the Company is obligated to make minimum royalty payments until sales meet certain pre-determined thresholds at which time the Company will pay a percentage of net sales of the Arnold product line. For the three months and nine month's ended September 30, 2013, the company recognized \$3,680,504 in net sales of the Arnold product line, which did not meet the minimum sales threshold for royalty payments. For the three and nine month's ended September 30, 2013, the Company recognized \$365,591 of expense for minimum royalties under the agreement. Payments for minimum royalty payments are included as a component of Advertising and promotion expense in the Consolidated Statement of Operations. Future payments in excess of the minimum royalty will be recorded as a component of Cost of Goods Sold.

In connection with this agreement, the Company also issued Marine MP, LLC 780,000 fully vested restricted shares of common stock. As of September 30, 2013, the amount of unamortized stock compensation expense related to this agreement was \$8,018,400. The current and non-current portions of this unamortized stock compensation is included as a component of Prepaid Stock Compensation in the Consolidated Balance Sheet.

**Note 15: Subsequent Events**

**(A) Board of Directors and Corporate Officer Changes**

On October 16, 2013, the Company hired Sydney Rollock as our Chief Marketing Officer. There is no family relationship between Mr. Rollock and any of our other officers and directors. There are no understandings or arrangements between Mr. Rollock and any other person pursuant to which Mr. Rollock was selected as an officer.

On October 17, 2013, Mr. John H. Blucher resigned his position as Executive Vice President of the Company. Mr. Blucher will continue to serve on the Company's Board of Directors until December 31, 2013.

Simultaneously with Mr. Blucher's resignation as an employee of the Company, Mr. Blucher and the Company entered into a Separation and Release of Claims Agreement pursuant to which Mr. Blucher ended his employment with the Company. Pursuant to the Release Agreement, Mr. Blucher shall receive (i) all unpaid base salary plus unused vacation time, (ii) \$150,000, (iii) reimbursement for group health insurance for 12 months, and (iv) all unvested restricted stock units owned by Mr. Blucher pursuant to a previously executed RSU Agreement and previously executed Restricted Stock Agreements (as both are defined the Release Agreement) in exchange for releasing and discharging the Company and its affiliates and subsidiaries from any and all claims of any kind arising out of, or related to, his employment and separation from employment with the Company.

Mr. Blucher's resignation was not as a result of any disagreements with the Company's operations, policies or practices.

**(B) Related Party Transactions**

On October 16, 2013, the Company entered into an office lease agreement with Frost Real Estate Holdings, LLC, a Florida limited liability company owned by Dr. Phillip Frost. Pursuant to the lease, the Company will rent 1,437 square feet of office space in Florida for an initial term of three years, with an option to renew for an additional three year term. Total lease commitments under the initial term of the lease are \$142,923.

**(C) Note Conversion**

On October 24, 2013, the Company converted \$1,000,000 of the convertible note (discussed in Note 5) into 5,000,000 shares of Biozone common stock. Additionally, Biozone repaid the remaining principal balance and approximately \$32,000 in interest to the Company.

**(D) Biozone Acquisition**

On November 12, 2013 the Company's newly formed wholly-owned subsidiary, Biozone Laboratories, Ltd., entered into an asset purchase agreement ("APA") with BioZone Pharmaceuticals, Inc., pursuant to which the company acquired all assets associated with QuSomes, Intense C Serum PM and EquaSomes drug delivery technology and the name "Biozone". The closing of the purchase of the Seller's assets is subject to certain conditions precedent including delivery of a fairness opinion to the Company and the Seller by their respective financial advisors, and the Seller's shareholders' approval of the transaction and is expected to occur prior to December 31, 2013.

**(E) Security Purchases and Sales**

On November 7, 2013, the Company purchased, from Fuse Science, Inc. (OTCBB:DROP) ("Fuse"): (i) a 10% senior secured convertible promissory note in the principal amount of \$200,000 to mature 60 days after issuance, and (ii) warrants to purchase 6,666,000 shares of Fuse common stock at an exercise price of \$0.06 per share.

In November, the Company sold an aggregate of 1,000,000 shares of common stock in Biozone Laboratories, Ltd. for gross proceeds \$1,500,000.



significant part of our sales for the foreseeable future.

We started formulating our nutritional supplements in 2008 for consumption by active individuals, high performance athletes and fitness enthusiasts. We launched our sales and marketing programs in late 2008 through our internal sales executives and staff targeting specialty retail distributors.

Our wide-range variety of nutritional supplements, include Assault<sup>®</sup>, Combat Powder<sup>®</sup>, MusclePharm MuscleGel<sup>®</sup>, MusclePharm Shred Matrix<sup>®</sup>, and Re-Con<sup>®</sup>. These products are comprised of amino acids, herbs, and proteins tested by our scientists for the overall health of athletes. We developed these nutritional supplements to enhance the effects of workouts, repair muscles, and nourish the body for optimal physical fitness.

### **Our Growth and Core Marketing Strategy**

Our primary growth strategy is to:

- increase our product distribution and sales through increased market penetrations both domestically and internationally;
- increase our margins by focusing on streamlining our operations and seeking operating efficiencies in all areas of our operations;

- continue to conduct additional testing of the safety and efficacy of our products and formulate new products; and
- increase awareness of our products by increasing our marketing and branding opportunities through endorsements, sponsorships and brand extensions.

Our core marketing strategy is to brand MusclePharm as the “must have” fitness brand for workout enthusiasts and elite athletes. We seek to be known as the athlete’s company, run by athletes who create their products for other athletes both professional and otherwise. We believe that our marketing mix of endorsers, sponsorships and providing sample products for our retail resellers to use is an optimal strategy to increase sales.

## Results of Operations

### For the Three Months Ended September 30, 2013 and 2012 (unaudited):

	Three Months Ended September 30,	
	2013	2012
Sales - gross	\$ 31,080,225	\$ 20,627,691
Discounts and sales allowances	(5,736,257)	(2,053,965)
Sales - net	25,343,968	18,573,726
Cost of sales	17,937,768	14,507,761
Gross profit	7,406,200	4,065,965
Operating expenses	12,278,980	7,876,778
Loss from operations	(4,872,780)	(3,810,813)
Other income (expense)	926,944	(2,263,224)
Net (Loss) Income	\$ (3,945,836)	\$ (6,074,037 )
Net (loss) income per share - basic and diluted	\$ (0.47)	\$ (3.21 )
Weighted average number of common shares outstanding during the period basic and diluted	8,475,084	1,894,202

### *Sales - gross*

Gross sales increased approximately \$10.5 million or 51% to \$31,080,000 for the three months ended September 30, 2013, compared to \$20,628,000 for the three months ended September 30, 2012. The increase in sales was a result of the Company hiring experienced sales managers, penetrating new markets, developing new product lines and hiring strategic planning individuals to measure the efforts of marketing our product brand. The Company has added new distribution channels and products in an effort to expand our customer base. Since inception, the Company has focused on an aggressive marketing plan to penetrate the market domestically and internationally. As such, significant promotional expenditures have been made to increase product sales through adding new customers and expanding our product line.

In this quarter the Company entered into an Endorsement Licensing and Co-Branding agreement by and between Arnold Schwarzenegger, Marine MP, LLC, and Fitness Publications, Inc. Under the terms of the agreement Mr. Arnold Schwarzenegger will endorse the Company’s products and a special Arnold Schwarzenegger product line, which will be marketed under Mr. Schwarzenegger’s name and likeness. The product line was launched this quarter and accounted for approximately \$3.7 million of gross sales. We believe we will continue to build on the strong sales realized in third quarter, and that the Arnold product line will account for a larger portion of our gross sales going forward. As part of the agreement, the Company must make minimum royalty payments until sales meet certain pre-determined thresholds at which time the Company will pay a percentage of net sales of the Arnold product line.

Payments for minimum royalty payments are included as a component of Advertising and Promotion in the Consolidated Statement of Operations. Future payments in excess of the minimum royalty will be recorded as a component of Cost of Goods Sold.

We have also realized continued growth in our FitMiss product line, which was launched in second quarter. The momentum is beginning to show increasing sales for this new product line, and accounted for approximately \$982,000 of gross sales. The Company believes it has a good position for market share with a women's line of products. The Company is also considering other new products. Overall as a direct result of our aggressive marketing plan, our products are currently being offered in more retail stores, both domestically and internationally, receiving better shelf placement, and receiving recognized awards compared to the prior period.

At the 2013 Bodybuilding.com Supplement Awards, we received seven Awards of Excellence; (i) the “Recovery Supplement of the Year” award and “Amino Supplement of the Year” award for our Amino 1 products, (ii) the “Best Packaging of the Year” award, (iii) the “Men’s Support Supplement of the Year” award for our Battle Fuel XT product, (iv) the “Glutamine Supplement of the Year” award for our Glutamine product, (v) the “RTD Supplement of the Year” award for our MuscleGel product, (vi) and “Clothing Brand of the Year” for our MusclePharm Sportswear products, and MusclePharm remains the product of choice for the Ultimate Fighting Championship, UFC.

***Discounts and sales allowances***

Discounts and sales allowances for the three months ended September 30, 2013 increased to approximately \$5,736,000 or 18.5% of gross sales as compared to \$2,054,000 or 10.0% of gross sales for the three months ended September 30, 2012. This increase in discounts and allowances is primarily related to our campaign to close out and sell the remainder of our old Assault products due to the launch of our new pre-workout Assault formulation during the quarter. This Assault campaign resulted in additional discounts and sales allowances of approximately \$1,880,000, which represents 32.8% of the total discounts for the quarter.

***Sales - net***

Net sales increased approximately \$6.8 million or 36% to \$25,344,000 for the three months ended September 30, 2013, compared to \$18,574,000 for the three months ended September 30, 2012. A significant growth area for the Company was nutritional product sales in international markets. International sales are included in the results of operations and increased approximately \$1.7 million or 28% to \$7,891,000 for the three months ended September 30, 2013, compared to \$6,165,000 for the three months ended September 30, 2012.

***Gross Profit***

Gross profit increased approximately \$3.3 million or 82% to \$7,406,000 for the three months ended September 30, 2013, compared to \$4,066,000 for the three months ended September 30, 2012. The gross profit percentage increased to approximately 29% of net sales during the three months ended September 30, 2013, from 22% for the three months ended September 30, 2012. This increase was primarily due to new product pricing from our Tennessee manufacturer, taking over our own order fulfillment effective July 1, 2013, and the reduction of shipping costs. As discussed in Note 2 of the financial statements, the Company is handling its own shipping and has decreased the cost to ship product to the customer thereby increasing gross profit. Shipping expense for the three months ended September 30, 2013 was 2.4% of net sales down from 3.3% of net sales for the three months ended September 30, 2012.

We have experienced a decrease in cost of goods sold as a result of improved product pricing. For the three months ended September 30, 2013 the cost of goods as a percentage to sales was 58% compared to the three months ended September 30, 2012 of 70%. We expect to focus on streamlining our operations and seek operating efficiencies in order to further improve our gross profit percentage.

***Operating Expenses***

Operating expenses for the three months ended September 30, 2013, increased to approximately \$12,279,000, compared to approximately \$7,877,000 for the three months ended September 30, 2012 a 56% increase. Part of the reason for this increase in Operating expenses were non-cash expenses totaling \$4,241,339 as summarized in the table below.

Three months ended September 30,	2013
Professional fee stock compensation amortization	\$2,039,322
Depreciation expense	178,316



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Non-cash legal settlement expense	260,000
Legal fee accrual	250,000
Employee & director restricted stock amortization	1,513,701
	\$4,241,339

The 51% increase in sales necessitated increases in our operating expenses and included \$1,443,000 in the area of advertising and promotions used to promote brand and product awareness. We expect as we continue to promote our brand and products, these areas and levels of promotion will hold steady or increase relative to overall efforts to increase product awareness and sales.

Another area of increase is salaries and benefit expenses of \$2,615,000. Our 51% increase in sales necessitated increases in staffing in sales, finance and operations to help support the Company's growth.

The \$4.4 million increase in operating expenses including the significant items listed above were partially offset by the decrease of \$452,000 in professional fees.

The following table provides an overview of expense categories and percentage of net revenue:

	Three Months Ended September 30,					
	2013	% of Revenue		2012	% of Revenue	
Advertising expense	\$ 4,043,064	15.95	%	\$ 2,599,691	14.00	%
General and administrative expense	1,936,610	7.64	%	1,141,435	6.15	%
Professional & R&D expense	2,429,361	9.59	%	2,881,235	15.51	%
Salary and wage expense	3,869,945	15.27	%	1,254,417	6.75	%
Total operating expenses	\$ 12,278,980	48.45	%	\$ 7,876,778	42.41	%

***Loss from Operations***

The net loss from operations for the three months ended September 30, 2013, was approximately \$4,873,000, compared to a net loss from operations of approximately \$3,811,000 for the three months ended September 30, 2012.

***Other Income (Expenses)***

Other income was \$927,000 for the three months ended September 30, 2013, compared to net expense of \$2,263,000 for the three months ended September 30, 2012. Refer to Note 8 for further detail of costs related to derivative agreements.

	Three Months Ended September 30,	
	2013	2012
Derivative expense	\$ -	\$ (1,922,763)
Change in fair value of derivative liabilities	\$ 305,421	\$ 4,403,875
Gain (loss) on settlement of accounts payable and debt	\$ 67,489	\$ (1,510,613)
Gain on marketable securities	\$ 444,059	\$ -
Accretion of note discount	\$ 115,429	\$ -
Interest expense	\$ (1,302)	\$ (3,265,053)
Other (expense) income	\$ (4,152)	\$ 31,330
Total other income (expense)	\$ 926,944	\$ (2,263,224)

***Net Loss***

For the foregoing reasons, we had a net loss of approximately \$3,946,000 for the three months ended September 30, 2013, compared to net loss of approximately \$6,074,000 for the three months ended September 30, 2012.

Inflation did not have a material impact on our operations for the period. Other than the foregoing, management knows of no trends, demands, or uncertainties that are reasonably likely to have a material impact on our results of operations.

**For the Nine Months Ended September 30, 2013 and 2012 (unaudited):**

Nine Months Ended September 30,	
2013	2012

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Sales - gross	\$	84,519,744	\$	58,799,563
Discounts and sales allowances		(11,134,551)		(8,235,818)
Sales - net		73,385,193		50,563,746
Cost of sales		49,900,891		40,345,528
Gross profit		23,484,302		10,218,218
Operating expenses		31,819,494		16,420,665
Loss from operations		(8,335,192)		(6,202,447)
Other income (expenses) - net		(5,394,435)		(9,724,979)
Net Loss	\$	(13,729,627)	\$	(15,927,426)
Net loss per share - basic and diluted	\$	(2.07)	\$	(9.62)
Weighted average number of common shares outstanding during the period basic and diluted		6,626,125		1,656,218

***Sales - gross***

Gross sales increased approximately \$25.7 million or 44% to \$84,520,000 for the nine months ended September 30, 2013, compared to \$58,800,000 for the nine months ended September 30, 2012. The increase in sales was due primarily to increased awareness of our product brand, combined with hiring additional sales and marketing staff, and adding new products in an effort to expand our customer base. Since inception, we have focused on an aggressive marketing plan to penetrate the market. As such, significant promotional expenditures have been made to increase product sales through adding new customers and expanding our product line.

During third quarter the Company entered into an Endorsement Licensing and Co-Branding agreement by and between Arnold Schwarzenegger, Marine MP, LLC, and Fitness Publications, Inc. Under the terms of the agreement Mr. Arnold Schwarzenegger will endorse the Company's products and a special Arnold Schwarzenegger product line, which will be marketed under Mr. Schwarzenegger's name and likeness. The product line was launched during third quarter and accounted for approximately \$3.7 million gross sales. We believe we will continue to build on the strong sales realized in third quarter, and that the Arnold product line will account for a larger portion of our gross sales going forward. As part of the agreement, the Company must make minimum royalty payments until sales meet certain pre-determined thresholds at which time the Company will pay a percentage of net sales of the Arnold product line. Payments for minimum royalty payments are included as a component of Advertising and Promotion in the Consolidated Statement of Operations. Future payments in excess of the minimum royalty will be recorded as a component of Cost of Goods Sold.

We have also realized continued growth in our FitMiss product line, which was launched in second quarter. The momentum is beginning to show increasing sales for this new product line, and accounted for \$1,418,000 of gross sales. The Company believes it has a good position for market share with a women's line of products. The Company is also considering other new products. Overall as a direct result of our aggressive marketing plan, our products are currently being offered in more retail stores, both domestically and internationally, receiving better shelf placement, and receiving recognized awards compared to the prior period.

At the 2013 Bodybuilding.com Supplement Awards, we received seven Awards of Excellence; (i) the "Recovery Supplement of the Year" award and "Amino Supplement of the Year" award for our Amino 1 products, (ii) the "Best Packaging of the Year" award, (iii) the "Men's Support Supplement of the Year" award for our Battle Fuel XT product, (iv) the "Glutamine Supplement of the Year" award for our Glutamine product, (v) the "RTD Supplement of the Year" award for our MuscleGel product, (vi) and "Clothing Brand of the Year" for our MusclePharm Sportswear products, and MusclePharm remains the product of choice for the Ultimate Fighting Championship, UFC.

***Discounts and sales allowances***

Discounts and sales allowances for the nine months ended September 30, 2013 decreased to approximately \$11,135,000 or 13.2% of gross sales as compared to \$8,234,000 or 14.0% of gross sales for the nine months ended September 30, 2012. This decrease in discounts and allowances is a result driven by continued efforts to place controls around discounting and greater efforts to define customer terms and allowances.

***Sales - net***

Net sales increased approximately \$22,800,000 million or 45% to \$73,385,000 for the nine months ended September 30, 2013, compared to \$50,564,000 for the nine months ended September 30, 2012. A significant growth area for the Company was nutritional product sales in international markets. International sales are included in the results of operations and increased approximately \$8.4 million or 54% to \$24,045,000 for the nine months ended September 30, 2013, compared to \$15,620,000 for the nine months ended September 30, 2012.

***Gross Profit***

Gross profit increased approximately \$13.3 million or 130% to \$23,484,000 for the nine months ended September 30, 2013, compared to \$10,218,000 for the nine months ended September 30, 2012. The gross profit percentage increased to approximately 32% of net sales during the nine months ended September 30, 2013, from 20% for the nine months ended September 30, 2012. This increase was primarily due to the reduction in discounts as a percentage of sales, new product pricing from our Tennessee manufacturer, taking over our own order fulfillment effective July 1, 2013, and the reduction of shipping costs. As discussed in Note 2 of the financial statements, the Company is handling its own shipping and has decreased the cost to ship product to the customer thereby increasing gross profit. Shipping expense for the nine months ended September 30, 2013 was 2.3% of net sales down from 3.3% of net sales for the nine months ended September 30, 2012.

For the nine months ended September 30, 2013 the discounts as a percentage of gross sales was 13.2% compared to the nine months ended September 30, 2012 of 14%. We have also experienced a decrease in cost of goods sold as a result of improved product pricing For the nine months ended September 30, 2013 the cost of goods as a percentage to sales was 59% compared to the nine months ended September 30, 2012 of 69%. We expect to focus on streamlining our operations and seek operating efficiencies in order to further improve our gross profit percentage.

### ***Operating Expenses***

Operating expenses for the nine months ended September 30, 2013, increased to approximately \$31,819,000, compared to approximately \$16,421,000 for the nine months ended September 30, 2012, a 94% increase. Part of the reason for this increase in Operating expenses were non-cash expenses totaling \$11,641,911 as summarized in the table below.

Nine months ended September 30,	2013
Professional fee stock compensation amortization	\$8,938,834
Depreciation expense	511,699
Non-cash legal settlement expense	320,000
Legal fee accrual	250,000
Employee & director restricted stock amortization	1,621,378
	\$11,641,911

The 44% increase in sales necessitated increases in our operating expenses and included \$3,059,000 in the area of advertising and promotions used to promote brand and product awareness. We expect as we continue to promote our brand and products, these areas and levels of promotion will hold steady or increase relative to overall efforts to increase product awareness and sales. As more fully described in Note 8 above, the Company recognized expense of \$1,588,000 related to amortization of compensation expense for certain employee RSUs and RSA agreements.

Another area of increase is salaries and benefit expenses of \$3,809,000. Our 44% increase in sales necessitated increases in staffing in sales, finance and operations to help support the Company's growth. The remaining increase of \$1,516,000 was due to other various operating expense increases necessitated by our 44% increase in year over year sales. Included in the \$1,516,000 is approximately \$504,000 in settlement expenses related to various legal proceedings that the Company has been involved in during the first three quarters of 2013.

The following table provides an overview of expense categories and percentage of net revenue:

	Nine Months Ended September 30,					
	2013	% of Revenue		2012	% of Revenue	
Advertising expense	\$ 9,635,642	13.13	%	\$ 6,576,531	13.01	%
General and administrative expense	5,000,831	6.82	%	3,146,029	6.22	%
Professional & R&D expense	10,452,208	14.24	%	3,776,033	7.47	%
Salary and wage expense	6,730,813	9.17	%	2,922,072	5.78	%
Total operating expenses	\$ 31,819,494	43.36	%	\$ 16,420,665	32.48	%

### ***Loss from Operations***

Our net loss from operations for the nine months ended September 30, 2013, was approximately \$8,335,000, compared to approximately \$6,202,000 for the nine months ended September 30, 2012.

***Other Income (Expenses)***

Other expenses were approximately \$5,394,000 for the nine months ended September 30, 2013, compared to approximately \$9,725,000 for the nine months ended September 30, 2012. During the nine months ended September 30, 2013, the Company issued warrants to convert 1,500,000 shares of preferred stock into 3,000,000 shares of common stock. Refer to Note 8 for further detail of costs related to derivative agreements.

	Nine Months Ended September 30,	
	2013	2012
Derivative expense	\$ (96,913 )	\$ (4,409,214 )
Change in fair value of derivative liabilities	\$ (5,466,542 )	\$ 5,900,749
Gain (loss) on settlement of accounts payable and debt	\$ 392,144	\$ (4,452,439 )
Gain on marketable securities	\$ 444,059	\$ -
Accretion of note discount	\$ 115,429	\$ -
Interest expense	\$ (782,747 )	\$ (6,812,255 )
Other income	\$ 135	\$ 48,180
Total other expenses	\$ (5,394,435 )	\$ (9,724,979 )

**Net Loss**

For the foregoing reasons, we had a net loss of approximately \$13,730,000 for the nine months ended September 30, 2013, compared to approximately \$15,927,000 for the nine months ended September 30, 2012.

Inflation did not have a material impact on our operations for the period. Other than the foregoing, management knows of no trends, demands, or uncertainties that are reasonably likely to have a material impact on our results of operations.

**Liquidity and Capital Resources**

The following table summarizes total current assets, liabilities and working capital at September 30, 2013, compared to December 31, 2012.

	September 30, 2013	December 31, 2012	Increase/Decrease
Current Assets	\$ 34,407,715	\$ 4,949,881	\$ 29,457,834
Current Liabilities	\$ 18,865,271	\$ 16,520,456	\$ 2,344,815
Working Capital (Deficit)	\$ 15,542,444	\$ (11,570,575 )	\$ 27,113,019

Our primary source of operating cash has been through the sale of equity and through the issuance of convertible secured promissory notes and other short-term debt as discussed below.

The Company's management believes current levels of liquidity are sufficient for current operations, but additional capital may be needed to execute the business plan, which includes buying more inventory. There can be no assurance that such capital will be available on acceptable terms or at all.

On March 27, 2013, MusclePharm sold an aggregate of 703,236 shares of its common stock, \$0.001 par value per share at a per share price of \$8.50 in a private placement to certain accredited investors for an aggregate purchase price of approximately \$5,977,506, thereby providing working capital.

The common stock was sold pursuant to subscription agreements dated March 27, 2013 between the Company and the Purchasers. The Subscription Agreements contained customary terms regarding, among other things, representations and warranties and indemnification.

On May 6, 2013, MusclePharm sold an aggregate of 100,000 shares of its common stock, \$0.001 par value per share at a per share price of \$8.50 in a private placement to certain accredited investors, thereby providing working capital.



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The common stock was sold pursuant to subscription agreements dated May 6, 2013 between the Company and the Purchasers. The Subscription Agreements contained customary terms regarding, among other things, representations and warranties and indemnification.

On June 3, 2013, MusclePharm sold an aggregate of 150,000 shares of its common stock, \$0.001 par value per share at a per share price of \$10.00 in a private placement to certain accredited investors, for an aggregate purchase price of approximately \$1,398,139 thereby providing working capital.

The common stock was sold pursuant to subscription agreements dated June 3, 2013 between the Company and the Purchasers. The Subscription Agreements contained customary terms regarding, among other things, representations and warranties and indemnification.

On August 15, 2013, MusclePharm sold an aggregate of 238,096 shares of its common stock, \$0.001 par value per share at a per share price of \$10.50 in a private placement to certain accredited investors, for an aggregate purchase price of approximately \$2,500,002 thereby providing working capital.

The common stock was sold pursuant to subscription agreements dated August 15, 2013 between the Company and the Purchasers. The Subscription Agreements contained customary terms regarding, among other things, representations and warranties and indemnification.

At September 30, 2013, we had cash of \$5,683,656 and working capital of approximately \$15,542,000 compared to cash of \$0 and a working capital deficit of approximately \$11,571,000 at December 31, 2012. The working capital increase of approximately \$27,113,000 was primarily due to a net increase in cash of \$5,684,000, an increase in accounts receivable of \$7,609,000, an increase in inventory of \$9,375,000, an increase in prepaid stock compensation of \$3,324,000, an increase in debt securities of \$926,000, an increase in derivative instruments of \$1,692,000, a net increase in other current assets of \$636,000, which was offset by an increase in current liabilities of \$2,345,000.

Cash used in operating activities was \$8,045,389 for the nine months ended September 30, 2013, as compared to cash provided by operating activities of \$286,825 for the nine months ended September 30, 2012. The increase in cash used in operating activities of approximately \$8.3 million for the nine months ended September 30, 2013, compared to the nine months ended September 30, 2012, was primarily due to an increase in accounts receivable and prepaid expenses of approximately \$9.5 million, an increase in inventory of approximately \$9.2 million, a decrease in loss on settlement expense of approximately \$3.7 million, an increase in the change in fair value of derivative assets of approximately \$0.4 million, and a decrease in deferred revenue of approximately \$0.9 million offset by a decrease in net loss of approximately \$2.2 million, an increase in depreciation of approximately \$0.2 million, an increase in amortization and accretion of approximately \$3.0 million, decrease in derivative expense and change in fair value of derivatives of approximately \$6.6 million and an increase in accounts payable and accrued liabilities of approximately \$3.0 million.

Cash used in investing activities increased to \$2,928,195 from \$934,823 for the nine months ended September 30, 2013 and 2012, due to increased spending on marketable securities, notes, and other assets offset by slightly lower spending on fixed assets. Future investments in property and equipment, as well as further development of our Internet presence will largely depend on available capital resources.

Cash flows provided by financing activities were \$16,664,190 for the nine months ended September 30, 2013, compared to \$615,548 for the nine months ended September 30, 2012. The approximately \$16 million increase was due primarily to the net increase of approximately \$19.5 million net proceeds from equity offerings, a decrease of approximately \$0.4 million in the repurchase of common stock and a decrease of approximately \$0.2 million in debt issue and a decrease of approximately \$0.8 million in repayment of debt offset by a decrease of approximately \$4.8 million in proceeds from issuance of debt.

Cash Flows From Financing Activities:	Nine Months Ended	
	September 30, 2013	2012
Proceeds from issuance of debt	\$ -	\$ 4,823,950
Repayment of debt	(4,397,107)	(5,241,234)
Debt issuance costs	-	(166,950)
Repurchase of common stock	(103,537)	(460,978)
Proceeds from issuance of common stock and warrants	10,827,501	1,660,760
Proceeds from issuance of preferred stock	12,000,000	-
Stock issuance costs	(1,662,667)	-
Net Cash Provided By Financing Activities	\$ 16,664,190	\$ 615,548

#### Off-Balance Sheet Arrangements

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Other than the operating leases, as of September 30, 2013, we did not have any off-balance sheet arrangements. We are obligated under an operating lease for the rental of office space. Future minimum rental commitments with a remaining term in excess of one year as of September 30, 2013 are as follows:

Years Ending December 31,

2013 (3 months)	\$ 130,987
2014	569,618
2015	391,069
2016	79,860
2017	19,965
Total minimum lease payments	\$1,191,499

## **Critical Accounting Policies and Estimates**

The preparation of financial statements in conformity with GAAP 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.

Making estimates requires management to exercise significant judgment. It is at least reasonably possible that the estimate of the effect of a condition, situation or set of circumstances that existed at the date of the financial statements, which management considered in formulating its estimate could change in the near term due to one or more future non-conforming events. Accordingly, the actual results could differ significantly from estimates.

### **Accounts Receivable and Allowance for Doubtful Accounts**

Accounts receivable represents trade obligations from customers that are subject to normal trade collection terms. We periodically evaluate the collectability of our accounts receivable and considers the need to establish an allowance for doubtful accounts based upon historical collection experience and specific customer information. Accordingly, the actual amounts could vary from the recorded allowances.

We perform ongoing evaluations of our customers' financial condition and generally do not require collateral. Management reviews accounts receivable periodically and reduces the carrying amount by a valuation allowance that reflects management's best estimate of amounts that may not be collectible. Allowances, if any, for uncollectible accounts receivable are determined based upon information available and historical experience.

We do not charge interest on past due receivables. Receivables are determined to be past due based on the payment terms of the original invoices.

### **Fair Value of Financial Instruments**

We measure assets and liabilities at fair value based on an expected exit price as defined by the authoritative guidance on fair value measurements, which represents the amount that would be received on the sale of an asset or paid to transfer a liability, as the case may be, in an orderly transaction between market participants. As such, fair value may be based on assumptions that market participants would use in pricing an asset or liability. The authoritative guidance on fair value measurements establishes a consistent framework for measuring fair value on either a recurring or nonrecurring basis whereby inputs, used in valuation techniques, are assigned a hierarchical level.

The following are the hierarchical levels of inputs to measure fair value:

- Level 1: Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2: Inputs reflect quoted prices for identical assets or liabilities in markets that are not active; quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the assets or liabilities; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- Level 3: Unobservable inputs reflecting our assumptions incorporated in valuation techniques used to determine fair value. These assumptions are required to be consistent with market participant assumptions that are reasonably available.

## **Revenue Recognition**

We record revenue when all of the following have occurred: (1) persuasive evidence of an arrangement exists, (2) product has been shipped or delivered, (3) the sales price to the customer is fixed or determinable, and (4) collectability is reasonably assured.

Depending on individual customer agreements, sales are recognized either upon shipment of products to customers or upon delivery. We record sales allowances and discounts as a direct reduction of sales.

We have determined that advertising related credits that were granted to customers fell within the guidance of ASC No. 605-50-55 ("*Revenue Recognition*" *Customer Payments and Incentives Implementation Guidance and Illustrations*). The guidance indicates that, absent evidence of benefit to the vendor, appropriate treatment requires netting these types of payments against revenues and not expensing as advertising expense.

We have an informal seven day right to return products. There were nominal returns during the nine month periods ended September 30, 2013 and 2012.

### **Foreign Currency**

We began operations in Canada in April 2012. The Canadian Dollar was determined to be the functional currency as the majority of the transactions related to the day to day operations of the business are exchanged in Canadian Dollars. At the end of the period, the financial results of the Canadian operation are translated into United States Dollars, which is the reporting currency, and added to the U.S. operations for consolidated company financial results. The revenue and expense items are translated using the average rate for the period and the assets and liabilities at the end of period rate. Transactions that have completed the accounting cycle and resulted in a gain or loss related to translation are recorded in realized gain or loss due to foreign currency translation under other income expense on the income statement. Transactions that have not completed their accounting cycle but appear to have gain or loss due to the translation process are recorded as unrealized gain or loss due to translation and held in the equity section on the balance sheet until such date the accounting cycle of a transaction is complete and the actual realized gain or loss is recognized.

### **Beneficial Conversion Feature**

For conventional convertible debt where the rate of conversion is below market value, we record a “beneficial conversion feature” (“BCF”) and related debt discount.

When we record a BCF, the relative fair value of the BCF would be recorded as a debt discount against the face amount of the respective debt instrument. The discount would be amortized to interest expense over the life of the debt.

### **Derivative Assets and Liabilities**

Fair value accounting requires bifurcation of embedded derivative instruments such as conversion features in convertible debt or equity instruments, and measurement of their fair value for accounting purposes. In determining the appropriate fair value, we use the Black-Scholes option-pricing model. In assessing the convertible debt instruments, management determines if the convertible debt host instrument is conventional convertible debt and further if there is a beneficial conversion feature requiring measurement. If the instrument is not considered conventional convertible debt, we will continue our evaluation process of these instruments as derivative financial instruments.

Once determined, derivative liabilities are adjusted to reflect fair value at each reporting period end, with any increase or decrease in the fair value being recorded in results of operations as an adjustment to fair value of derivatives. In addition, the fair value of freestanding derivative instruments such as warrants, are also valued using the Black-Scholes option-pricing model.

### **Debt Issue Costs and Debt Discount**

We may pay debt issue costs, and record debt discounts in connection with raising funds through the issuance of convertible debt. These costs are amortized over the life of the debt to interest expense. If a conversion of the underlying debt occurs, a proportionate share of the unamortized amounts is immediately expensed.

### **Original Issue Discount**

For certain convertible debt issued, we provide the debt holder with an original issue discount. The original issue discount is recorded to debt discount and additional paid in capital at an amount not to exceed gross proceeds raised, reducing the face amount of the note and is amortized to interest expense over the life of the debt.

### **Share-Based Payments**

Generally, all forms of share-based payments, including stock option grants, warrants, restricted stock grants and stock appreciation rights are measured at their fair value on the awards' grant date, based on estimated number of awards that are ultimately expected to vest. Share-based compensation awards issued to non- employees for services rendered are recorded at either the fair value of the services rendered or the fair value of the share-based payment, whichever is more readily determinable.

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

Not Applicable.

**Item 4. Controls and Procedures.**

*(a) Evaluation of Disclosure Controls and Procedures*

Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our Principal Executive Officer and Principal Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(c) and 15d-15(e) under the Securities Exchange Act of 1934 as amended (the “Exchange Act”) were not effective to ensure that information required to be disclosed by us in report that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms and to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Principal Executive Officer and Principal Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

*(b) Changes in Internal Control Over Financial Reporting*

There were no changes in our internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act, during our most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.



## PART II OTHER INFORMATION

### Item 1. Legal Proceedings.

Except as disclosed in Note 8: Commitments, Contingencies and Other Matters, to the Financial Statements contained herein, we are currently not involved in any new litigation that we believe could have a material adverse effect on our financial condition or results of operations. Except as disclosed in Note 8: Commitments, Contingencies and Other Matters, there is no action, suit, proceeding, inquiry or investigation before or by any court, public board, government agency, self-regulatory organization or body pending or, to the knowledge of the executive officers of our Company or any of our subsidiaries, threatened against or affecting our company, our common stock, any of our subsidiaries or of our companies or our subsidiaries' officers or directors in their capacities as such, in which an adverse decision could have a material adverse effect.

### Item 1A. Risk Factors.

We believe there are no changes that constitute material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2012, filed with the SEC on April 1, 2013. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

The Company has not, during the nine months ended September 30, 2013, issued securities in addition to what is (i) reported in a Current Report on Form 8-K, or (ii) disclosed in the "Liquidity and Capital Resources" section herein.

### Item 3. Defaults Upon Senior Securities.

There were no defaults upon senior securities during the nine months ended September 30, 2013.

### Item 4. Mine Safety Disclosures

Not applicable.

### Item 5. Other Information.

None.

### Item 6. Exhibits.

#### Exhibit No. Description

31.1*	Rule 13 (A)	14(A) Certification of Principal Executive Officer
31.2*	Rule 13 (A)	14(A) Certification of Principal Financial Officer
32.1*	Section 1350	Certification of Principal Executive Officer
32.2*	Section 1350	Certification of Principal Financial Officer
101.INS	XBRL Instance Document	

101.SCH XBRL Taxonomy Extension Schema

101.CAL XBRL Taxonomy Extension Calculation Linkbase

101.DEF XBRL Taxonomy Extension Definition Linkbase

101.LAB XBRL Taxonomy Extension Label Linkbase

101.PRE XBRL Taxonomy Extension Presentation Linkbase

\*Filed Herewith

**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.

**MUSCLEPHARM CORPORATION**

Date: November 14, 2013

By: */s/ Brad J. Pyatt*  
Name: Brad J. Pyatt  
Title: Chief Executive Officer and  
President  
(Principal Executive Officer)

Date: November 14, 2013

By: */s/ L. Gary Davis*  
Name: L. Gary Davis  
Title: Chief Financial Officer,  
Treasurer (Principal Financial Officer)  
(Principal Accounting Officer)