

MusclePharm Corp
Form 10-Q/A
July 02, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A (Amendment No. 1)

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

For the quarter ended: **June 30, 2011**

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 77-0664193
(State or other jurisdiction of (I.R.S. Employer

incorporation or organization) Identification No.)

4721 Ironton Street, Building A

Denver, CO 90839

(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:

Large accelerated filer ☐ Accelerated filer ☐

Non-accelerated filer ☐ Smaller reporting company ☒

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

As of June 29, 2012, there were 1,399,074,207 shares outstanding of the registrant's common stock.

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Explanatory Note

On May 14, 2012, MusclePharm Corporation's (the "Company") independent registered public accounting firm and the Company's board of directors (the "Board") determined, after consultation with Company management that the Company's unaudited financial statements for the period ended June 30, 2011, filed in a quarterly report on Form 10-Q with the Securities and Exchange Commission (the "Commission") on August 23, 2011, contained certain material misstatements. Our financial statements contained in this amended quarterly report on Form 10-Q/A restate a previous error in accounting for the Company's calculation of net sales and presentation of general and administrative expenses. The Company has 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 foregoing guidance indicates that, absent evidence of benefit to the vendor, appropriate U.S. GAAP treatment requires netting these types of payments against gross revenues and not as advertising expense. The Company also noted other credits and discounts that, upon further review, had been previously classified as advertising expense as a component of general and administrative expense that require a reallocation of presentation as amounts to be netted against gross revenues. Additionally, for the quarter ended June 30, 2011, the Company reclassified certain items classified as samples originally included as an advertising expense to cost of sales. There were no such reclassifications for 2010.

The Company previously deducted certain credits and promotions as general and administrative expenses. After a thorough analysis and review as noted above, the Company has determined to net any credits and promotions directly against gross sales instead of classifying the same amounts as an advertising expense. Because this accounting change is a reclassification of expenses in the Company's Consolidated Statements of Operations, the Company's net loss will not be affected by the restatement, nor does the restatement affect the net loss amounts reported in this unaudited quarterly financial statements. The financial statements contained herein have been restated solely for 2011.

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

MUSCLEPHARM CORPORATION AND SUBSIDIARY

CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2011 (Restated)

(UNAUDITED)

MusclePharm Corporation and Subsidiary

Notes to Consolidated Financial Statements

June 30, 2011 (Restated)

(unaudited)

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MusclePharm Corporation and Subsidiary**Consolidated Balance Sheets**

	June 30, 2011 (unaudited)	December 31, 2010
Assets		
Accounts receivable	2,399,097	426,761
Prepaid stock compensation	382,546	893,240
Other current assets	9,211	42,605
	3,308,665	1,406,310
 Total Current Assets	 514,404	 138,551
 Prepaid stock compensation	 810,399	 1,088,131
 Other assets	 239,603	 87,989
 Total Assets	 \$4,873,071	 \$ 2,720,981
 Liabilities and Stockholders' Deficit		
Accounts payable and accrued liabilities	\$2,885,403	\$ 3,155,701
Demand loans	278,600	-
Debt	2,008,567	289,488
Derivative liabilities	5,155,773	622,944
Deferred revenue	18,240	75,733
Due to factor	-	71,783
Total Current Liabilities	10,346,583	4,215,649
 Long Term Liabilities:		250,000
 Total Liabilities	 10,434,203	 4,465,649
 Stockholders' Deficit		
Series A, Convertible Preferred Stock, \$0.001 par value; 10,000,000 shares authorized, none issued and outstanding	-	118,649
Additional paid-in capital	28,510,297	20,012,122
Accumulated deficit	(34,323,984)	(21,875,438)
Total Stockholders' Deficit	(5,561,132)	(1,744,667)
	\$4,873,071	\$ 2,720,981

See accompanying notes to financial statements

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

	For The Three Months Ended June 30,		For the Six Months Ended June 30,	
	2011	2010	2011	2010
	(As Restated)		(As Restated)	
Sales - net	\$ 3,397,742	\$ 468,109	\$ 6,431,678	\$ 1,726,697
Cost of sales	2,512,828	361,250	4,914,361	1,192,608
Gross profit	884,914	106,859	1,517,317	534,089
General and administrative expenses	2,778,682	2,982,236	4,498,310	5,661,122
Loss from operations	(1,893,768)	(2,875,377)	(2,980,993)	(5,127,033)
Other income (expense)				
Derivative expense	(2,698,490)	-	(4,057,859)	-
Change in fair value of derivative liabilities	766,487	-	634,770	-
Loss on settlement of accounts payable and debt	(627,384)	-	(2,542,073)	-
Interest expense	(2,983,468)	(316,283)	(3,502,390)	(674,343)
Total other income (expense) - net	(5,542,854)	(316,283)	(9,467,552)	(674,343)
Net loss	\$ (7,436,623)	\$ (3,191,660)	\$ (12,448,545)	\$ (5,801,376)
Net loss per share available to common stockholders - basic and diluted	\$ (0.04)	\$ (0.11)	\$ (0.07)	\$ (0.21)
Weighted average number of common shares outstanding during the year – basic and diluted	201,864,655	29,247,811	174,365,323	27,702,640

See accompanying notes to financial statements

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

	Six Months Ended June 30,	
	2011	2010
Cash Flows From Operating Activities:		
Net loss	\$(12,448,545)	\$ (5,801,376)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	31,393	6,455
Bad debt (recovery)	(5,203)	660
Stock based compensation	758,826	2,641,067
Amortization of prepaid stock based compensation	1,039,925	-
Amortization of debt discount and debt issue costs	3,034,192	594,351
Derivative expense	4,057,859	-
Change in fair value of derivative liabilities	(634,770)	-
Loss on sale of accounts receivable	-	5,196
Loss on settlement of accounts payable	2,542,073	-
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	(1,967,133)	(459,454)
Prepaid and other	(48,359)	54,411
Inventory	-	(70,672)
Deposits	-	(55,055)
Other current Assets	-	(2,267)
Accounts payable and accrued liabilities	1,057,640	1,264,000
Deferred revenue	(57,493)	294,887
Due to factor	(5,853)	-
Net Cash Used In Operating Activities	(2,645,448)	(1,527,797)
Cash Flows From Investing Activities:		
Purchases of property and equipment	(324,435)	(6,884)
Net Used In Investing Activities	(324,435)	(6,884)
Cash Flows From Financing Activities:		
Proceeds from sale of accounts receivable	-	226,847
Repayment of debt - related party	-	(39,797)
Proceeds from issuance of debt	3,648,083	1,026,000
Debt issue costs	(204,093)	-
Payment for recapitalization from merger	-	(25,108)
Proceeds from issuance of common stock	-	317,098
Bank overdrafts	-	29,641
Net Cash Provided By Financing Activities	3,443,990	1,534,681

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Net increase in cash	474,107	-
Cash at end of period	\$517,811	\$ -

Supplemental disclosures of cash flow information:

Cash paid for interest	\$2,518,761	
Cash paid for taxes	\$-	\$ -

Supplemental disclosure of non-cash investing and financing activities:

Stock issued for future services - third parties	\$251,500	\$ -
Debt discount recorded on convertible debt accounted for as a derivative liability	\$3,258,108	\$ -
Stock issued to settle accounts payable and accrued expenses - third parties	\$1,393,868	\$ -
Conversion of notes to common stock	\$1,454,635	\$ 167,199
Reclassification of convertible notes to demand loans	\$278,600	\$ -
Reclassification of derivative liability to additional paid in capital	\$1,284,928	\$ -
Beneficial conversion feature - convertible debt	\$-	\$ 366,000
Conversion of preferred stock to common stock	\$-	\$ 15
Stock issued to acquire equipment	\$82,811	\$ -
Share cancellation	\$350	\$ -

See accompanying notes to financial statements

MusclePharm Corporation and Subsidiary

Notes to Consolidated Financial Statements

June 30, 2011 (Restated)

(unaudited)

Note 1 Nature of Operations and Basis of Presentation (Restated)

Nature of Operations

MusclePharm Corporation (the “Company”, or “MusclePharm”), was organized as a limited liability company in the State of Colorado on April 22, 2008. On February 18, 2010, the Company executed a reverse recapitalization with Tone in Twenty, Inc., a then inactive public shell company, and changed its name to MusclePharm Corporation.

The Company markets branded 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 and the rules and regulations of the United States Securities and Exchange Commission (the “SEC”) for interim financial information.

The financial information as of December 31, 2010 is derived from the audited financial statements presented in the Company’s Annual Report on Form 10-K for the years ended December 31, 2010 and 2009. 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 the Management’s Discussion and Analysis, for the years ended December 31, 2010 and 2009.

Certain information or footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been 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 six months ended June 30, 2011, are not necessarily indicative of results for the full fiscal year.

Restatement

On May 14, 2012, the Company determined that a material misstatement exists in the Company's 2011 quarterly and 2011 and 2010 annual financial statements. The Company concluded that the following financial statements contained material misstatements: (i) the Company's audited financial statements for the year ended December 31, 2011, filed in an annual report on Form 10-K with the U.S. Securities and Exchange Commission (the "SEC") on April 16, 2012; (ii) the Company's audited financial statements for the year ended December 31, 2010, filed in an annual report on Form 10-K with the U.S. Securities and Exchange Commission (the "SEC") on April 1, 2011; (iii) the Company's unaudited financial statements for the period ended September 30, 2011, filed in a quarterly report on Form 10-Q with the SEC on November 14, 2011; (iv) the Company's unaudited financial statements for the period ended June 30, 2011, filed in a quarterly report on Form 10-Q with the SEC on August 16, 2011; and (v) the Company's unaudited financial statements for the period ended March 31, 2011, filed in a quarterly report on Form 10-Q with the SEC on May 23, 2011.

The foregoing financial statements contained material misstatements pertaining to the Company's calculation of net sales and presentation of general and administrative expenses and cost of sales. The Company has 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. The Company also noted other credits and discounts that, upon further review, had been previously classified as advertising expense as a component of general and administrative expense that require a reallocation of presentation as amounts to be netted against revenues. The Company's net loss and loss per share will not be affected by this reallocation in the statement of operations. Additionally, for the quarter ended June 30, 2011, the Company reclassified certain items classified as samples originally included as an advertising expense to cost of sales. There were no such reclassifications for 2010.

Promotions, credits and non-specific advertising with its customers have been reclassified from general and administrative expenses to revenues.

Samples shipped to customers not clearly identifiable were reclassified from general and administrative expense to cost of sales.

MusclePharm Corporation and Subsidiary**Notes to Consolidated Financial Statements****June 30, 2011 (Restated)****(unaudited)**

For the three months and six months ended June 30, 2011:

	The Three Months Ended June 30, 2011 As Restated	Adjustments	The Three Months Ended June 30, 2011 As Issued	The Six Months Ended June 30, 2011 As Restated	Adjustments	The Six Months Ended June 30, 2011 As Issued
Sales - net	\$ 3,397,742	\$ (405,064)	\$ 3,802,806	\$ 6,431,678	\$ (888,902)	\$ 7,320,580
Cost of sales	2,512,828	31,171	2,481,657	4,914,361	108,496	4,805,865
Gross profit	884,914	(436,235)	1,321,149	1,517,317	(997,398)	2,514,715
General and administrative expenses	2,778,682	(436,235)	3,214,917	4,498,310	(997,398)	5,495,708
Loss from operations	(1,893,768)	-	(1,893,768)	(2,980,993)	-	(2,980,993)
Other income (expense)						
Derivative expense	(2,698,490)	-	(2,698,490)	(4,057,859)	-	(4,057,859)
Change in fair value of derivative liabilities	766,487	-	766,487	634,770	-	634,770
Loss on settlement of accounts payable and debt	(627,384)	-	(627,384)	(2,542,073)	-	(2,542,073)
	(2,983,468)	-	(2,983,468)	(3,502,390)	-	(3,502,390)

Interest expense						
Total other income (expense) - net	(5,542,854)	-	(5,542,854)	(9,467,552)	-	(9,467,552)
Net loss	\$ (7,436,623)	\$ -	\$ (7,436,623)	\$ (12,448,545)	\$ -	\$ (12,448,545)
Net loss per share available to common stockholders - basic and diluted	\$ (0.04)	\$ -	\$ (0.04)	\$ (0.07)	\$ -	\$ (0.07)
Weighted average number of common shares outstanding during the year – basic and diluted	201,864,655	-	201,864,655	174,365,323	-	174,365,323

Note 2 Summary of Significant Accounting Policies

Principles of consolidation

All significant intercompany accounts and transactions have been eliminated in consolidation.

MusclePharm Corporation and Subsidiary

Notes to Consolidated Financial Statements

June 30, 2011 (Restated)

(unaudited)

Use of estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes.

Such estimates and assumptions impact, among others, the following: the fair value of share-based payments, fair value of derivative liabilities, estimates of the probability and potential magnitude of contingent liabilities and the valuation allowance for deferred tax assets due to continuing operating losses.

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 consolidated financial statements, which management considered in formulating its estimate could change in the near term due to one or more future confirming events. Accordingly, the actual results could differ significantly from our 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 and other risks, including the potential risk of business failure. Also, see Note 3 regarding going concern and liquidity matters.

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. There were no cash equivalents at June 30, 2011 and at December 31, 2010.

The Company minimizes its credit risk associated with cash by periodically evaluating the credit quality of its primary financial institution. The balance at times may exceed federally insured limits.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable represents trade obligations from customers that are subject to normal trade collection terms. 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.

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.

MusclePharm Corporation and Subsidiary

Notes to Consolidated Financial Statements

June 30, 2011 (Restated)

(unaudited)

Accounts receivable at June 30, 2011 and December 31, 2010:

Accounts receivable	\$2,509,996	\$542,863
Less: allowance for doubtful accounts	(110,899)	(116,102)
Accounts receivable – net	\$2,399,097	\$426,761

At June 30, 2011 and December 31, 2010, the Company had the following concentrations of accounts receivable with customers:

Customer	2011	2010
A	34 %	86 %
B	17 %	9 %
C	15 %	- %
D	13 %	- %

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 statements of operations. Repairs and maintenance costs are expensed as incurred. Depreciation is provided using the straight- line method for all property and equipment.

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 an 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.

MusclePharm Corporation and Subsidiary

Notes to Consolidated Financial Statements

June 30, 2011 (Restated)

(unaudited)

Fair Value of Financial Instruments

The Company measures 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 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 following are the major categories of liabilities measured at fair value on a recurring basis as of June 30, 2011 and December 31, 2010, using quoted prices in active markets for identical liabilities (Level 1); significant other observable inputs (Level 2); and significant unobservable inputs (Level 3):

June 30, December

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		2011	31, 2010
Derivative liabilities	Level 2	\$5,155,773	\$ 622,944

The Company's financial instruments consisted primarily of cash, accounts receivable, prepaid stock compensation, other assets, accounts payable and accrued liabilities, demand loans and short term debt. The carrying amounts of the Company's financial instruments generally approximated their fair values as of June 30, 2011 and December 31, 2010, respectively, due to the short-term nature of these instruments.

MusclePharm Corporation and Subsidiary

Notes to Consolidated Financial Statements

June 30, 2011 (Restated)

(unaudited)

Revenue Recognition (Restated)

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 one of our largest customers, which represents 10% of our total revenue for the six months ended June 30, 2011, revenue is recognized upon delivery.

The Company has 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.

The Company records store support, giveaways, sales allowances and discounts as a direct reduction of sales. The Company recorded reductions to gross revenues totaling approximately \$1,077,911 and \$84,909 for the six months June 30, 2011 and 2010, respectively.

Sales for the three and six months ended June 30, 2011 and 2010, are as follows:

The Three Months Ended June 30, 2011 As Issued		The Three Months Ended June 30, 2011 As Restated	The Three Months Ended June 30, 2010	The Six Months Ended June 30, 2011 As Issued		The Six Months Ended June 30, 2011 As Restated	The S Months June 2010
	Adjustments				Adjustments		

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Sales	\$ 3,838,374	\$ -	\$ 3,838,374	\$ 491,151	\$ 7,509,589	\$ -	\$ 7,509,589	\$ 1,8
Discounts	(35,568)	(405,064)	(440,632)	(23,042)	(189,009)	(888,902)	(1,077,911)	(84
Sales - Net	\$ 3,802,806	\$ (405,064)	\$ 3,397,742	\$ 468,109	\$ 7,320,580	\$ (888,902)	\$ 6,431,678	\$ 1,7

The Company has an informal 7-day right of return for products. There were nominal returns for the three and six months ended June 30, 2011 and 2010.

For the six months ended June 30, 2011 and 2010, the Company had the following concentrations of revenues with customers:

Customer	2011 (As Restated)	2010
A	39 %	31 %
B	10 %	13 %
C	7 %	14 %
D	0 %	28 %

Cost of Sales (Restated)

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

Cost of sales increased by \$108,496 for the six months ended June 30, 2011 due to a reclassification from advertising expense to cost of sales due to our restatement.

At June 30, 2011 and 2010, the Company had the following concentrations of purchases from vendors:

Customer	2011	2010
A	100 %	16 %
B	- %	76 %

See discussion of restatement

Shipping and Handling

Product sold is typically shipped directly to the customer from the manufacturer. Any freight billed to customers is offset against shipping costs and included in cost of sales.

Advertising (Restated)

The Company expenses advertising costs when incurred.

Advertising for the three months ended June 30, 2011 and 2010 are as follows:

	The Three Months Ended June 30, 2011 As Issued	Adjustments	The Three Months Ended June 30, 2011 As Restated	The Three Months Ended June 30, 2010
Advertising	\$ 2,049,275	\$ (436,235)	\$ 1,613,040	\$ 1,817,540

Advertising for the six months ended June 30, 2011 and 2010 are as follows:

	The Six Months Ended June 30, 2011 As Issued	Adjustments	The Six Months Ended June 30, 2011 As Restated	The Six Months Ended June 30, 2010
Advertising	\$ 3,192,633	\$ (997,398)	\$ 2,195,235	\$ 3,055,512

See discussion of restatement

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 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.

There were no recorded BCF's during 2011.

Derivative 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, the Company uses 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, the Company will continue its 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. At June 30, 2011 and December 31, 2010, the Company had derivative liabilities in the amounts of \$5,155,773 and \$622,944, respectively.

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 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.

MusclePharm Corporation and Subsidiary

Notes to Consolidated Financial Statements

June 30, 2011 (Restated)

(unaudited)

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 note and is being 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.

Earnings per Share

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

Since the Company reflected a net loss for the three and six months ended June 30, 2011 and 2010, respectively, the effect of considering any common stock equivalents, if exercisable, would have been anti-dilutive. A separate computation of diluted earnings (loss) per share is not presented.

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The Company has the following common stock equivalents at June 30, 2011 and 2010:

	2011	2010
Stock options (exercise price - \$0.50/share)	2,767,500	-
Warrants (exercise price - \$0.025 - \$1.50/share)	59,843,333	-
Convertible debt	43,933,988	2,202,000
Total common stock equivalents	106,544,821	2,202,000

In the above table, some of the outstanding convertible debt and warrants from 2011 and 2010 contains discount to market 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.

Reclassification

Certain items in the 2010 unaudited financial statement presentation have been reclassified to conform to the 2011 presentation. Such reclassifications have no effect on previously reported financial condition, operations or cash flows.

MusclePharm Corporation and Subsidiary

Notes to Consolidated Financial Statements

June 30, 2011 (Restated)

(unaudited)

Recent Accounting Pronouncements

There are no recent accounting pronouncements that are expected to have an effect on the Company's consolidated financial statements.

Note 3 Going Concern and Liquidity

As reflected in the accompanying unaudited interim consolidated financial statements, the Company had a net loss of \$12,448,545 and net cash used in operations of \$2,645,448 for the six months ended June 30, 2011 and a working capital deficit and stockholders' deficit of \$7,037,918 and \$5,561,132, respectively, at June 30, 2011. These factors raise substantial doubt about the Company's ability to continue as a going concern.

The ability of the Company to continue its operations is dependent on management's plans, which include the raising of capital through debt and/or equity markets with some additional funding from other traditional financing sources, including term notes, sale of aged debt to third parties in exchange for free trading stock, until such time that funds provided by operations are sufficient to fund working capital requirements. The Company may need to incur liabilities with certain related parties to sustain the Company's existence.

The Company will require additional funding to finance the growth of its current and expected future operations as well as to achieve its strategic objectives. The Company believes its current available cash along with anticipated revenues may be insufficient to meet its cash needs for the near future. There can be no assurance that financing will be available in amounts or terms acceptable to the Company, if at all.

In response to these problems, management has taken the following actions:

seeking additional third party debt and/or equity financing;

generate new sales from international customers; and

allocate sufficient resources to continue with advertising and marketing efforts.

MusclePharm Corporation and Subsidiary

Notes to Consolidated Financial Statements

June 30, 2011 (Restated)

(unaudited)

The accompanying unaudited interim consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. These financial statements do not include any adjustments relating to the recovery of the recorded assets or the classification of the liabilities that might be necessary should the Company be unable to continue as a going concern.

Note 4 Property and Equipment

Property and equipment consisted of the following at June 30, 2011 and December 31, 2010:

	June 30, 2011	December 31, 2010	Estimated Useful Life
Leasehold improvements	\$ 142,194	\$ 67,760	*
Furniture and fixtures	388,117	55,305	3 years
Displays	32,057	32,057	5 years
Website	11,462	11,462	3 years
	573,830	166,584	
Less: Accumulated depreciation and amortization	(59,426)	(28,033)	
	\$ 514,404	\$ 138,551	

* The shorter of 5 years or the life of the lease.

Note 5 Debt

At June 30, 2011 and December 31, 2010, debt consists of the following:

June 30, 2011	December 31, 2010
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Convertible debt –secured – derivative liabilities	\$2,759,995	\$380,000
Conventional convertible debt – secured	-	225,000
Less: debt discount	(689,408)	(331,261)
Convertible debt – net	2,070,587	273,739
Secured debt	-	187,500
Unsecured debt	25,600	78,249
Total debt	2,096,187	539,488
Less: current portion	(2,008,567)	(289,488)
Long term debt	\$87,620	\$250,000

MusclePharm Corporation and Subsidiary**Notes to Consolidated Financial Statements****June 30, 2011 (Restated)****(unaudited)****(A) Convertible Debt – Secured – Derivative Liabilities**

During the six months ended June 30, 2011, the Company issued \$3,735,733 (net proceeds was \$3,443,990) in convertible debt – secured – derivative liabilities. The Company issued these debt instruments with 13 different sets of conversion terms. The Material terms of the Company's convertible debt – secured – derivative liabilities are as follows:

		Face Amount of Debt
Interest Rate	6% - 12%	
Default interest rate	15% - 22%	
Maturity	April 5, 2011 to June 2, 2014	
Conversion terms 1	Average 10 day trade pricing divided by 200% of outstanding principal balance	\$ 764,600
Conversion terms 2	Lesser of: Average of the lowest 2 closing prices of the 5 days preceding conversion date or \$0.025/share	\$ 775,000
Conversion terms 3	60% of the average of the lowest 3 closing prices in the 10 days preceding conversion date	\$ 170,000
Conversion terms 4	\$0.03	\$ 100,000
Conversion terms 5	65% of the average of the lowest 3 closing prices in the 30 days preceding conversion	\$ 303,800
Conversion terms 6	62% of the lowest closing prices in the 7 days preceding conversion date	\$ 40,000
Conversion terms 7	70% of the average of the lowest 3 closing prices in the 30 days preceding conversion	\$ 600,000
Conversion terms 8	50% of the average closing prices in the 10 days preceding conversion	\$ 85,000
Conversion terms 9	45% of the lowest 3 closing prices in the 10 days preceding conversion	\$ 277,500
Conversion terms 10	35% of the lowest 3 closing prices in the 10 days preceding conversion	\$ 100,000
Conversion terms 11	Lesser of: 50% of average of the lowest 3 closing prices of the 20 days preceding conversion date or \$0.05/share	\$ 33,000
Conversion terms 12	50% of lowest trade price in preceding 20 days	\$ 45,000
Conversion terms 13	80% of lowest trade price in preceding 30 days	\$ 441,833
		\$ 3,735,733
	Less original issue discount	\$ (87,650)
	Less debt issue costs	\$ (204,093)
	Net proceeds	\$ 3,585,900

MusclePharm Corporation and Subsidiary

Notes to Consolidated Financial Statements

June 30, 2011 (Restated)

(unaudited)

During the six months ended June 30, 2011, the Company converted \$1,077,138 in notes into 49,941,545 shares of the Company's common stock at prices ranging from \$0.016 to \$0.036/per share, based upon the terms of the debt conversion.

During the six months ended June 30, 2011, \$278,600 in convertible debt was reclassified to demand loans due to the maturity of the notes. The notes are unsecured and bear no interest.

The following is a summary of the Company's convertible debt - secured:

Convertible debt – secured – derivative liabilities – December 31, 2010	\$380,000
Issuance of convertible debt	3,735,733
Conversions of convertible debt to common stock	(1,077,138)
Conversions of convertible debt to demand loans	(278,600)
Convertible debt - secured – June 30, 2011	\$2,759,995

On June 29, 2011, the Company issued a convertible note and warrants. The note has an aggregate amount of \$2,651,000, of which the Company can draw down in a series of tranches. As of June 30, 2011, the Company received \$400,000 net of original discount of \$41,833 under the following terms:

- 6% interest;
- Due 48 months from drawdown date; and
- Unsecured.

The warrants contain the following provisions:

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one warrant to purchase common stock equal to \$800,000 divided by 80% of the lowest trade price of the stock during the 30 days immediately preceding the issue date;

- The number of warrants is variable; and
- The warrants expire 5 years from issuance.

(B) Conventional Convertible Debt – Secured

Terms of the Company's conventional convertible debt are as follows:

- Interest rate 8%;
- All notes were due by December 31, 2010, and were converted in 2011;
- Conversion of principal and accrued interest at rates ranging from 150% - 300%;
- Secured by all assets of the Company; and
- All conversion rates associated with these instruments were at or above market. There is no BCF.

MusclePharm Corporation and Subsidiary

Notes to Consolidated Financial Statements

June 30, 2011 (Restated)

(unaudited)

During the six months ended June 30, 2011, the Company issued 7,226,649 shares of common stock, having a fair value of \$426,970 (\$0.06 - \$0.10/share) to settle convertible notes payable, originating prior to December 31, 2010, having a face value of \$225,000. As a result, the Company recorded a loss on debt conversion of \$137,017.

The following is a summary of the Company's conventional convertible debt - secured:

Conventional convertible debt - secured – December 31, 2010	\$225,000
Settlement of debt through issuance of common stock	(225,000)
Conventional convertible debt - secured – June 30, 2011	\$-

(C) Secured Debt

During the six months ended June 30 2011, \$187,500 was converted into 7,500,000 shares of common stock, having a fair value of \$437,500 (\$0.058/share - \$0.059/share), based upon the quoted closing trading price. The Company recorded a loss on debt settlement of \$250,000.

The following is a summary of the Company's secured debt:

Secured debt – December 31, 2010	\$187,500
Settlement of debt through issuance of common stock	(187,500)
Secured debt – June 30, 2011	\$-

(D) Unsecured Debt

During the six months ended June 30, 2011, \$52,649 was converted into 1,337,445 shares of common stock, having a fair value of \$76,647 (\$0.101/share), based upon the quoted closing trading price. The Company recorded a loss on debt settlement of \$24,107.

The following is a summary of the Company's unsecured debt:

Unsecured debt – December 31, 2010	\$78,249
Settlement of debt through issuance of common stock	(52,649)
Unsecured debt – June 30, 2011	\$25,600

MusclePharm Corporation and Subsidiary

Notes to Consolidated Financial Statements

June 30, 2011 (Restated)

(unaudited)

(E) Debt Issue Costs

The following is a summary of the Company's debt issue costs:

Debt issue costs – net – December 31, 2010	\$34,404
Issue costs paid during six months ended June 30, 2011	216,367
Amortization of debt issue costs – June 30, 2011	(134,233)
Debt issue costs – net – June 30, 2011	\$116,538

(F) Debt Discount

During the six months ended June 30, 2011, the Company issued convertible debt with embedded derivatives and warrants. The Company recorded the derivatives and warrants at fair value and are amortizing the debt discount over the life of the debt. Debt discount is as follows:

Debt discount balance at December 31, 2010	\$331,261
Discount recorded for convertible notes issued during six months ended June 30, 2011	3,258,106
Accretion of debt discount to interest expense during the six months ended June 30, 2011	(2,899,959)
Debt discount balance at June 30, 2011	\$689,408

Note 6 Derivative Liabilities

The Company identified conversion features embedded within convertible debt - secured (see Note 5(A)). 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 a result of the application of ASC No. 815, the fair value of the conversion feature is summarized as follows:

Derivative liability balance at December 31, 2010	\$622,944
Fair value at the commitment date for convertible notes issued during six months ended June 30, 2011	6,452,527
Reclassification of derivative liability to additional paid in capital	(1,284,928)
Fair value mark to market adjustment	(634,770)
Derivative liability balance at June 30, 2011	\$5,155,773

MusclePharm Corporation and Subsidiary**Notes to Consolidated Financial Statements****June 30, 2011 (Restated)****(unaudited)**

The Company recorded the derivative liability to debt discount to the extent of the gross proceeds raised, and expensed immediately the remaining value of the derivative as it exceeded the gross proceeds of the note. The Company recorded a derivative expense for \$4,057,859 during the six months ended June 30, 2011.

The fair value at the commitment and remeasurement dates for embedded conversion features and warrants were based upon the following management assumptions:

	Commitment Date		Remeasurement Date	
Expected dividends	0	%	0	%
Expected volatility	180	%	180	%
Expected term: conversion feature	0.08 – 3 years		0.04 – 2.93 years	
Expected term: warrants	2.5 – 5 years		2.5 – 5 years	
Risk free interest rate	0.11% - 2.76	%	0.11 – 1.16	%

Note 7 Stockholders' Deficit**(A) Common Stock**

On April 18, 2011, the Company increased its authorized shares of common stock to 500,000,000.

During the six months ended June 30, 2011, the Company issued the following common stock:

Transaction Type	Quantity	Valuation	Loss on Settlement	Range of Value per Share
Conversion of debt (1)	66,005,639	\$2,109,677	\$411,124	\$ 0.012–0.066

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Settlement of accounts payable and accrued expenses (2)	54,746,257	\$3,625,771	\$2,130,949	\$ 0.012–0.101
Services – rendered (3)	10,466,497	\$510,681		\$ 0.03–1.15
Services – prepaid stock compensation (4)	4,000,000	\$251,500		\$ 0.047–0.08
Contract settlement (5)	2,187,666	\$126,885		\$ 0.058
Shares in dispute (6)	3,500,000	\$350	-	\$ 0.0001
Total	133,906,059	\$6,624,164	\$2,542,073	\$ 0.012–1.15

The fair value of all stock issuances above is based upon the quoted closing trading price on the date of issuance, except for stock issued for cash and warrants, which was based upon the cash received. Stock issued in the conversion of preferred stock was recorded at par value.

MusclePharm Corporation and Subsidiary

Notes to Consolidated Financial Statements

June 30, 2011 (Restated)

(unaudited)

The following is a more detailed description of some of the Company's stock issuances from the table above:

(1) Conversion of Debt

The Company issued 66,005,639 shares of common stock to settle notes payable having a fair value of \$2,109,677 (\$0.012 - \$0.066/share), based upon the quoted closing trading price. The Company also recorded a loss on settlement of \$411,124.

(2) Settlement of Accounts Payable and Accrued Expense and Loss on Settlement

Of the total shares issued to settle accounts payable and accrued expenses, the Company issued 54,746,257 shares of common stock having a fair value of \$3,625,771 (\$0.016 - \$0.10/share), based upon the quoted closing trading price. The Company settled \$1,494,822 in accounts payable and recorded a loss on settlement of \$2,130,949.

(3) Stock Issued for Services

During six months ended June 30, 2011, the Company issued 10,466,497 (\$0.030 - \$1.15/share) shares of common stock for services, having a fair value of \$510,681 based upon the quoted closing trading price.

(4) Prepaid Stock Compensation

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During six months ended June 30, 2011, the Company issued 4,000,000 shares of common stock for future services, having a fair value of \$251,500 (\$0.047 - \$0.08/share), based upon the quoted closing trading price. The agreements terminate during the periods July 2011 - November 2012.

The following represents the allocation of prepaid stock compensation:

	Short- Term	Long- Term	Total
Prepaid stock compensation - – December 31, 2010	\$893,240	\$1,088,131	\$1,981,371
Prepaid issuances of stock for services	150,000	101,500	251,500
Reclassification from long-term to short-term	379,232	(379,232)	-
Amortization – 2011	(1,039,926)	-	(1,039,926)
Prepaid stock compensation – June 30, 2011	\$382,546	\$810,399	\$1,192,945

MusclePharm Corporation and Subsidiary

Notes to Consolidated Financial Statements

June 30, 2011 (Restated)

(unaudited)

(5) Contract Settlement

In connection with litigation (See Note 8(A)), the Company issued stock that has been accounted for as a settlement expense and a component of other expense.

- (6) The Company cancelled 3,500,000 shares having a par value of \$350 (\$0.0001). The Company is disputing the issuance of these shares due to non-performance by a consultant.

(B) Stock Options

On February 1, 2010, the Company's board of directors and shareholders approved the 2010 Stock Incentive Plan ("2010 Plan"). The 2010 Plan allows the Company to grant incentive stock options, non-qualified stock options, restricted stock awards, restricted stock units and stock appreciation rights to key employees and directors of the Company or its subsidiaries, consultants, advisors and service providers. Any stock option granted in the form of an incentive stock option will be intended to comply with the requirements of Section 422 of the Internal Revenue Code of 1986, as amended. Only stock options granted to employees qualify for incentive stock option treatment. No incentive stock option shall be granted after February 1, 2020, which is 10 years from the date the 2010 Plan was initially adopted. A stock option may be exercised in whole or in installments, which may be cumulative. Shares of common stock purchased upon the exercise of a stock option must be paid for in full at the time of the exercise in cash or such other consideration determined by the compensation committee. Payment may include tendering shares of common stock or surrendering of a stock award, or a combination of methods.

The 2010 Plan will be administered by the compensation committee. The compensation committee has full and exclusive power within the limitations set forth in the 2010 Plan to make all decisions and determinations regarding the selection of participants and the granting of awards; establishing the terms and conditions relating to each award; adopting rules, regulations and guidelines; and interpreting the 2010 Plan. The Compensation Committee will determine the appropriate mix of stock options and stock awards to be granted to best achieve the objectives of the 2010 Plan. The 2010 Plan may be amended by the Board or the compensation committee, without the approval of stockholders, but no such amendments may increase the number of shares issuable under the 2010 Plan or adversely affect any outstanding awards without the consent of the holders thereof. The total number of shares that may be

issued shall not exceed 5,000,000, subject to adjustment in the event of certain recapitalizations, reorganizations and similar transactions.

MusclePharm Corporation and Subsidiary**Notes to Consolidated Financial Statements****June 30, 2011 (Restated)****(unaudited)**

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, 2010 – outstanding	2,767,500	\$ 0.50		\$ -
Balance – December 31, 2010 – exercisable	2,767,500	\$ 0.50		\$ -
Granted		\$		
Exercised		\$		
Forfeited		\$		
Balance – June 30, 2011 – outstanding	2,767,500	\$ 0.50	1.25 years	\$ -
Balance - June 30, 2011 – exercisable	2,767,500	\$ 0.50	1.25 years	\$ -
Grant date fair value of options granted – 2011		\$		
Weighted average grant date fair value – 2011		\$		
Outstanding options held by related parties – 2011	2,000,000			
Exercisable options held by related parties – 2011	2,000,000			
Fair value of stock options granted to related parties – 2011	\$-			

(C) Stock Warrants

During the six months ended June 30, 2011, the Company issued 58,893,333 stock warrants attached to certain convertible debt (Note 5A). The Company recorded the fair value of the discount to additional paid in capital. The Company is amortizing the discount over the life of the convertible debt.

In addition, the Company issued 200,000 5 year stock purchase warrants with exercise prices ranging from \$0.08 - \$0.10 per share for services rendered. The Company recorded an expense of \$16,200 as a result of the issuance.

The Company applied fair value accounting for stock warrant issuance. The fair value of each stock warrant granted is estimated on the date of issuance using the Black-Scholes option-pricing model. The Black-Scholes assumptions used at issuance are as follows:

MusclePharm Corporation and Subsidiary**Notes to Consolidated Financial Statements****June 30, 2011 (Restated)****(unaudited)**

Exercise price	\$0.025 - \$1.50	
Expected dividends	0	%
Expected volatility	180	%
Risk free interest rate	1.16	%
Expected life of warrants	2.5 to 5 years	
Expected forfeitures	0	%

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

	Warrants	Weighted Average Exercise Price	
Outstanding – December 31, 2010	750,000	\$	1.50
Exercisable – December 31, 2010	750,000	\$	1.50
Granted	59,093,333	\$	0.08
Exercised	-	\$	-
Forfeited/Cancelled	-	\$	-
Outstanding – June 30, 2011	59,843,333	\$	0.09
Exercisable – June 30, 2011	59,843,333	\$	0.51

Warrants Outstanding Warrants Exercisable

Range of exercise price	Warrants Outstanding		Weighted Average Exercise Price	Warrants Exercisable	
	Number	Weighted Average Remaining Contractual Life (in years)		Number	Weighted Average Exercise Price
\$0.025- \$1.50	59,843,333	2.64 years			