

HEALTHSOUTH CORP  
Form 8-K  
October 28, 2015

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

FORM 8-K  
CURRENT REPORT  
Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934  
Date of Report (date of earliest event reported): October 28, 2015

HealthSouth Corporation  
(Exact name of Registrant as specified in its Charter)  
Delaware  
(State or Other Jurisdiction of Incorporation)  
001-10315  
(Commission File Number)

63-0860407  
(IRS Employer Identification No.)

3660 Grandview Parkway, Suite 200, Birmingham, Alabama 35243  
(Address of Principal Executive Offices, Including Zip Code)  
(205) 967-7116  
(Registrant's Telephone Number, Including Area Code)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

- .. Written communication pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
  - .. Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
  - .. Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
  - .. Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))
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ITEM 2.02. Results of Operations and Financial Condition.

The information contained herein is being furnished pursuant to Item 2.02 of Form 8-K, “Results of Operations and Financial Condition,” and Item 7.01 of Form 8-K, “Regulation FD Disclosure.” This information shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), or incorporated by reference in any filing under the Securities Act of 1933, as amended, (the “Securities Act”) or the Exchange Act, except as shall be expressly set forth by specific reference in such a filing.

On October 28, 2015, HealthSouth Corporation (the “Company”) issued a press release reporting the financial results of the Company for the three and nine months ended September 30, 2015. A copy of the press release is attached to this report as Exhibit 99.1 and incorporated herein by reference.

ITEM 7.01. Regulation FD Disclosure.

See Item 2.02, “Results of Operations and Financial Condition,” above.

In addition, a copy of the supplemental slides which will be discussed during the Company’s earnings call at 9:00 a.m. Eastern Time on Thursday, October 29, 2015 is attached to this report as Exhibit 99.2 and incorporated herein by reference. This information shall not be deemed “filed” for purposes of Section 18 of the Exchange Act, or incorporated by reference in any filing under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such a filing.

Note Regarding Presentation of Non-GAAP Financial Measures

The financial data contained in the press release and supplemental slides include non-GAAP financial measures, including the Company’s leverage ratio and Adjusted EBITDA. Adjusted EBITDA, as defined below, is used on both a consolidated basis and a segment basis. No corporate overhead is allocated to either of our reportable segments.

The leverage ratio referenced therein is defined as the ratio of consolidated total debt to Adjusted EBITDA for the trailing four quarters, subject to pro forma adjustments resulting from debt transactions and development activities. The Company believes its leverage ratio and Adjusted EBITDA are measures of its ability to service its debt and its ability to make capital expenditures. Additionally, the leverage ratio is a standard measurement used by investors to gauge the creditworthiness of an institution. The Company’s credit agreement also includes a maximum leverage ratio financial covenant which allows the Company to deduct up to \$75 million of cash on hand from consolidated total debt. The Company reconciles Adjusted EBITDA to net income in the press release attached as Exhibit 99.1 and the supplemental slides attached as Exhibit 99.2 and to net cash provided by operating activities in the supplemental slides attached as Exhibit 99.2 and below. Adjusted EBITDA for the Company’s reportable segments is reconciled to net income from continuing operations before income tax expense below.

The Company uses Adjusted EBITDA on a consolidated basis as a liquidity measure. The Company believes this financial measure on a consolidated basis is important in analyzing its liquidity because it is the key component of certain material covenants contained within the Company’s credit agreement, which is discussed in more detail in Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations, “Liquidity and Capital Resources,” and Note 8, Long-term Debt, to the consolidated financial statements included in its Annual Report on Form 10-K for the year ended December 31, 2014 (the “2014 Form 10-K”) and Note 4, Long-term Debt, to the condensed consolidated financial statements included in Part I, Item 1, Financial Statements (Unaudited), of the Company’s quarterly report on Form 10-Q for the quarterly period ended September 30, 2015 (the “September 2015 Form 10-Q”), when filed. These covenants are material terms of the credit agreement. Noncompliance with these financial covenants under the credit agreement—its interest coverage ratio and its leverage ratio—could result in the Company’s lenders requiring the Company to immediately repay all amounts borrowed. If the Company anticipated a potential covenant violation, it would seek relief from its lenders, which would have some cost to the Company, and such relief might be on terms less favorable to those in the Company’s existing credit agreement. In addition, if the Company cannot satisfy these financial covenants, it would be prohibited under the credit agreement from engaging in certain activities, such as incurring additional indebtedness, paying common stock dividends, making certain payments, and acquiring and disposing of assets. Consequently, Adjusted EBITDA is critical to the Company’s assessment of its liquidity.

In general terms, the credit agreement definition of Adjusted EBITDA, therein referred to as “Adjusted Consolidated EBITDA,” allows the Company to add back to consolidated net income interest expense, income taxes, and depreciation and amortization and then add back to consolidated net income (1) all unusual or nonrecurring items

reducing consolidated net income (of which only up to \$10 million in a year may be cash expenditures), (2) any losses from discontinued operations and closed locations, (3) costs and expenses, including legal fees and expert witness fees, incurred with respect to litigation

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associated with stockholder derivative litigation, including the matters related to Ernst & Young LLP and Richard Scrusby discussed in Note 18, Contingencies and Other Commitments, to the consolidated financial statements accompanying the 2014 Form 10-K, and (4) share-based compensation expense. The Company also subtracts from consolidated net income all unusual or nonrecurring items to the extent they increase consolidated net income. Under the credit agreement, the Adjusted EBITDA calculation does not include net income attributable to noncontrolling interests and includes (1) gain or loss on disposal of assets, (2) professional fees unrelated to the stockholder derivative litigation, and (3) unusual or nonrecurring cash expenditures in excess of \$10 million. These items may not be indicative of the Company's ongoing performance, so the Adjusted EBITDA calculation presented here includes adjustments for them.

Adjusted EBITDA is not a measure of financial performance under generally accepted accounting principles in the United States of America ("GAAP"), and the items excluded from Adjusted EBITDA are significant components in understanding and assessing financial performance. Therefore, Adjusted EBITDA should not be considered a substitute for net income or cash flows from operating, investing, or financing activities. Because Adjusted EBITDA is not a measurement determined in accordance with GAAP and is thus susceptible to varying calculations, Adjusted EBITDA, as presented, may not be comparable to other similarly titled measures of other companies. Revenues and expenses are measured in accordance with the policies and procedures described in Note 1, Summary of Significant Accounting Policies, to the consolidated financial statements accompanying the 2014 Form 10-K and Note 1, Basis of Presentation, "Net Operating Revenues," and "Accounts Receivable and Allowance for Doubtful Accounts," to the condensed consolidated financial statements included in Part I, Item 1, Financial Statements (Unaudited), of the September 2015 Form 10-Q, when filed.

The Company also uses adjusted free cash flow as an analytical indicator to assess its performance. Management believes the presentation of adjusted free cash flow provides investors an efficient means by which they can evaluate the Company's capacity to reduce debt, pursue development activities, and return capital to its common stockholders. The calculation of adjusted free cash flow and a reconciliation of net cash provided by operating activities to adjusted free cash flow are included in the press release attached as Exhibit 99.1 and the supplemental slides attached as Exhibit 99.2. This measure is not a defined measure of financial performance under GAAP and should not be considered as an alternative to net cash provided by operating activities. The Company's definition of adjusted free cash flow is limited and does not represent residual cash flows available for discretionary spending. Because this measure is not determined in accordance with GAAP and is susceptible to varying calculations, it may not be comparable to other similarly titled measures presented by other companies. See the condensed consolidated statements of cash flows included in the September 2015 Form 10-Q, when filed, and in the press release attached as Exhibit 99.1 for the GAAP measures of cash flows from operating, investing, and financing activities.

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Reconciliation of Net Cash Provided by Operating Activities to Consolidated Adjusted EBITDA

	Three Months Ended		Nine Months Ended		Year Ended December	
	September 30,		September 30,		31,	
	2015	2014	2015	2014	2014	2013
	(In Millions)					
Net cash provided by operating activities	\$ 163.3	\$ 139.6	\$ 368.2	\$ 374.7	\$ 444.9	\$ 470.3
Provision for doubtful accounts	(10.7 )	(8.2 )	(33.2 )	(25.0 )	(31.6 )	(26.0 )
Professional fees—accounting, tax, and legal	0.4	4.0	2.7	7.6	9.3	9.5
Interest expense and amortization of debt discounts and fees	35.6	27.8	98.3	83.5	109.2	100.4
Equity in net income of nonconsolidated affiliates	2.4	1.9	6.3	8.8	10.7	11.2
Net income attributable to noncontrolling interests in continuing operations	(17.1 )	(14.7 )	(50.9 )	(44.3 )	(59.7 )	(57.8 )
Amortization of debt-related items	(4.6 )	(3.2 )	(10.9 )	(9.5 )	(12.7 )	(5.0 )
Distributions from nonconsolidated affiliates	(0.8 )	(2.9 )	(4.5 )	(9.4 )	(12.6 )	(11.4 )
Current portion of income tax expense	3.5	3.2	10.4	9.8	13.3	6.3
Change in assets and liabilities	(7.8 )	(0.8 )	93.3	43.7	90.1	48.9
Net premium (received) paid on bond transactions	(1.8 )	(6.3 )	2.0	(6.3 )	4.3	1.7
Net cash used in (provided by) operating activities of discontinued operations	0.5	(0.2 )	0.8	1.0	1.2	1.9
Reliant/CareSouth transaction costs	2.3	—	5.6	—	—	—
Encompass transaction costs	—	—	—	—	9.3	—
Other	0.2	(0.2 )	2.9	2.2	1.9	1.6
Consolidated Adjusted EBITDA	\$ 165.4	\$ 140.0	\$ 491.0	\$ 436.8	\$ 577.6	\$ 551.6

Reconciliation of Segment Adjusted EBITDA to Income from Continuing Operations Before Income Tax Expense

	Three Months Ended		Nine Months Ended
	September 30,		
	2015	2014	2015
	In Millions		
Total segment Adjusted EBITDA	\$ 186.9	\$ 162.5	\$ 557.7
General and administrative expenses	(30.6 )	(27.5 )	(97.3 )
Depreciation and amortization	(33.7 )	(27.4 )	(98.3 )
Loss on disposal or impairment of assets	(0.9 )	(2.7 )	(0.2 )
Government, class action, and related	—	—	(8.0 )

settlements  
 Professional  
 fees -  
 accounting, tax,  
 and legal

(0.4 ) (4.0 ) (2.7 )

Loss on early  
 extinguishment  
 of debt

— — (20.0 ) The following table details our outstanding debt as of September 30, 2007:  
*(In thousands)*

**As of  
 September 30  
 2007**

**Short-term**

Demand notes payable to related party	\$	1,72
<b>Subtotal short-term</b>	<b>\$</b>	<b>1,72</b>
<b>Grand total</b>	<b>\$</b>	<b>1,72</b>

Demand notes payable consisted of a 4% secured note payable to Mr. Nolan Quan, of our principal shareholders, and are secured by the assets of the Company.

**BROADCASTER, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(CONTINUED)****9.****EARNINGS PER SHARE POTENTIALLY DILUTIVE SECURITIES**

Basic earnings per share are computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share are computed using the weighted average number of common and potentially dilutive securities outstanding during the period. Potentially dilutive securities consist of the incremental common shares issuable upon exercise of stock options and warrants (using the treasury stock method). Potentially dilutive securities are excluded from the computation if their effect is anti-dilutive. The following table summarizes the weighted average shares outstanding:

	<b>Three months ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
<b>Basic weighted average shares outstanding</b>	51,207	31,69
Total stock options outstanding	4,357	2,09
Less: anti dilutive stock options due to loss	(4,357 )	(2,09
Total warrants outstanding	1,349	2,26
Less: anti dilutive warrants due to loss	(1,349 )	(2,26
<b>Diluted weighted average shares outstanding</b>	51,207	31,69

**9.****STOCK-BASED AWARDS**

The Company has two stock option plans, The 2004 Incentive Stock Option Plan (the 2004 Plan ) adopted during fiscal 2004 and the 1993 Incentive Option Plan adopted June 30, 1993 (the 1993 Plan ). The purpose of the 2004 and the 1993 Plans was to further the growth and general prosperity of Broadcaster by enabling our employees to acquire our common stock, increasing their personal involvement in the Company and thereby enabling Broadcaster to attract and retain our employees. The 1993 Plan is no longer used

Broadcaster believes that the ability to grant incentive stock options to its employees is critically important. We hope to offer incentive compensation to such employees on

par with those provided by our competition and others in the high-tech industry. In addition, tax laws and incentive compensation policies have changed since adoption of the 1993 Plan. As a result, our Board of Directors has adopted and our shareholders have approved the 2004 Plan to permit Broadcaster to offer a wide range of incentives, including incentive and non-statutory stock options and stock purchase rights.

Stock options are granted at an exercise price equivalent to the closing fair market value on the date of grant. All options are granted at the discretion of the Company's Board of Directors and have a term of not greater than 10 years from the date of grant. Options are exercisable when vested. Vesting requires continuous employment up to the vesting date and the vesting schedule is determined by the Board of Directors at the time of each option grant.

### **The 2004 Plan**

The 2004 Plan provides for the granting of options to purchase up to an aggregate of 10,500,000 shares of common stock to employees, directors and other service providers of Broadcaster. Any options that expire prior to exercise will become available for new grants from the pool of options. Options that are granted under the 2004 Plan may be either options that qualify as incentive stock options under the Internal Revenue Code ( Incentive Options ), or those that do not qualify as such ( Non-Qualified Options ).

The Incentive Options may not be granted at a purchase price less than the fair market value of the common stock on the date of the grant (or, for an option granted to a person holding more than 10% of the Company's voting stock, at less than 110% of market value) and Non-Qualified Options may not be granted at a purchase price less than 85% of fair market value on the date of grant. As a matter of policy, Broadcaster's Board of Directors will not



**BROADCASTER, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(CONTINUED)****9.****STOCK-BASED AWARDS (Continued)**

grant options at less than fair market value. The term of each option, under the 2004 Plan, which is fixed at the date of grant, may not exceed 10 years from the date the option is granted (by law, an Incentive Option granted to a person holding more than 10% of the Company's voting stock may be exercisable only for five years). As of the date of this Report, 826,233 options remain available for grant.

The following table summarizes options at September 30, 2007.

	<b>Number of Shares</b>	<b>Weighted Average Exercise Price</b>
<b>Outstanding, June 30, 2007</b>	4,752,041	2.39
Granted	25,000	2.30
Exercised	108,750	1.99
Cancelled	311,544	2.81
<b>Outstanding, September 30, 2007</b>	4,356,747	2.36

The following table summarizes options at September 30, 2007.

	<b>Number of Shares</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Term (in years)</b>	<b>Aggregated Intrinsic Value (\$000 s)</b>
Outstanding	4,356,747	2.36	7.29	96
Vested and Expected to Vest	4,333,297	2.36	7.30	96

Exercisable	1,657,038	2.50	7.23	31
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At September 30, 2007, the Company had \$299,000 of unrecognized compensation expense, net of forfeitures, related to stock options that will be recognized over the weighted average remaining vesting period of 0.29 years.

**Warrants**

Warrants have been granted from time to time in conjunction with financings, debt settlements, Board of Directors and employee compensation and consulting arrangements. The following table summarizes warrant activity for the three months ended September 30, 2006 and the three months ended September 30, 2007.

	<b>Number of Warrants</b>	<b>Average Exercise Price</b>
<b>Outstanding, June 30, 2007</b>	1,982,941	3.71
Granted		
Exercised		
Exercised cashless		
Expired	633,500	
<b>Outstanding, September 30, 2007</b>	1,349,441	4.69

**BROADCASTER, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(CONTINUED)****9.****STOCK-BASED AWARDS (Continued)****Other Information Regarding Stock Options and Warrants**

Additional information regarding stock options and warrants outstanding as of September 30, 2007 is as follows:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Avg. Remaining Life	Weighted Avg. Exercise Price	Number Exercisable	Weighted Avg. Exercise Price
\$0-\$2.97	3,218,906	8.0	\$2.01	1,186,947	\$2.08
\$2.9701-\$5.94	1,130,341	5.3	\$3.32	462,591	\$3.49
\$5.9401-\$8.94	7,500	1.8	\$7.25	7,500	\$7.25
\$8.9401-\$50.0					
	4,356,747	7.3	\$2.36	1,657,038	\$2.50

  

Range of Exercise Prices	Warrants Outstanding		Warrants Exercisable	
	Number Outstanding	Weighted Avg. Exercise Price	Number Exercisable	Weighted Avg. Exercise Price
\$0.0-\$2.97	852,295	\$1.85	852,295	\$1.85
\$2.971-\$5.94	300,000	\$3.95	30,000	\$3.95
\$5.949-\$11.88	62,500	\$10.00	62,500	\$10.00
\$11.889-\$14.85	62,500	\$12.96	62,500	\$12.96
\$14.8501-\$29.70	72,146	\$29.56	72,146	\$29.56
	1,349,441	\$4.69	1,349,441	\$4.69

The fair value of each option granted was estimated on the date of the grant using the Black-Scholes option-pricing model using the following weighted average assumptions:

	<b>Three months ended</b>	
	<b>September 30,</b>	
	<b>2007</b>	<b>2006</b>
Risk-free interest rates	4.26%	4.59%
Expected dividend yields		
Expected volatility	85%	82%
Expected option life (in years)	5	

The weighted average fair value as of the grant date for grants made during the quarter ended September 30, 2007 and 2006 were \$2.15 and \$1.30, respectively.

## ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**The Following Discussion Should Be Read Together with the Information Contained in the Financial Statements and Related Notes Included Elsewhere in this Form 10-Q.**

### Overview

Prior to November 2006, AccessMedia's business model consisted of an online entertainment portal that charged users a monthly subscription fee. In November 2006, we decided to focus our efforts and resources related to building a user base. Because of this, we incorporated Broadcaster Interactive Group, Inc. ("BIG"), which focuses on building innovative products online and offering our community numerous content offerings. AccessMedia's business recently ceased when the last subscription ended and we no longer had to support its website. In July 2007, we started to generate nominal revenue from BIG from the sale of advertising. We are currently concentrating on building an increasing number of unique monthly visitors and repeat use of Broadcaster.com by these visitors.

As a result of the negative cash flow from BIG and our corporate overhead, our Board of Directors is closely monitoring BIG's operations and exploring strategic alternatives. We are planning on launching another subscription offering in an effort to generate material near term cash flow. Among possible alternatives are the sale of BIG, discontinuing its operations and acquisitions of other Internet businesses.

Highlights for the three months ended September 30, 2007 consisted of:

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In July 2007, we launched our Social Video Network and began generating nominal revenues in BIG.

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In August 2007, we released "Remote Video" embed tags, which allow users to easily integrate a live video stream into their favorite social networking websites.

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We incurred a non-cash stock option expense of \$610,000 for the three months ended September 30, 2007.

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We incurred a non-cash impairment charge of \$5,200,000 relating to the AccessMedia acquisition.

### **Critical Accounting Estimates**

Our significant accounting policies are more fully described in the notes to our consolidated financial statements. The policies discussed immediately below, are particularly important to the portrayal of our financial position and results of operations and require the application of significant judgment by our management to determine the appropriate assumptions to be used in the determination of certain estimates.

Those material accounting estimates that we believe are the most critical to an investor's understanding of our financial results and condition are discussed below.

### **Revenue Recognition**

Revenues are recognized in accordance with American Institute of Certified Public Accountants Statement of Position ( SOP ) 97-2, *Software Revenue Recognition*, and SOP 98-9, *Modification of SOP 97-2, With Respect to Certain Transactions*. Revenue is recognized when persuasive evidence of an arrangement exists, product or service has been delivered, the fee is fixed and determinable, and collection of the resulting account is probable.

Revenues related to the display of advertisements on the Internet as impressions (the number of times that an advertisement appears in pages viewed by users) are delivered as long as no significant obligations remain at the end of the period. To the extent that significant obligations remain at the end of a period, the Company will defer recognition of the corresponding revenues until the remaining guaranteed amounts are achieved.

Revenues from the display of text-based links to the websites of our advertisers are recognized as the click-throughs (the number of times a user clicks on an advertiser listing) occur.

Subscription revenues are recognized ratably over the contract period.

### Results of Operations

The following tables set forth our results of operations that have been adjusted to reflect the sale of Houseplans and include only results from continuing operations for the three months ended September 30, 2007 and 2006.

#### *Three Months Ended September 30, 2007 compared to the Three Months Ended September 30, 2006.*

(In Thousands)

	Three Months Ended September 30,				
	2007		2006		\$ Change
	\$	As % of Sales	\$	As % of Sales	Variance
Net revenues	\$ 596	100 %	\$ 2,937	100 %	\$ (2,341 )
Product cost	816	137 %	1,187	40 %	(371 )
<b>Gross margin</b>	(220 )	-37 %	1,750	60 %	(1,970 )
Operating expenses					
Sales and marketing	604	101 %	1,578	45 %	(974 )
General and administrative	2,533	425 %	1,908	53 %	625
<b>Total operating Expenses</b>	3,137	526 %	3,486	98 %	(349 )
<b>Loss</b>	(3,357 )	-563 %	(1,736 )	-59 %	(1,621 )
Other income (expenses)					
Interest and other, net	50	8 %	82	3 %	(32 )
Realized/unrealized gain (loss) on marketable securities		0 %	25	1 %	(25 )

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Impairment	(5,200 )	-872 %			(5,200 )
<b>Total other income (loss)</b>	(5,150 )	-864 %	107	4 %	(5,257 )
<b>Loss before income tax benefit</b>	(8,507 )	1,427 %	(1,629 )	-55 %	(6,878 )
Income tax benefit	259	43 %	180	6 %	79
<b>Loss from continuing operations</b>	(8,248 )	1,384 %	(1,449 )	-49 %	(6,799 )
Loss from discontinued operations, net of income tax	(4 )	-1 %	(239 )	-8 %	235
<b>Net loss</b>	(8,252 )	1,385 %	(1,688 )	-57 %	(6,564 )

*Net Revenues*

With the sale of Houseplans and cessation of AccessMedia's subscription business, we have two operating subsidiaries, BIG which operates our free model and AccessMedia which generated revenues of \$550,000 and \$2,937,000 for the quarters ended September 30, 2007 and September 30, 2006, respectively. Revenues include software sales, Internet media advertising sales and the sale of text-based Internet links. Sales of downloaded products are recognized ratably over the term of the license sold. Sales of advertisements are recognized upon the delivery of the impressions guaranteed. Sales of click-throughs are recognized upon delivery of the click-throughs guaranteed. BIG, which operates our free entertainment portal, had sales of \$46,000 for the quarter ended September 30, 2007.



### **Gross Margin**

Our consolidated gross margin was (\$220,000) and \$1,750,000 for the quarter ended September 30, 2007, and the quarter ended September 30, 2006, respectively. The negative margin is based on the production and programming related costs to BIG.

AccessMedia's cost of revenues consists of costs related to the products and services AccessMedia provided to customers. These costs include materials, salaries and related expenses for product support personnel, depreciation and maintenance of equipment used in providing services to customers and facilities expenses. During the quarter ended September 30, 2007, cost of sales expenses included \$359,000 related to services provided by Alchemy Communications, Inc., a company controlled by Mr. Nolan Quan, one of our principal shareholders.

### ***Sales and Marketing***

Sales and marketing expenses were \$604,000 and \$1,578,000 for the quarter ended September 30, 2007 and the quarter ended September 30, 2006.

Sales and marketing expense for BIG consists primarily of salaries and related expenses for sales, support and marketing personnel, commissions, costs and expenses for customer acquisition programs and referrals, a portion of facilities expenses and depreciation and amortization of equipment. BIG anticipates that the percentage of sales and marketing expense will decrease due to BIG's generation of revenues and reduction in the purchase of traffic starting in July 2007.

During the quarter ended September 30, 2007, sales and marketing expenses included \$13,000 related to services provided by Alchemy Communications, a company controlled by Mr. Nolan Quan, one of our principal stockholders.

### ***General and Administrative***

General and administrative expense consists primarily of salaries and related expenses for administrative, finance, legal, human resources and executive personnel, fees for professional services and costs of accounting and internal control systems to support its operations. Expenses have increased primarily due to the addition of personnel in management and administration to support the increasing activity levels and as a result of amortization of assets acquired during 2007. Additionally, the adoption of SFAS 123R resulted in a non-cash expense of \$610,000 for the quarter ended September 30, 2007. We expect we will incur approximately \$908,000 of non-cash stock option expense in fiscal 2008, of which \$610,000 was expensed in the three months ended September 30, 2007, related to the fair value of options unvested at June 30, 2007.

We anticipate that general and administrative expense will decrease in absolute dollars as BIG continues to reduce costs to preserve cash. BIG expects to secure a number of services from a related party Alchemy at a market rate. During the quarter ended September 30, 2007, general and administrative expenses included \$37,000 related to

services provided by Alchemy.

***Research and Development***

We had no research and development costs for the three months ended September 30, 2007.

***Interest and other, net***

Interest and other, net, was a net gain of \$50,000 for the quarter ended September 30, 2007. This was due to an increase in cash balances and a reduction in debt obligations resulting from the deployment of proceeds from the sale of Precision Design and Houseplans. Our interest expenses included \$17,000 related to a loan from Mr. Nolan Quan.

***Provision for State and Federal Income Taxes***

***Accounting for Uncertainty in Income Taxes*** - In June 2006, the FASB issued FIN No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. The interpretation prescribes a recognition threshold and measurement

attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 requires recognition of tax benefits that satisfy a greater than 50% probability threshold. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN No. 48 is effective for us beginning July 1, 2007.

We recorded income tax benefit of \$259,000 for the quarter ended September 30, 2007. The tax benefit for the quarter ended September 30, 2007 primarily represents the release of deferred tax provision on amortization of intangible assets.

We have not recorded a tax benefit for domestic tax losses because of the uncertainty of realization. We adhere to SFAS No. 109, *Accounting for Income Taxes*, which requires an asset and liability approach to financial accounting and reporting for income taxes. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. Consistent with our past practice, we have recorded a full valuation allowance at June 30, 2007 as the realizability of our operating loss carry-forwards is not determinable.

### **Discontinued Operations**

#### ***(Loss) from discontinued operations, net of income tax***

##### *Sale of Houseplans*

On May 1, 2007, we sold 100% of the issued and outstanding capital stock of Houseplans to Kransco Houseplans, LLC, for \$8 million. The sale price is composed of \$5 million in cash on closing and a note receivable of \$3 million, paid in installments over a three year period. The note receivable consists of eight quarterly payments of \$250,000 commencing on March 31, 2008, and a final payment of \$1,000,000 payable on March 31, 2010. The note receivable bears interest at a rate of 5% and any accrued interest will be paid on each installment. The results of operations for the quarter ended September 30, 2006 have been revised to eliminate the operations of Houseplans.

### **Liquidity and Capital Resources**

Net cash used in operating activities was \$3,405,000 for the three months ended September 30, 2007 in contrast to \$2,456,000 for the three months ended September 30, 2006

Net cash provided by investing activities was \$0 for the three months ended September 30, 2007 in contrast to \$1,005,000 in the three months ended September 2006. The principal factor consisted of \$1,500,000 received from the sale of Precision Design during the quarter ended September 30, 2006

Our net cash provided by financing activities for the three months ended September 30, 2007 and 2006 was \$217,000 and \$194,000, respectively, reflecting proceeds from the exercise of options and warrants.

To achieve our growth objectives, we are considering different strategies, including growth through acquisitions. As a result, we are evaluating and we will continue to evaluate other companies and businesses for potential synergies that would add value to our existing operations.

At November 9, 2007, we had \$5,640,000 in cash which is projected to meet all of our working capital needs for the next twelve months.

Notwithstanding our current negative cash flow, based on anticipated revenues and cost reductions, we expect we will have sufficient capital for the next twelve months. However, if we do not meet our revenue targets or if we use our cash for acquisition, we will require additional financing. We expect that any financing will be of common stock, convertible debt or convertible preferred stock, which will dilute our existing shareholders. We believe that we will be able to obtain any additional financing required on competitive terms particularly if we are successful in improving our financial performance. In addition, we will continue to seek opportunities and discussions with third parties concerning the sale or license of certain product lines and/or the sale or license of a portion of our assets.

We have no material commitments for capital expenditures except for those required to support the normal operating activities.

### **Related Person Transactions**

We receive services from Alchemy, a company controlled by Mr. Nolan Quan, one of our principal shareholders. For the quarter ended September 30, 2007, we incurred \$409,000 of expenses related to Alchemy, \$17,000 in interest related to a loan from Mr. Quan and consulting fees of \$6,000 payable to Mr. Quan. The company also owes Mr. Quan \$1,725,000 evidenced by demand promissory notes bearing 4% per annum interest and secured by the company's assets. During the three months ended September 30, 2007, we incurred \$14,000 in legal fees from Ms. Elaine Rosen. In addition, we paid Mr. Kevin Rosen-Quan \$14,000 as a Producer. Ms. Rosen and Mr. Rosen-Quan are the wife and son of Mr. Nolan Quan, one of our principal shareholders.

### **Forward-Looking Statements**

This quarterly report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including the initiation of our new subscription model and our liquidity. These forward-looking statements are subject to a number of risks and uncertainties, many of which are beyond our control. When used in this report, the words will, believe, anticipate, intend, estimate, expect, project and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain the identifying words. Although we believe that our plans, intentions, and expectations reflected in or suggested by the forward-looking statements we make in this report are reasonable, we cannot assure you that these plans, intentions, or expectations will be achieved. Actual results may differ materially from those stated in these forward-looking statements as a result of a variety of factors including acceptance by consumers of our current and future products, including our new business model, the repeated usage of our free website, the acceptance by advertisers of our website metrics, and our ability to complete development of new products. Investors should also review the risk factors contained in our Form 10-KSB for the year ended June 30, 2007 and the additional risk factors contained in this Report. We do not undertake a duty to update these forward-looking statements.

### **ITEM 3. - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

#### **Market Risk**

Our financial instruments consist primarily of cash and cash equivalents, marketable securities, accounts receivable, notes receivable, accounts payable and notes payable. At September 30, 2007, the fair value of these instruments approximates their carrying amounts.

#### **Currency Risk**

For the quarters ended September 30, 2007 and 2006, we did not have any revenues from foreign operations.

**Interest rate risk**

Our indebtedness is limited and does not have any variable rate aspect.

**ITEM 4 - CONTROLS AND PROCEDURES**

(a)

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-14(c) promulgated under the Securities Exchange Act of 1934, as of September 30, 2007, the end of the period covered by this quarterly report. Based on their evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures are effective.

(b)

We have evaluated our accounting procedures and control processes in place as of September 30, 2007 related to material transactions to ensure they are recorded timely and accurately in the financial statements. There have been no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of the evaluation referenced in paragraph (a) above.

## **PART II - OTHER INFORMATION**

### **ITEM 1 - LEGAL PROCEEDINGS**

As previously reported, Broadcaster filed suit against former officers Paul A. Jakab and Gordon Landies, each of whom filed counterclaims against Broadcaster. The Landies litigation has been resolved by Broadcaster making a payment to Landies. The Jakab litigation remains pending.

We are subject to legal proceedings, claims, and litigation arising in the ordinary course of business. While the outcome of these matters is currently not determinable, we do not expect that the ultimate costs to resolve these matters will have a material adverse effect on our consolidated financial position, results of operations, or cash flows. There have been no material changes in any litigation to which we are a party, except as reported above.

### **ITEM 1A RISK FACTORS**

Our business is subject to a number of risk factors which investors should review before deciding to purchase or sell our common stock, including the risk factors found in our annual report on Form 10-KSB for the year ended June 30, 2007.

**Because Broadcaster's business model is changing and is unproven, it is difficult to evaluate its current business and future prospects.**

Our business is substantially dependent upon Broadcaster's ability to generate revenue from users in addition to advertising revenue. To accomplish this, we intend to offer subscriptions beginning in December. These are relatively new products which make an evaluation of its current business and future prospects difficult. The revenue and income potential of these additional products are unproven.

### **ITEM 2 - UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

Not Applicable

### **ITEM 3 - DEFAULTS UPON SENIOR SECURITIES**

Not Applicable

**ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

Not Applicable

**ITEM 5 - OTHER INFORMATION**

Not Applicable

**ITEM 6 - EXHIBITS**

Exhibits

The following exhibits are filed as part of, or incorporated by reference into this Report:

<b>Number</b>	<b>Exhibit Title</b>
<u>31.1</u>	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
<u>31.2</u>	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
<u>32.1</u>	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
<u>32.2</u>	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002



**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 authorized.

**Date: November 14, 2007**

**BROADCASTER, INC.**

By: /s/ MARTIN WADE, III  
Martin Wade, III  
Chief Executive Officer

By: /s/ BLAIR MILLS  
Blair Mills  
Chief Financial Officer (Principal Accounting Officer)

**EXHIBIT INDEX**

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