

Edgar Filing: GOLFGEAR INTERNATIONAL INC - Form 10QSB

GOLFGEAR INTERNATIONAL INC  
Form 10QSB  
July 18, 2005

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

FORM 10-QSB  
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QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For quarterly period ended: March 31, 2004

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT

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

Commission file number: 000-28007  
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GOLFGEAR INTERNATIONAL, INC.  
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(Name of small business issuer in its charter)

NEVADA

43-1627555  
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(State or other jurisdiction of incorporation or organization)

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

11562 KNOTT AVENUE. SUITE 9, GARDEN GROVE  
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90067-2320  
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(Address of principal executive offices)

(Zip Code)

Issuer's telephone number including area code: (714) 892-8889

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

COMMON STOCK, \$0.001 PAR VALUE  
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(Title of Class)

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS

Check whether the registrant filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by a court. Yes: ; No: -----

APPLICABLE ONLY TO CORPORATE ISSUERS

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State the number of shares outstanding of each of the issuer's classes of common equity, as of July 8, 2005: 42,203,966

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Transitional Small Business Disclosure Format (Check One): Yes:     ; No: X  
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GOLFGEAR INTERNATIONAL, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEET  
MARCH 31, 2004  
(UNAUDITED)

Part I - Financial Information

Item 1. Financial Statements

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ASSETS

|  |            |
|--|------------|
| Current assets:  |            |
| Cash   | \$ 3,316   |
| Accounts receivable, net of allowance<br>for doubtful accounts of \$37,869 | --         |
| Inventories  | 74,151     |
| Prepaid expenses   | 51,166     |
|  | -----      |
| Total current assets   | 128,633    |
| Property and equipment, net  | 29,180     |
| Other assets:  |            |
| Intangible assets, net   | 69,185     |
| Deposits   | 7,770      |
|  | -----      |
| Total assets   | \$ 234,768 |
|  | =====      |

LIABILITIES AND STOCKHOLDERS' DEFICIT

|  |              |
|--|--------------|
| Current liabilities:   |              |
| Accounts payable and accrued expenses  | \$ 1,025,388 |
| Accrued product warranties   | 91,416       |
| Accrued interest payable   | 184,409      |
| Bank lines of credit   | 64,688       |
| Notes payable  | 33,177       |
| Convertible debentures due to related parties  | 1,000,000    |
| Convertible debentures   | 1,200,000    |
|  | -----        |
| Total current liabilities  | 3,599,078    |
|  | -----        |
| Commitments and contingencies  |              |
| Stockholders' deficit:   |              |
| Preferred stock, \$.001 par value; 10,000,000<br>shares authorized; none issued and outstanding    | --           |
| Common stock, \$.001 par value; 50,000,000 shares<br>authorized; 40,445,076 issued and outstanding | 40,445       |
| Additional paid-in capital   | 14,275,837   |
| Deferred compensation  | (55,784)     |
| Accumulated deficit  | (17,624,808) |
|  | -----        |
| Total stockholders' deficit  | (3,364,310)  |
|  | -----        |
| Total liabilities and stockholders' deficit  | \$ 234,768   |
|  | =====        |

See notes to condensed consolidated financial statements.

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GOLFGEAR INTERNATIONAL, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
THREE MONTHS ENDED MARCH 31, 2004 and 2003  
(UNAUDITED)

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|   | 2004           | 2003           |
|---|----------------|----------------|
|   | -----          | -----          |
| Net sales   | \$ 371,557     | \$ 545,245     |
| Cost of goods sold  | 176,854        | 328,338        |
|   | -----          | -----          |
| Gross profit  | 194,703        | 216,907        |
| Operating expenses:   |                |                |
| Selling and marketing   | 87,168         | 189,951        |
| Tour and pro contracts  | 20,388         | 21,234         |
| General and administrative  | 298,447        | 400,041        |
| Depreciation and amortization   | 7,562          | 21,257         |
| Total operating expenses  | 413,565        | 632,483        |
|   | -----          | -----          |
| Loss from operations  | (218,862)      | (415,576)      |
| Other income (expense):   |                |                |
| Interest income   | --             | 6,809          |
| Interest expense  | (1,018,764)    | (776,930)      |
| Other, net  | (5,139)        | 40,181         |
|   | -----          | -----          |
| Total expense, net  | (1,023,903)    | (729,940)      |
|   | -----          | -----          |
| Loss before provision for income taxes                                      | (1,242,765)    | (1,145,516)    |
| Provision for income taxes  | 2,400          | 2,400          |
|   | -----          | -----          |
| Net loss  | \$ (1,245,165) | \$ (1,147,916) |
|   | =====          | =====          |
| Loss per common share - basic and diluted                                   | \$ (0.03)      | \$ (0.03)      |
|   | =====          | =====          |
| Weighted average number of common shares<br>outstanding - basic and diluted | 40,445,076     | 36,020,321     |
|   | =====          | =====          |

See notes to condensed consolidated financial statements

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GOLFGEAR INTERNATIONAL, INC., AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
THREE MONTHS ENDED MARCH 31, 2004 AND 2003  
(UNAUDITED)

|  | 2004           | 2003           |
|--|----------------|----------------|
|  | -----          | -----          |
| Cash flows from operating activities:  |                |                |
| Net loss   | \$ (1,245,165) | \$ (1,147,916) |
| Adjustments to reconcile net loss to net cash<br>provided by (used in) operating activities: |                |                |
| Amortization of deferred compensation  | 11,157         | 8,367          |

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|  |            |           |
|--|------------|-----------|
| Depreciation and amortization  | 7,562      | 21,257    |
| Accrued interest on stock purchase note receivable                               | --         | (6,805)   |
| Amortization of debt discount  | 977,778    | 643,565   |
| Amortization of deferred financing costs   | --         | 86,009    |
| Provision for bad debts  | --         | 17,758    |
| Loss on disposal of assets   | 5,963      | --        |
| Gain on settlement of accounts payable   | --         | (22,626)  |
| Changes in operating assets and liabilities:                                     |            |           |
| (Increase) decrease in:  |            |           |
| Accounts receivable  | 131,395    | (29,382)  |
| Inventories  | (4,772)    | 9,688     |
| Prepaid expenses   | 23,829     | 1,669     |
| Deferred advertising costs   | --         | (600)     |
| Increase (decrease) in:  |            |           |
| Accounts payable and accrued expenses  | 124,515    | (40,673)  |
| Accrued product warranties   | (267)      | 147       |
| Accrued interest payable   | 12,070     | 37,594    |
| Deferred licensing revenue   | (50,303)   | (12,031)  |
|  | -----      | -----     |
| Net cash used in operating activities  | (6,238)    | (433,979) |
|  | -----      | -----     |
| Cash flows used in investing activities:   |            |           |
| Purchases of property and equipment  | (6,250)    | (6,251)   |
|  | -----      | -----     |
| Cash flows from financing activities:  |            |           |
| (Repayments) borrowings under bank lines of credit, net                          | (44,535)   | 93,627    |
| Proceeds from issuance of common stock   | --         | 280,000   |
| Repayment of convertible debt  | (100,000)  | --        |
| Collection of amount due from stockholder<br>for convertible debenture financing | 100,000    | --        |
| Proceeds from exercise of stock options  | --         | 250       |
|  | -----      | -----     |
| Net cash (used in) provided by financing activities                              | (44,535)   | 373,877   |
|  | -----      | -----     |
| Net decrease in cash   | (57,023)   | (66,353)  |
|  | -----      | -----     |
| Cash, beginning of period  | 60,339     | 117,018   |
|  | -----      | -----     |
| Cash, end of period  | \$ 3,316   | \$ 50,665 |
|  | -----      | -----     |
| Supplemental disclosures of cash flow information:                               |            |           |
| Cash paid for interest   | \$ 25,778  | \$ 6,761  |
|  | =====      | =====     |
| Cash paid for income taxes   | \$ --      | \$ --     |
|  | =====      | =====     |
| Supplemental disclosure of non-cash activities:                                  |            |           |
| Settlement of convertible debenture with transfer of inventory                   | \$ 100,000 | \$ --     |
|  | =====      | =====     |

See notes to condensed consolidated financials statements.

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GOLFGEAR INTERNATIONAL AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
MARCH 31, 2004 AND 2003

1. BASIS OF PRESENTATION

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Management of GolfGear International, Inc. (the "Company") has prepared, without audit, the accompanying condensed consolidated financial statements for the three months ended March 31, 2004 and 2003. The information furnished has been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial reporting. Accordingly, certain disclosures normally included in a complete set of financial statements prepared in accordance with GAAP have been condensed or omitted. In the opinion of management, all adjustments considered necessary for the fair presentation of the Company's financial position, results of operations and cash flows have been included and are only of a normal recurring nature. The results of operations for the three months ended March 31, 2004 are not necessarily indicative of the results of operations for the year ended December 31, 2004. The interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto contained in the Company's Form 10-KSB for the year ended December 31, 2003.

### 2. LIQUIDITY AND MANAGEMENT'S PLANS

During the third quarter of 2004, the Company suspended normal operations, including expanding brands and product offerings, new marketing programs, and direct marketing to customers, due to a lack of operating working capital resources. To the extent that the Company is unable to secure financing in 2005, the Company's liquidity and ability to continue to conduct operations will be impaired. The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. Since inception, the Company has incurred recurring losses and requires additional capital to finance continuing operations. The Company incurred a loss of \$1,245,165 for the three months ended March 31, 2004. As of March 31, 2004, the Company had a working capital deficit of \$3,470,445 and a stockholders' deficit of \$3,364,310. These factors, among others, raise substantial doubt about the Company's ability to continue as a going concern. The accompanying condensed consolidated financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that may result should the Company be unable to continue as a going concern.

The Company is attempting to increase revenues through various means, including expanding brands and product offerings, new marketing programs, and possibly direct marketing to customers, subject to the availability of operating working capital resources. To the extent that the Company is unable to increase revenues in the next few years, the Company's liquidity and ability to continue to conduct operations may be impaired.

The Company will require additional capital to fund operating requirements. The Company is exploring various alternatives to raise this required capital, including convertible debentures, private infusion of equity and various collateralized debt instruments, but there can be no assurance that the Company will be successful in this regard. To the extent the Company is unable to secure the capital necessary to fund its future cash requirements on a timely basis and/or under acceptable terms and conditions, the Company may have to substantially reduce its operations to a level consistent with its available working capital resources. The Company may also be required to consider a formal or informal restructuring or reorganization.

As discussed in Note 10 the Company has secured a commitment for a \$10,000,000 private placement offering whereby a third party investor will purchase up to \$10,000,000 of the Company's common stock over a twenty-four month period to provide the Company with operating capital. Funding is subject to, among other things, the Company filing a registration statement with the United States Securities and Exchange Commission with respect to the resale of

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common stock sold in the private placement offering. The Company is currently working towards satisfying all conditions precedent to closing the funding, but there can be no assurance that the Company will be successful in satisfying these terms.

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The summary of significant accounting policies presented below is designed to assist in understanding the Company's condensed consolidated financial statements. Such condensed consolidated financial statements and accompanying notes are the representations of the Company's management, who is responsible for their integrity and objectivity. These accounting policies conform to GAAP in all material respects, and have been consistently applied in preparing the accompanying condensed consolidated financial statements.

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#### GOLFGEAR INTERNATIONAL AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) MARCH 31, 2004 AND 2003

##### Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, GGI, Inc., GearFit Golf Company, Pacific Golf Holdings, Inc. Bel Air Players Group, Inc. and Leading Edge Acquisition, Inc. All significant intercompany transactions and balances have been eliminated in consolidation. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates made by management are, among others, the realizability of accounts receivable and inventories, recoverability of long-lived assets, and valuation of deferred tax assets. Actual results could differ from those estimates.

##### Inventories

Inventories are stated at the lower of cost (first-in, first-out) or estimated market, and consist of raw materials of \$30,747 and finished goods of \$43,404. Market is determined by comparison with recent sales or estimated net realizable value.

Net realizable value is based on management's forecasts for sales of the Company's products and services in the ensuing years and/or consideration and analysis of changes in the customer base, product mix, or other issues that may impact the estimated net realizable value. Should the demand for the Company's products and/or services prove to be significantly less than anticipated, the ultimate realizable value of the Company's inventories could be substantially less than reflected in the accompanying condensed consolidated balance sheet.

##### Property and Equipment

Property and equipment are stated at cost. Depreciation is computed on the straight-line method over the estimated useful lives of the assets that

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range from five to seven years. Leasehold improvements are amortized on the straight-line method over the term of the lease or the useful life of the asset, whichever is shorter. Maintenance and repairs are charged to expense as incurred. Renewals and improvements of a major nature are capitalized. At the time of retirement or other disposition of property and equipment, the cost and accumulated depreciation are removed from the accounts and any resulting gains or losses are reflected in operations.

### Intangible Assets

Intangible assets include the cost of patents and trademarks, and are being amortized on the straight-line basis over their estimated useful lives, which vary from two to seventeen years.

### Long-Lived Assets

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," the Company evaluates the carrying value of long-lived assets for impairment whenever events or change in circumstances indicate that such carrying values may not be recoverable. Under SFAS No. 144, the Company estimates the future undiscounted cash flows derived from an asset to assess whether or not a potential impairment exists when events or circumstances indicate the carrying value of a long-lived asset may differ. An impairment loss is recognized when the undiscounted future cash flows are less than its carrying amount. The Company uses its best judgment based on the most current facts and circumstances surrounding its business when applying these impairment rules to determine the timing of the impairment test, the undiscounted cash flows used to assess impairments and the fair value of a potentially impaired asset. Changes in assumptions used could have a significant impact on the Company's assessment of recoverability. At March 31, 2004, the Company determined that no impairment loss was necessary. There can be no assurance, however, that demand for the Company's products will continue, which could result in impairment of long-lived assets in the future.

### Deferred Financing Costs

Deferred financing costs represent costs incurred in connection with the issuance of the convertible debentures. Deferred financing costs are amortized over the life of the convertible debentures on the straight-line basis, which approximates the effective interest method.

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GOLFGEAR INTERNATIONAL AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
MARCH 31, 2004 AND 2003

### Beneficial Conversion Feature

The convertible feature of certain convertible notes provides for a rate of conversion that is below market value. Such feature is normally characterized as a "beneficial conversion feature" ("BCF"). Pursuant to Emerging Issues Task Force ("EITF") Issue No. 98-5, "Accounting For Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratio" and EITF Issue No. 00-27, "Application of EITF Issue No. 98-5 To Certain Convertible Instruments," the relative fair values of the BCF's have been recorded as a discount to the face amount of the respective debt instrument. The Company amortizes the discount using the straight-line method,



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which approximates the effective interest method, through maturity of such instruments. The Company will record the corresponding unamortized debt discount related to the BCF and the warrants as interest expense when the related instrument is converted into the Company's common stock.

### Fair Value of Financial Instruments

The Company's financial instruments consist of cash, accounts receivable, payables, accrued expenses, notes payable and convertible debentures. The carrying value for all such instruments, except the convertible debentures, considering the terms, approximates fair value at March 31, 2004. The fair value of convertible debentures is not determinable as equivalent instruments could not be located.

### Revenue Recognition

Revenue is recognized in accordance with Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition in Financial Statements", as revised by SAB 104. The Company recognizes revenue when products are shipped to a customer and the risks and rewards of ownership and title have passed based on the terms of sale. The Company records a provision for sales returns and claims based upon historical experience. Actual returns and claims in any future period may differ from the Company's estimates.

Amounts billed to customers for shipping and handling fees are included in net sales, and freight costs incurred related to these fees are included in cost of goods sold in accordance with EITF Issue No. 00-01, "Accounting for Shipping and Handling Fees and Costs."

Licensing revenue is recognized when earned per the terms of royalty agreements. Occasionally, licensees pay royalties in advance, which are recorded as deferred licensing revenue in the accompanying consolidated balance sheet until such time they are earned.

### Product Warranties

The Company generally provides a lifetime warranty against defects. The Company maintains a reserve for its product warranty liability based on estimates calculated using historical warranty experience. While warranty costs have historically been within the Company's expectations, there can be no assurance that the Company will continue to experience the same warranty return rates or repair costs as in prior years. A significant increase in product return rates, or a significant increase in the costs to repair product, could have a material adverse impact on the Company's operating results. Warranty activity was not significant during the periods presented.

### Advertising

Advertising costs for the three months ended March 31, 2004 and 2003 were \$12,252 and \$50,866, respectively, which is included in selling and marketing expenses in the accompanying condensed consolidated statements of operations.

### Basic and Diluted Loss Per Share

Basic earnings (loss) per common share are computed based on the weighted average number of shares outstanding for the period. Diluted earnings (loss) per share is computed by dividing net income (loss) by the weighted average shares outstanding assuming all dilutive potential common shares are issued. Basic and diluted loss per share is the same as the effect of stock options and warrants on loss per share are anti-dilutive and thus not included in the diluted loss per share calculation. However, the impact under the

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treasury stock method of dilutive stock options and warrants would have been zero and 2,344,047 incremental shares for three months ended March 31, 2004 and 2003, respectively.

### Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation.

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### GOLFGEAR INTERNATIONAL AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) MARCH 31, 2004 AND 2003

#### Segment and Geographic Information

The Company operates in one business segment. The Company sells to customers in the United States and the Far East. During the three months ended March 31, 2004 and 2003 the Company had no international sales.

#### Stock-Based Compensation

The Company periodically issues common stock options and common stock purchase warrants to employees and non-employees in non-capital raising transactions for services rendered and to be rendered, and as financing costs.

Stock-based awards to non-employees are accounted for using the fair value method in accordance with SFAS No. 123, "Accounting for Stock-Based Compensation," and EITF Issue No. 96-18, "Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services." All transactions in which goods or services are the consideration received for the issuance of equity instruments are accounted for based on the fair value of the consideration received or the fair value of the equity instrument issued, whichever is more reliably measurable. The measurement date used to determine the fair value of the equity instrument issued is the earlier of the date on which the third-party performance is complete or the date on which it is probable that performance will occur.

The Company accounts for stock-based awards to employees using the intrinsic value method in accordance with APB Opinion No. 25. As permitted by SFAS No. 123, as amended by SFAS No. 148, the Company has chosen to continue to account for its employee stock-based compensation plan under APB Opinion No. 25 and provide the expanded disclosures specified in SFAS No. 123, as amended by SFAS No. 148. Had employee stock based compensation cost been determined using the fair value method, the Company's net loss and loss per share would have been adjusted to the pro forma amounts indicated below:

|  | For the Three Months<br>Ended March 31, |                |
|--|---|----------------|
|  | 2004                                    | 2003           |
| Net loss as reported   | \$ (1,245,165)                          | \$ (1,147,916) |
| Deduct: Total stock-based employee<br>compensation under fair value based method<br>for all awards, net of related tax effects | --                                      | (37,417)       |

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|  |                |                |
|--|----------------|----------------|
| Pro forma net loss                             | \$ (1,245,165) | \$ (1,185,333) |
|  | =====          | =====          |
| Basic and diluted loss per share - as reported | \$ (0.03)      | \$ (0.03)      |
|  | =====          | =====          |
| Basic and diluted loss per share - pro forma   | \$ (0.03)      | \$ (0.03)      |
|  | =====          | =====          |

### Recently Issued Accounting Pronouncements

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 establishes standards for the classification and measurement of certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 also includes required disclosures for financial instruments within its scope. For the Company, SFAS No. 150 was effective for instruments entered into or modified after May 31, 2003 and otherwise will be effective as of January 1, 2004, except for mandatory redeemable financial instruments. For certain mandatory redeemable financial instruments, SFAS No. 150 will be effective for the Company on January 1, 2005. The Company is in process of evaluating whether the adoption of SFAS No. 150 will have a significant impact on the Company's overall results of operations or financial position.

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### GOLFGEAR INTERNATIONAL AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) MARCH 31, 2004 AND 2003

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs, an amendment of ARB No. 43, Chapter 4." The amendments made by SFAS No. 151 clarify that abnormal amounts of facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges and require the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. The guidance is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company is in the process of evaluating whether the adoption of SFAS No. 151 will have a significant impact on the Company's overall results of operations or financial position.

In December 2004, the FASB issued SFAS No. 123 (revised 2004) ("SFAS No. 123(R)"), "Share-Based Payment," to provide investors and other users of financial statements with more complete and neutral financial information by requiring that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. Statement No. 123(R) covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. SFAS No. 123(R) replaces SFAS No. 123 and supersedes APB Opinion No. 25. SFAS No. 123, as originally issued in 1995, established as preferable a fair-value-based method of accounting for share-based payment transactions with employees. However, that statement permitted entities the option of continuing to apply the guidance in APB Opinion No. 25, as long as the footnotes to financial statements disclosed what net income would have been had the preferable fair-value-based method been used. The Company will be required to apply SFAS No. 123(R) as of January 1, 2006. The Company is in the process of evaluating whether the adoption of SFAS No. 123(R) will have a significant impact on the Company's overall results of operations or financial position.

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In December 2004, the FASB issued SFAS No. 153, "Exchanges of Non-monetary Assets - an amendment of APB Opinion No. 29, Accounting for Non-monetary Transactions." This statement amends APB Opinion No. 29 to eliminate the exceptions for non-monetary exchanges of similar productive assets and replaces it with a general exception for exchanges of non-monetary assets that do not have commercial substance. A non-monetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The provisions for SFAS No. 153 are effective for non-monetary asset exchanges incurred during fiscal years beginning after June 15, 2005. The Company is currently evaluating the effect, if any, of adopting SFAS No. 153.

#### 4. BANK LINES OF CREDIT

The Company had a \$250,000 bank line collateralized by eligible accounts receivable. The line of credit originally matured on December 9, 2003 and was extended to June 2004. Outstanding borrowings bore interest at 28% annually. Interest was payable monthly. There were no outstanding borrowings under this line at March 31, 2004. This credit line was closed and paid in full in June 2004. The Company also had an unsecured \$70,000 line of credit with another bank. Interest was payable monthly at a variable rate (10% at March 31, 2004). Outstanding borrowings at March 31, 2004 were \$64,688. This line of credit was closed and paid in full in September 2004. Interest expense related to the bank lines of credit was \$6,403 and \$9,403 for the three months ended March 31, 2004 and 2003, respectively.

#### 5. CONVERTIBLE DEBENTURES DUE TO RELATED PARTIES

On October 7, 2003, the Company completed the sale of \$250,000 of 5% convertible debentures to MC Corporation, a company affiliated with a Company director and stockholder ("MC Corp"). These debentures were convertible into common stock at \$0.09 per share for a period of three months from the date of issuance. For each share of common stock issued upon conversion of the debentures, one common stock purchase warrant will be issued and will be exercisable for a period of twelve months at \$0.045 per share. Issuance costs were not significant. The estimated value of the beneficial conversion feature was not significant at the date of issuance. In December 2003, these debentures, including accrued interest of \$2,083, were converted into 2,800,922 shares of common stock. The warrants expired unexercised.

On December 30, 2003, the Company completed the sale of \$1,000,000 of 5% convertible debentures to Quincy and MC Corp. The debentures were automatically convertible into 525,000 shares of Series A preferred stock of the Company within ninety days of the date of issuance. Pursuant to the terms of the debenture agreement, if the Company was unable to convert the debentures into shares of Series A preferred stock within ninety days of issuance, the debentures would become immediately due and payable in full, with interest continuing to accrue at the face rate of interest of 5% per annum. As of December 31, 2003, the Company had not received \$100,000 in proceeds from Quincy, and accordingly, the Company recorded \$100,000 due from stockholder in the accompanying consolidated balance sheet. The amount was subsequently received in January 2004. The debentures are currently in default and are due on demand.

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Holder of the Series A preferred stock have the right to convert the Series A preferred stock into shares of common stock of the Company at conversion rates of 158:1 for Quincy and 161:1 for MC Corp. upon any of the following: (i) eighteen months after the date of issuance of the Series A preferred stock, (ii) a change of control, as defined, or (iii) upon the date the Company is no longer required to file reports or financial statements with the United States Securities Exchange Commission.

The conversion feature of the convertible debentures provides for a rate of conversion that is below market value, resulting in a beneficial conversion feature. The Company estimated the fair value of the beneficial conversion feature to be \$1,000,000 at date of issuance, and recorded such conversion feature as a debt discount. The Company recorded interest expense of \$977,778 during the three months ended March 31, 2004 related to the amortization of the debt discount.

### 6. CONVERTIBLE DEBENTURES

On June 6, 2002, the Company completed the sale of \$2,100,000 of 7% convertible debentures. The debentures are convertible into common stock at \$0.25 per share for the period of 12 months commencing six months after the initial sale of the debentures, and were due in December 2003. The Company's patents, trademarks, and other intangible assets secure the debentures. For each share of common stock issued upon conversion of the debentures, one common stock purchase warrant will be issued, which will be exercisable at \$0.10 per share for a period of 18 months from the date of conversion.

The conversion feature of the convertible debentures provides for a rate of conversion that is below market value, resulting in a beneficial conversion feature. The Company estimated the fair value of the beneficial conversion feature to be \$2,100,000 at date of issuance, and recorded such conversion feature as a debt discount, which was amortized to interest expense over the term of the debentures. On December 16, 2002, the Company's Board of Directors approved a modification to the original debenture agreement to provide for the exercise of warrants prior to the conversion of the debentures. The Company estimated the fair value of the warrants at the date of the modification and reallocated \$600,000 of the original debt discount of \$2,100,000 to the warrants based on the relative fair values of the warrants and beneficial conversion feature as of December 16, 2002. The estimated fair value of the warrants was amortized over the remaining term of the debentures.

In connection with the issuance of the debentures, the Company issued 420,000 shares of the Company's common stock valued at \$105,000 to Wyngate as a finder's fee. In addition, the Company granted Wyngate a warrant to purchase 420,000 shares of the Company's common stock at an exercise price of \$0.10 per share, which were exercisable for a period of eighteen months. The warrants were valued at \$172,200 using the Black-Scholes option-pricing model. In addition, the Company issued 540,000 shares of the Company's common stock valued at \$135,000 as a finder's fee to an unrelated third party. The Company also paid legal fees of \$29,934 related to the financing.

The costs incurred in connection with the financing were capitalized as deferred financing costs and amortized over the term of the convertible debentures. Amortization of deferred financing costs was \$86,009 during the three months ended March 31, 2003 and is included in interest expense in the accompanying consolidated statements of operations.

In January and February 2004, the Company repaid an additional \$200,000 in debentures, including accrued interest, which was satisfied with approximately \$122,000 cash and inventories valued at \$100,000. The Company continues to accrue interest on all outstanding debentures at the face rate of

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interest.

Interest expense related to the convertible debentures was \$24,970 and \$682,040 for the three months ended March 31, 2004 and 2003, respectively. For the three months ended March 31, 2003, \$643,565 related to the amortization of debt discount. Accrued interest at March 31, 2004 was \$169,062.

### 7. STOCKHOLDERS' EQUITY

During the three months ended March 31, 2003, the Company issued 2,800,000 shares of common stock for exercised warrants at \$0.10 per share. During the three months ended March 31, 2003, the Company issued 25,000 shares of common stock for exercised options at \$0.01 per share.

During the three months ended March 31, 2004, the Company issued no equity instruments.

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### GOLFGEAR INTERNATIONAL AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) MARCH 31, 2004 AND 2003

### 8. COMMITMENTS AND CONTINGENCIES

#### Litigation

On December 18, 2003, the Company received a resignation letter from Donald A. Anderson as a member of the Board of Directors of the Company. On December 19, 2003, Mr. Anderson also resigned as Chief Executive Officer of the Company. Prior to his resignation, on or about November 8, 2003, Mr. Anderson was suspended pending an investigation into possible violations of his employment contract with the Company and breach of fiduciary duty.

On November 18, 2003, Mr. Anderson filed a complaint against the Company and its officers for breach of written contract, wrongful termination of employment and slander. Subsequently, the Company filed a cross complaint against Mr. Anderson for, among other things, breach of fiduciary duty and breach of written contract.

On June 23, 2004, the Company, its officers and Mr. Anderson entered into a Settlement Agreement (the "Settlement Agreement"), wherein, among other things, the Company withdrew its allegation that Mr. Anderson breached his fiduciary duties. Pursuant to the terms of the Settlement Agreement, the Company agreed to (i) pay Mr. Anderson \$165,000 in varying installments through January 30, 2006, (ii) transfer the title of a 1996 Ford custom tour van (with a net book value of approximately \$7,000) owned by the Company to Mr. Anderson, and remove Mr. Anderson as a guarantor from certain Company debt obligations. In return, Mr. Anderson returned to the Company 994,110 shares of the Company's common stock owned by him valued at approximately \$30,000 (fair market value of the Company's stock on the settlement date). As of December 31, 2003, the Company recorded a net liability of approximately \$142,000 related to the settlement of this lawsuit. Mr. Anderson also agreed to convert \$60,000 in debentures, including accrued interest, held by him into shares of the Company's common stock at a conversion rate of \$0.095 per share. These debentures were converted into 753,000 shares of the Company's common stock on February 23, 2005.

The Company is currently in default for payment of amounts due to Mr. Anderson under the Settlement Agreement. On February 15, 2005, Mr. Anderson

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received a judgment for \$76,310 due to him under the terms of the Settlement Agreement. Pursuant to the Settlement Agreement, the Company agreed to issue a new stock certificate to Mr. Anderson for a stolen stock certificate for 2,642,625 shares of the Company's common stock. As of July 8, 2005, the Company has not issued this stock certificate. Mr. Anderson will dismiss the lawsuit upon the Company's full performance of the Settlement Agreement.

In March 2004, holders in the amount of \$200,000 of the Company's convertible debentures filed suit against the Company claiming, among other things, breach of written contract and default under security agreement and possession of collateral. The plaintiffs are seeking repayment of the principal amount of the debentures, including accrued interest, which matured on January 6, 2004, and possession of the intellectual property, including patents and trademarks, which collateralized the debentures. The parties are currently attempting to reach agreement on resolving this action in its entirety.

From time to time the Company is involved in various types of litigation in the normal course of business, none of which is considered material at this time.

### Indemnities and Guaranties

The Company has executed certain contractual indemnities and guarantees, under which it may be required to make payments to a guaranteed or indemnified party. The Company also has agreed to indemnify its directors, officers, employees and agents to the maximum extent permitted under the laws of the State of Nevada. In connection with a certain facility lease, the Company has indemnified its lessor for certain claims arising from the use of the facilities. The duration of the guarantees and indemnities varies, and in many cases is indefinite. These guarantees and indemnities do not provide for any limitation of the maximum potential future payments the Company could be obligated to make. Historically, the Company has not been obligated to make any payments for these obligations and no liabilities have been recorded for these indemnities and guarantees in the accompanying consolidated balance sheet.

### 9. RESTATEMENT OF PREVIOUSLY ISSUED FINANCIAL STATEMENTS

During the year ended December 31, 2003, the Company determined that the manner in which it accounted for the beneficial conversion option on the sale of its \$2,100,000 of convertible debentures in 2002 was not in accordance with Emerging Issues Task Force Issue No. 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments," which states that the debt discount resulting from recording a beneficial conversion option should be accreted from

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### GOLFGEAR INTERNATIONAL AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) MARCH 31, 2004 AND 2003

the date of issuance to the stated redemption date of the convertible instrument, regardless of when the earliest conversion date occurs. Accordingly, in connection with the restatement adjustments, the Company has appropriately reflected the amortization of the debt discount resulting from the recording of the beneficial conversion option over the term of the convertible debentures. The Company had previously recorded the amortization of the debt discount over the earliest period that the convertible debentures could be converted.

During the year ended December 31, 2003, the Company also determined

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that certain transactions involving the issuance of its common stock were not recorded appropriately in 2002. During 2002, the Company acquired the operating assets of Lazereyes and issued 150,000 shares of its common stock valued at \$42,000 as purchase consideration. In connection with the restatement adjustments, the Company has reflected the value of the purchase consideration at \$42,000 and amortized the additional purchase consideration that was allocated to acquired intangibles. The Company had previously recorded the purchase consideration as 100,000 shares of its common stock valued at \$28,000. In addition, during 2002 the Company issued 960,000 shares of its common stock valued at \$240,000 and warrants valued at \$172,200 as deferred financing costs in connection with the \$2,100,000 convertible debenture financing. The Company had previously recorded 1,072,000 shares of its common stock valued at \$268,000 and warrants valued at \$218,120 as deferred financing costs. Accordingly, in connection with the restatement adjustments, the Company has reflected the appropriate number of shares issued and the associated value, and amortized the adjusted amount over the term of the convertible debentures.

The following table presents a summary of the effects of the restatement adjustments on the Company's consolidated statement of operations for the three months ended March 31, 2003:

Consolidated statement of operations:

|  | As previously<br>Reported | Adjustments | As Restated |
|--|---------------------------|-------------|-------------|
|  | -----                     | -----       | -----       |
| Interest expense                             | \$ 133,365                | \$ 643,565  | \$ 776,930  |
| Depreciation and amortization                | 19,507                    | 1,750       | 21,257      |
| Net loss                                     | (502,601)                 | (645,315)   | (1,147,916) |
| Loss per common share -<br>basic and diluted | \$ (0.01)                 | \$ (0.02)   | \$ (0.03)   |

### 10. SUBSEQUENT EVENTS

During the third quarter of 2004 the Company suspended normal operations, including expanding brands and product offerings, new marketing programs, and direct marketing to customers, due to a lack of operating working capital resources. To the extent that the Company is unable to secure financing in 2005, the Company's liquidity and ability to continue to conduct operations will be impaired (see below about future financing).

From July 2004 through June 2005, a director and stockholder has advanced approximately \$300,000 to the Company to be used for working capital. The Company has received these funds and recorded them as loans from stockholder of \$185,600 during 2004 and \$114,400 during 2005.

On January 14, 2005, the Company secured a commitment for a \$10,000,000 private placement offering whereby a third party investor (the "Investor") will purchase up to \$10,000,000 of the Company's common stock over a twenty-four month period to provide the Company with operating capital. Funding is subject to, among other things, the Company filing a registration statement with the U.S. Securities and Exchange Commission with respect to the resale of common stock sold in the private placement offering. The Company is currently working towards satisfying all conditions precedent to closing the funding, but there can be no assurance that the Company will be successful in satisfying these terms. In connection with the funding commitment, the Company paid a structuring fee of \$10,000 and issued 2,000,000 shares of the Company's common stock to the Investor as a commitment fee.

On February 23, 2005, a debenture for \$60,000, including accrued interest, was converted to 753,000 shares of the Company's common stock.



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

OVERVIEW

The following discussion should be read in conjunction with the condensed unaudited consolidated financial statements and notes thereto of the Company appearing elsewhere in this report. Such financial statements have been prepared to reflect the Company's financial position as of March 31, 2004, together with the results of operations for the three months ended March 31, 2004 and 2003, and cash flows for the three months ended March 31, 2004 and 2003.

FORWARD-LOOKING STATEMENTS

Historical results and trends should not be taken as indicative of future operations. Management's statements contained in this report that are not historical facts are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act".) Actual results may differ materially from those included in the forward-looking statements. The Company intends such forward-looking statements to be covered by the safe-harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and is including this statement for purposes of complying with those safe-harbor provisions. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of the Company, are generally identifiable by use of the words "believe," "expect," "intend," "anticipate," "estimate," "project," "prospects," or similar expressions. The Company's ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse affect on the operations and future prospects of the Company on a consolidated basis include, but are not limited to: changes in economic conditions generally in the United States of America and the other countries in which the Company operates, legislative/regulatory changes, the political climate in the foreign countries in which the Company operates, the availability of capital, interest rates, competition, and accounting principles generally accepted in the United States of America ("GAAP"). These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Further information concerning the Company and its business, including additional factors that could materially affect the Company's financial results, is included herein and in the Company's other filings with the Securities and Exchange Commission.

OVERVIEW

The Company designs, develops and markets premium golf clubs and related golf products. The Company utilizes its proprietary forged face insert technology to offer a full line of golf equipment. The Company's patent portfolio with respect to insert technology is the largest and most comprehensive in the golf industry, with nine domestic and foreign patents issued related to forged face insert technology. These patents incorporate a wide variety of forged face insert materials, including titanium, beryllium copper, stainless steel, carbon steel, aluminum, and related alloys thereof, and include technology relating to varying the face thickness of the insert. The Company operates in one business segment. The Company sells to customers in the United States and the Far East.

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The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, GGI, Inc., GearFit Golf Company, Pacific Golf Holdings, Inc., Bel Air Players Group, Inc. and Leading Edge Acquisition, Inc. All intercompany transactions and balances have been eliminated in consolidation.

During the third quarter of 2004, the Company suspended normal operations, including expanding brands and product offerings, new marketing programs, and direct marketing to customers, due to a lack of operating working capital resources. To the extent that the Company is unable to secure financing in 2005, the Company's liquidity and ability to continue to conduct operations will be impaired.

### Restatement of Previously Issued Financial Statements

During the year ended December 31, 2003, the Company determined that the manner in which it accounted for the beneficial conversion option on the sale of its \$2,100,000 of convertible debentures in 2002 was not in accordance with Emerging Issues Task Force Issue No. 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments," which states that the debt discount resulting from recording a beneficial conversion option should be accreted from the date of issuance to the stated redemption date of the convertible instrument, regardless of when the earliest conversion date occurs. Accordingly, in connection with the restatement adjustments, the Company has appropriately reflected the amortization of the debt discount resulting from the recording of the beneficial conversion option over the term of the convertible debentures. The Company had previously recorded the amortization of the debt discount over the earliest period that the convertible debentures could be converted.

During the year ended December 31, 2003, the Company also determined that certain transactions involving the issuance of its common stock were not recorded appropriately in 2002. During 2002, the Company acquired the operating

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assets of Lazereyes and issued 150,000 shares of its common stock valued at \$42,000 as purchase consideration. In connection with the restatement adjustments, the Company has reflected the value of the purchase consideration at \$42,000 and amortized the additional purchase consideration that was allocated to acquired intangibles. The Company had previously recorded the purchase consideration as 100,000 shares of its common stock valued at \$28,000. In addition, during 2002 the Company issued 960,000 shares of its common stock valued at \$240,000 and warrants valued at \$172,200 as deferred financing costs in connection with the \$2,100,000 convertible debenture financing. The Company had previously recorded 1,072,000 shares of its common stock valued at \$268,000 and warrants valued at \$218,120 as deferred financing costs. Accordingly, in connection with the restatement adjustments, the Company has reflected the appropriate number of shares issued and the associated value, and amortized the adjusted amount over the term of the convertible debentures.

See Note 9 to the accompanying condensed consolidated financial statements included in this Quarterly Report on Form 10-QSB for a summary of the effects of the restatement adjustments on the Company's consolidated statement of operations for the three months ended March 31, 2003. The information provided in the accompanying Management's Discussion and Analysis of Financial Condition and Results of Operations reflects the effect of the restatement adjustments.

RESULTS OF OPERATIONS

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### COMPARISON OF THREE MONTHS ENDED MARCH 31, 2004 AND 2003

Net sales decreased to \$371,557 in 2004 from \$545,245 in 2003, a decrease of \$173,688 or 31.9%. The decrease in net sales in 2004 as compared to 2003 is a result of the Company's lack of inventory and marketing efforts. The Company lacked the financial resources necessary to acquire inventory or sustain marketing efforts.

Gross profit decreased to \$194,703 in 2004 from \$216,907 in 2003, and increased as a percentage of net sales to 52.4% in 2004 from 39.8% in 2003. The increase in gross profit as a percentage in 2004 is due to the Company negotiating better pricing from its suppliers.

Selling and marketing expenses decreased to \$87,168 in 2004 (23.5% of net sales) from \$189,951 in 2003 (34.8% of net sales), a decrease of \$102,783. In 2004, the Company lacked the financial resources necessary to acquire inventory or sustain marketing efforts.

Tour and pro contract expenses decreased to \$20,388 in 2004 (5.5% of net sales) from \$21,234 in 2003 (3.9% of net sales), a decrease of \$846.

General and administrative expenses decreased to \$298,447 in 2004 (80.3% of net sales) from \$400,041 in 2003 (73.4% of net sales), a decrease of \$103,994. In 2004, the Company's limited resources required reducing non-essential expenses, including reduction in personnel.

Depreciation and amortization decreased to \$7,562 in 2004 from \$21,257 in 2003, a decrease of \$13,695. The decrease is a result of the Company's down-sizing and disposal of certain non-essential assets.

Interest expense increased to \$1,018,764 in 2004 from \$776,930 in 2003. The increase in interest expense was primarily due to the increase in interest expense related to the \$1,000,000 convertible debenture financing which closed in December 2003. The conversion feature of the convertible debentures provides for a rate of conversion that is below market value, resulting in a beneficial conversion feature. The Company estimated the fair value of the beneficial conversion feature to be \$1,000,000 at date of issuance, and recorded such conversion feature as a debt discount, which was amortized to interest expense over the term of the debentures. The Company recorded interest expense of \$977,778 during the three months ended March 31, 2004 related to the amortization of the debt discount.

Net loss was \$1,245,165 for 2004 as compared to a net loss of \$1,147,916 for 2003. The increase in the net loss is primarily related to the increase in non-cash interest expense noted above.

### Liquidity and Capital Resources

The consolidated financial statements as of and for the three months ended March 31, 2004 have been prepared assuming that the Company will continue as a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The carrying amounts of assets and liabilities presented in the consolidated financial statements do not purport to represent the realizable or settlement values. The Company has suffered recurring operating losses and requires additional financing to continue operations. For the three months ended March 31, 2004, the Company incurred a loss from operations of \$218,862 and a net loss of \$1,245,165; cash used in operating activities of \$6,238; and a working capital deficit of \$3,470,445 with a stockholders' deficit of \$3,364,310. As a result of these factors, among others, there is substantial doubt about the Company's ability to continue as a going concern.

The Company will require additional capital to fund operating requirements. The Company is exploring various alternatives to raise this required capital, including convertible debentures, private infusion of equity and various collateralized debt instruments, but there can be no assurances that the Company will be successful in this regard. To the extent that the Company is unable to secure the capital necessary to fund its future cash requirements on a timely basis and/or under acceptable terms and conditions, the Company may have to substantially reduce its operations to a level consistent with its available working capital resources. The Company may also be required to consider a formal or informal restructuring or reorganization.

The Company has financed its working capital requirements during the past few years principally from the private placement of securities. Such funds have periodically been supplemented with short-term borrowings under the Company's bank line of credit and other private sources. The Company's bank lines of credit were paid in full and closed in 2004. The Company is actively seeking an investment of additional capital. If adequate funds are not available on acceptable terms, the Company may be unable to continue operations, develop, enhance and market products, retain qualified personnel, take advantage of future opportunities, or respond to competitive pressures, any of which could have a material adverse effect on the Company's business, operating results, financial condition or liquidity (see financing activities below for additional information on future funding).

#### Operating Activities

The Company's operations used cash of \$6,238 during the three months ended March 31, 2004, as compared to utilizing cash of \$433,979 during the corresponding period for 2003. The decrease in cash utilized in operating activities in 2004 as compared to 2003 was primarily a result of higher gross margins, increased accounts payable, collection of accounts receivable and utilization of prepaid expenses. At March 31, 2004, cash was \$3,316 representing a decrease of \$57,023, as compared to \$60,339 at December 31, 2003. The Company had a working capital deficit of \$3,470,445 at March 31, 2004, as compared to a working capital deficit of \$2,243,712 at December 31, 2003.

#### Investing Activities

During the three months ended March 31, 2004 and 2003, net cash used in investing activities was \$6,250 and \$6,251, respectively.

#### Financing Activities

During the three months ended March 31, 2004, the Company reduced its borrowings under bank lines of credit by \$44,535 and reduced its outstanding convertible debt by \$200,000. During the three months ended March 31, 2003, the Company increased its borrowing on lines of credit by \$93,627 and received an aggregate of \$280,250 from the issuance of common stock.

Funds from these transactions have been used for working capital. We believe that our cash flow from operations, our March 31, 2004 cash balance, additional capital raised and the borrowing capacity available under the line of credit, will not be sufficient to meet our projected capital expenditures, working capital and other cash requirements for the near future. In order for the Company to continue its growth plan, additional funding will be required from outside sources.

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From January 2004 through June 2005, a director and stockholder has advanced approximately \$340,000 to the Company to be used for working capital. The Company has received these funds and recorded them as loans from stockholder of \$185,600 during 2004 and \$154,400 during 2005.

During the third quarter of 2004 the Company suspended normal operations, including expanding brands and product offerings, new marketing programs, and direct marketing to customers, due to a lack of operating working capital resources. To the extent that the Company is unable to secure financing in 2005, the Company's liquidity and ability to continue to conduct operations will be impaired.

On January 14, 2005, the Company secured a commitment for a \$10,000,000 private placement offering whereby a third party investor (the "Investor") will purchase up to \$10,000,000 of the Company's common stock over a twenty-four month period to provide the Company with operating capital. Funding is subject to, among other things, the Company filing a registration statement with the U.S. Securities and Exchange Commission with respect to the resale of common stock sold in the private placement offering. The Company is currently working towards satisfying all conditions precedent to closing the funding, but there can be no assurance that the Company will be successful in satisfying these terms. In connection with the funding commitment, the Company paid a structuring fee of \$10,000 and issued 2,000,000 shares of the Company's common stock to the Investor as a commitment fee.

### Off Balance Sheet Arrangements

As of March 31, 2004, the Company has no off balance sheet arrangements.

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### Inflation

We do not believe that inflation has had a material effect on our business, financial condition or results of operations. If our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could adversely affect our business, financial condition and results of operations.

### New Accounting Pronouncements

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 establishes standards for the classification and measurement of certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 also includes required disclosures for financial instruments within its scope. For the Company, SFAS No. 150 was effective for instruments entered into or modified after May 31, 2003 and otherwise will be effective as of January 1, 2004, except for mandatory redeemable financial instruments. For certain mandatory redeemable financial instruments, SFAS No. 150 will be effective for the Company on January 1, 2005. The Company currently does not have any financial instruments that are within the scope of SFAS No. 150.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs, an amendment of ARB No. 43, Chapter 4." The amendments made by SFAS No. 151 clarify that abnormal amounts of facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges and require

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the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. The guidance is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company is in the process of evaluating whether the adoption of SFAS No. 151 will have a significant impact on the Company's overall results of operations or financial position.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment," to provide investors and other users of financial statements with more complete and neutral financial information by requiring that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. Statement No. 123(R) covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. SFAS No. 123(R) replaces SFAS No. 123 and supersedes APB Opinion No. 25. SFAS No. 123, as originally issued in 1995, established as preferable a fair-value-based method of accounting for share-based payment transactions with employees. However, that statement permitted entities the option of continuing to apply the guidance in APB Opinion No. 25, as long as the footnotes to financial statements disclosed what net income would have been had the preferable fair-value-based method been used. Public entities (other than those filing as small business issuers) will be required to apply SFAS No. 123(R) as of the first interim or annual reporting period that begins after June 15, 2005. The Company is in the process of evaluating whether the adoption of SFAS No. 123(R) will have a significant impact on the Company's overall results of operations or financial position.

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Non-monetary Assets - an amendment of APB Opinion No. 29, Accounting for Non-monetary Transactions." This statement amends APB Opinion No. 29 to eliminate the exceptions for non-monetary exchanges of similar productive assets and replaces it with a general exception for exchanges of non-monetary assets that do not have commercial substance. A non-monetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The provisions for SFAS No. 153 are effective for non-monetary asset exchanges incurred during fiscal years beginning after June 15, 2005. The Company is currently evaluating the effect, if any, of adopting SFAS No. 153.

### Critical Accounting Policies

#### Inventories

Inventories are stated at the lower of cost (first-in, first-out) or estimated market, and consist of raw materials, work in process and finished goods. Market is determined by comparison with recent sales or estimated net realizable value.

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Net realizable value is based on management's forecasts for sales of the Company's products and services in the ensuing years and/or consideration and analysis of changes in the customer base, product mix, or other issues that may impact the estimated net realizable value. Should the demand for the Company's products or services prove to be significantly less than anticipated, the ultimate realizable value of the Company's inventories could be substantially less than reflected in the accompanying condensed consolidated balance sheet.

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### Long-Lived Assets

In July 2001, the Financial Accounting Standards Board (the "FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of." SFAS No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS No. 144 requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. If the cost basis of a long-lived asset is greater than the projected future undiscounted net cash flows from such asset, an impairment loss is recognized. Impairment losses are calculated as the difference between the cost basis of an asset and its estimated fair value.

As of March 31, 2004, management has determined that no such impairment exists and therefore, no adjustments have been made to the carrying values of long-lived assets. There can be no assurance, however, that market conditions will not change or demand for the Company's services and products will continue which could result in impairment of long-lived assets in the future.

### Intangible Assets

SFAS No. 142, "Goodwill and Other Intangible Assets", which is effective for fiscal years beginning after December 15, 2001, addresses how intangible assets that are acquired individually or with a group of other assets should be accounted for upon their acquisition and after they have been initially recognized in the financial statements. SFAS No. 142 requires that goodwill and intangible assets that have indefinite useful lives not be amortized, but rather be tested at least annually for impairment, and intangible assets that have finite useful lives be amortized over their estimated useful lives. SFAS No. 142 provides specific guidance for testing goodwill and identifiable intangible assets that will not be amortized for impairment. In addition, SFAS No. 142 expands the disclosure requirements about goodwill and other intangible assets in the years subsequent to their acquisition. The principal effect of SFAS No. 142 on the Company's accompanying consolidated financial statements is that the goodwill described in Note 4 to the accompanying condensed consolidated financial statements is not required to be amortized.

### Revenue Recognition

The Company recognizes revenue when products are shipped to a customer and the risks and rewards of ownership and title have passed based on the terms of sale. The Company records a provision for sales returns and claims based upon historical experience. Actual returns and claims in any future period may differ from the Company's estimates.

Amounts billed to customers for shipping and handling fees are included in net sales, and freight costs incurred related to these fees are included in cost of goods sold in accordance with Emerging Issues Task Force ("EITF") Issue No. 00-01, "Accounting for Shipping and Handling Fees and Costs."

Licensing revenue is recognized when earned per the terms of royalty agreements. Occasionally, licensees pay royalties in advance, which are recorded as deferred licensing revenue in the accompanying consolidated balance sheets until such time they are earned.

### Advertising

The Company expenses advertising costs as incurred, except certain direct-response advertising costs. Direct-response advertising costs are capitalized as incurred and then expensed when the related advertising program

is aired.

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ITEM 3. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures. The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), of the effectiveness of the Company's disclosure controls and procedures. Based upon that evaluation, the CEO and CFO concluded that as of March 31, 2004 our disclosure controls and procedures are of limited effectiveness at the reasonable assurance level such that the information relating to the Company, required to be disclosed in SEC reports (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to the Company's management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in internal control over financial reporting. There has been no change in the Company's internal control over financial reporting that occurred during the fiscal quarter ended March 31, 2004 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Limitations on the Effectiveness of Internal Controls

The Company's management, including the CEO and CFO, does not expect that our disclosure controls and procedures or our internal control over financial reporting will necessarily prevent all fraud and material error. An internal control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the internal control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, control may become inadequate because of changes in conditions, and/or the degree of compliance with the policies or procedures may deteriorate.

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PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, the Company may be involved in various claims, lawsuits, disputes with third parties, and actions involving allegations or



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discrimination or breach of contract actions incidental to the normal operations of the business. The Company is not currently involved in any litigation which management believes could have a material adverse effect on its financial position or results of operations.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

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

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

| Exhibit No. | Description  |
|-------------|--|
| -----       | -----  |
| Exhibit 31* | Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a) or 15d-14(a).   |
| Exhibit 32* | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

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\* Filed herewith

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SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

GOLFGEAR INTERNATIONAL, INC.  
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(Registrant)

Date: July 18, 2005      /s/ Daniel C. Wright  
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Daniel C. Wright  
President, Chief Executive Officer  
and Chief Financial Officer

EXHIBIT INDEX

Exhibit 31      Certification of Chief Executive Officer pursuant to Exchange

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Act Rule 13a-14(a) or 15d-14(a).

Exhibit 32

Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.