Propell Corporation.
Form 10-K
April 14, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For Fiscal Year Ended December 31, 2008

Commission file number

PROPELL CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**26-1856569**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

336 Bon Air Center, No. 352

Greenbrae, CA 94904

(Address of principal executive offices)

(415) 747-8775

(Registrant s telephone number, including area code)

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

Common Stock	None
(Title of Class)	(Name of each exchange on which registered)

Securities registered pursuant to Section 12 (g) of the Act: Common Stock, $0.001 par value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes [ ] No [X]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 of Section 15(d) of the Act.

Yes [ ] No [X]

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

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

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ý

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

The aggregate market value of the voting stock of the Company held by non-affiliates as of June 30, 2008 was approximately $99,090 based on the price at which the common stock was last sold prior to such date.

The Registrant has 20,207,593 shares of common stock outstanding as of March 30, 2009.

PROPELL CORPORATION AND SUBSIDIARIES

FORM 10-K

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2008

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PART I

CAUTIONARY STATEMENT RELATING TO THE SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This Annual Report on Form 10-K and the information incorporated by reference includes forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. We intend those forward looking-statements to be covered by the safe harbor provisions for forward-looking statements. All statements regarding our expected financial position and operating results, our business strategy, our financing plans and the outcome of any contingencies are forward-looking statements. Any such forward-looking statements are based on current expectations, estimates, and projections about our industry and our business. Words such as anticipates, expects, intends, plans, believes, seeks, estimates, or variations of those words and similar expressions are ir identify such forward-looking statements. Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those stated in or implied by any forward-looking statements. Factors that could cause actual results to differ materially from forward-looking statements include, but are not limited to, governmental regulations, ability to raise capital, ability to retain customers, dependence upon certain customers, reduction in orders from customers, competitive product offerings and pricing actions, the availability and pricing of key raw materials, dependence on key members of management, risks of entering into new European markets, and economic and political conditions in the United States and abroad.

Item 1. Business

Our Company

We are a recently organized Delaware corporation that is an integrated provider of image-based products and services for the digital photo and promotional products industries. We together with our subsidiaries deliver products and services through multiple channels, including online stores, our own proprietary photo kiosks, independent resellers and company-owned retail stores.

We believe we have built a diverse revenue model, with all revenue streams sharing a common theme of enabling the capture and delivery of images and image related products to consumers and businesses directly to consumers and small businesses, and in partnership with some of the biggest companies in the United States.

All of our current operations are conducted through Propell and our two wholly owned subsidiaries, Crystal Magic, Inc., and Arrow Media Solutions. Each subsidiary is responsible for one of our two lines of business. Our third subsidiary, Auleron 2005, LLC, temporarily discontinued its operations in 2008; however, management retains relationships with Auleron 2005, LLC s on-call network of 3,500 independent contractors to service our installations. Prior to our formation in January 2008, each subsidiary was independently owned.

We and our subsidiary, Crystal Magic, along with our and Crystal Magic partners, market our products and those of Crystal Magic online, at retail, and through business-to-business partners and resellers. Our current customers and the customers of Crystal Magic include the Walt Disney Co., AmerisourceBergen, and several e-commerce web sites. In addition, our management has a long track record of delivering a variety of consumer and photo products, services and logistics to partners, including Wal-Mart, Walgreens, CVS and Rite-Aid.

In April 2008, Crystal Magic, Inc. merged with and into a wholly owned subsidiary of ours, with Crystal Magic surviving the merger and becoming our subsidiary. In May 2008, each of Mountain Capital, LLC (d/b/a Arrow Media Solutions) and Auleron 2005, LLC (d/b/a Auleron Technologies) merged with and into wholly owned subsidiaries of ours. The result of each of the mergers was that each of Mountain Capital, LLC and Auleron 2005, LLC survived the merger and became wholly owned subsidiaries of ours. The transactions were completed in order to form a consolidated enterprise with subsidiaries that each have experience in complementary parts of the imaging and personalized products industries, and to expand their capabilities both online and at retail.

For accounting purposes, our interest in Crystal Magic, Inc. has been classified as an investment in our balance sheet and is accounted for under the cost method of accounting. At the time of the merger, Crystal Magic had a stockholders deficit and thus we determined the carrying value of this investment in our financial statements to be zero. Crystal Magic s financial statements were not consolidated with ours for accounting purposes based on the fact that during the year ended December 31, 2008, Mr. Rhodes could exert substantial influence over our board of directors due to our lack of independent directors and Mr. Rhodes had an option to acquire shares of Crystal Magic that if exercised could have resulted in him, and not us, being deemed to have control over Crystal Magic. Mr. Rhodes recently entered into an agreement with us which, among other things, terminated the option. In addition, while we have recently added an independent director to our Board of Directors, a majority of the members of our Board of Directors are still not independent.

Our principal offices are located at 336 Bon Air Center, No. 352, Greenbrae, CA 94904. Our telephone number is (415) 747-8775. Our fiscal year end is December 31.

The Arrow Media Solutions Division

Our Arrow Media Solutions division provides digital photo solutions for retail. Historically, Arrow Media Solutions has focused partners in nontraditional channels retailers who previously had limited presence in the photo category. We believe Arrow Media Solutions solutions help retailers in their goal to increase store visits and repeat business. In an effort to reduce customer costs, we have recently changed our focus from the sale of kiosks to our kiosk customers to the sale of our Web Stores to such customers. Prior to the beginning of this year, Arrow Media Solutions products were solely related to sales of kiosks to retailers. Arrow Media currently sells kiosk products through a distributor

Arrow Media Solutions revenues increased over the last two years after securing a relationship with AmerisourceBergen, a large healthcare company. During 2008, Arrow Media Solutions generated revenue of approximately $1.46 million of which approximately $1.4 million was derived from revenue generated from its relationship with AmerisourceBergen. Of the $1.46 million, $1.14 was generated after the date that Arrow Media Solutions became our subsidiary and is included in our consolidate revenue for the twelve months ended December 31, 2008. During 2007, Arrow Media Solutions generated revenue of approximately $1.4 million of which approximately $1.1 million was derived from revenue generated from its relationship with AmerisourceBergen.

During the past fiscal year Arrow Media Solutions sold its kiosks using a distribution model to generate revenue; however, due to current economic conditions Arrow Media has shifted its focus away from kiosks and is currently exploring utilizing PropellStores with its kiosk customers, which we believe will be more cost efficient for our customers. During the fiscal year ended December 31, 2008 all of the kiosks sold were sold directly from Arrow Media to the customer and we derived approximately $1.46 million in gross revenue from such sales. Arrow Media Solutions currently sells the kiosk solution to a distributor who then sells it to a customer at a profit. It is also anticipated that we will make additional revenues by selling supplies and other products to the partner. Most profits from retail sales are retained by the partner. Almost all of Arrow Media Solutions current kiosk revenues are based on the distribution model.

The Crystal Magic Division

Crystal Magic s core business began nearly a decade ago by using proprietary laser technology to create three-dimensional laser images engraved inside solid crystal blocks (such as paperweights) based on photographs of consumers, which then are visible engraved inside the crystal, and are sold as gifts in company-owned stores within

Disney and Universal theme parks, and later expanded to a wide range of image-based merchandise offered in mass market retail, such as mugs, T-shirts and other merchandise upon which personal photos, logos or other artwork are printed. The company s founders have long-standing relationships with Disney, Universal Studios and other entertainment locations.

Today, the Crystal Magic division s products are delivered at theme parks, on a wholesale basis to retailers, to small and large corporate clients and through our proprietary online system that allows partners to create Web Stores on Demand (now marketed as PropellStores). This system provides a special web site at which a customer-whether a business, group, or individual-can design and set up a web store featuring their own logos, photos or other artwork. That web store can then be embedded into the customer s own web site. We then operate that store for the customer, taking orders, manufacturing and shipping product and paying a share of the revenue to the customer.

We believe Web Stores on Demand opens up substantial new opportunities and channels for us by providing partner web sites with the opportunity to easily integrate a photo merchandise online store into their sites with little effort or cost, and was a key part of our and Crystal Magic s strategy for 2008 and is expected to be a key part of our strategy for 2009.

Crystal Magic also has a long track record delivering personalized products to the $19.4 billion promotional, incentive and award products industry, delivering quantities anywhere from one unit to over 500,000 in a single order. Crystal Magic has served these markets since 2001, and we see particular opportunity to leverage our Web Stores capabilities to expand its efforts in the promotional products category, where, according to the Promotional Products Association International s 2007 Estimate of Promotional Products Distribution sales, only 14% of industry revenues are generated from online sales methods.

Crystal Magic s operations run 365 days a year, permitting it to offer all its channels in what we believe to be consistent and rapid turnaround times, including during seasonal spikes. To do so, Crystal Magic has developed proprietary software and systems that integrate into each of its customers data processing systems. In addition, in Crystal Magic s theme park operations, it has developed in-house software that allows it to capture photos from specialty cameras, and put the photos into a format so that the customers can review and select them, and then converts them into a format that can be used for manufacturing. Crystal Magic does not currently have any patents for the intellectual property that it has developed.

Crystal Magic has also developed in-house a system that lets it track customer orders, batch them for manufacturing, and identify where they are in each stage of manufacturing and shipment. Crystal Magic also has developed various specialized reporting systems so that it can manage its revenues and expenses.

In Crystal Magic s production lab, Crystal Magic has developed software to convert a two-dimensional photo into two and a half D its name for software techniques that alters a photograph to create a perception of depth in the final image when it is engraved inside glass.

Crystal Magic has developed a web-based portal in which wholesale customers can place orders directly into its manufacturing queue. It also has developed a system that monitors orders that are ready to be shipped, and appropriately batches them with other orders in process, in an effort to save costs for both it and its customer. Crystal Magic has developed its own Electronic Data Interchange (EDI) software that translates its order data into a format that can be understood by its customers systems.

Crystal Magic is also one of fewer than 10 U.S. companies that hold a worldwide license from Laser Design International LLC (LDI) to its patented technology to perform subsurface laser etching in Crystal Magic s photo crystal product line. To our knowledge, there is no other way to create such products without violating the LDI patent.

Crystal Magic reduces costs by sourcing a significant percentage of its raw materials directly from overseas.

Since most of Crystal Magic s competitors in this category are privately held, and there is no published industry data for this category, we cannot determine the overall market size, or Crystal Magic s relative position in the market.

During the twelve months ended December 31, 2008 and 2007, Crystal Magic generated $2,681,656 and $4,129,182 in revenue.

<u>The Auleron Technologies Division</u>

Auleron Technologies was founded nearly seven years ago by the same management team that later created Arrow Media Solutions. Originally, Auleron was a service provider to third parties, helping retail, financial and technology organizations install new hardware and software in various locations.

Auleron has acted as a subcontractor to certain regional or national service providers to assist the service providers in completing contracts in which the service provider had been hired by a retailer to install computer equipment in many locations. Auleron s project managers and contract technicians would then manage and execute all or part of the installation work in various locations on behalf of the service provider.

For example, Qualxserv, a technology services company, was hired by the CVS drug store chain to upgrade computer equipment in its stores. Qualxserv subcontracted the work to Auleron, in which Auleron representatives visited 800 CVS stores, physically installed new computer network routers, configured the software for each router, and removed old equipment.

For Nfrastructure, another service provider, Auleron installed point-of-sale computer systems at 800 Footlocker stores. For Imagistics, a spinoff of Pitney Bowes Inc., Auleron technicians installed and tested cabling for computer network systems in 15 regional offices.

Auleron also worked with Cardtronics, a large supplier of automated teller machines (ATMs). Cardtronics hired Auleron to install and configure its ATMs at a variety of locations including those in Winn Dixie supermarkets, 7-Eleven convenience stores and Circle K gas stations. Cardtronics would ship equipment to a location, and Auleron technicians would then set up the ATM, configure its software, and test it.

While Auleron Technologies has temporarily discontinued its operations and no longer performs this work for third parties, the Auleron Technologies infrastructure has been maintained to serve our internal needs, making available an on-call network of over 3,500 technicians to service Propell installations. These technicians are not our employees but rather are independent contractors.

We believe that maintaining this capability gives us the ability to compete with large providers of photo kiosks. This network is useful in installing and maintaining hardware, and we believe in reassuring large customers that we can provide adequate field support.

Market size/opportunity

We were created to acquire and aggregate customers and leverage significant growth trends and opportunities in the rapidly evolving photo industry as well as related opportunities in the corporate market for customized products. We present here various statistics and other industry information that are generally available to the public or to members of industry trade associations. With respect to the Photo Marketing Association (PMA), Arrow Media Solutions pays to be a member of that association, and receives that association s statistics as all members do. We did not fund nor were we otherwise affiliated with any of the studies that are the basis for these statistics and other industry information.

Our management team has extensive experience in technology, customer acquisition, ecommerce and retail with particular focus in the online, kiosk and photo merchandise category, as well as the promotional products market.

We formed our company by joining businesses that already had experience in delivering wholesale and retail kiosk and photo gift products and services, and combining that with an expansion into providing online services that stand alone or integrate with the kiosk s retail solution.

The photography industry has evolved significantly in the last few years as digital technologies and services have replaced traditional film processing and online services have grown. As traditional film processing has declined, new opportunities, and new demands from consumers, have been created. Retail and online photo printing including in-store kiosks has grown from a $354 million business in 2003 to an estimated $2.2 billion in 2008, according to the PMA, which is the largest industry trade group.

The following chart, from the PMA s Marketing Research division, shows the spending in the United States on major digital photo categories during the years 2003 through 2009, with 2008 being estimated and 2009 being projected.

Separately, the custom products/gifts category defined by the PMA as personalized calendars, photo books, posters, t-shirts, mugs mouse pads, photo CDs and DVDs ordered at retail or at online stores has grown from $250 million in 2004 to an estimated $1.2 billion in 2008, a nearly fivefold increase in four years, according to the PMA research division.

Retail prints from digital cameras which can be made online, in-store on mini-labs or, increasingly, in-store using the type of kiosks that Propell offers grew from 700 million prints in 2003 to 10.5 billion prints estimated for 2008, with 2009 expected to increase slightly higher despite a weaker economy, according to the PMA research division. Prints made instantly on kiosks accounted for approximately one-fourth of online and in-store prints in 2006, or 30% of just in-store prints, according to the PMA. As online and other channels grow, we expect that kiosk growth will continue to grow in absolute numbers, although fast growth in online is expected to reduce kiosk printing as a percentage of the overall market. The number of prints ordered at retail in 2008 was estimated to be 5.4 billion, with a decline to 5 billion forecast for 2009.

The following charts from the PMA research division show the change in the methods used for making digital prints and the growth of custom photo gifts ordered at retail and online.

The online marketplace for image-based products actually spans several categories, including photo sharing web sites and image merchandise sites. Photo sharing web sites, such as Shutterfly, Kodak Gallery and Snapfish, are designed for consumers and are optimized for sharing and printing photos, and creating photo merchandise from those images. Image merchandise sites, such as Zazzle, Cafepress and Threadless, allow artists, consumers and small businesses to create their own custom web stores featuring selected images that can be reproduced on a broad variety of merchandise. Social networks, including Flickr, Myspace, and Facebook, have extensive photo capabilities integrated into their functionality.

We believe that the custom photo gift category is fragmented, with only one major player, the PhotoThis division of privately held District Photo, providing large-scale fulfillment across a broad category of products to multiple large customers, along with a number of smaller suppliers.

We and our subsidiaries also compete in the promotional products category, also known as the advertising specialty category. Promotional products, which include any products used to promote a product, service or company program, including textiles and other personalized products, constituted a $19.4 billion category in 2007, according to the most recent research available from the Promotional Products Association International (PPAI), an industry trade association.

We see significant opportunity given that more than half of distributors in the promotional products category are small businesses (defined as those under $2.5 million), and only 14% of industry revenues are generated from online sales methods, according to the most recent data available from PPAI.

Our Strategy

Overview

We believe that our combined resources permit us together with our subsidiaries to offer a complete, integrated package of image-related products and services from a single source delivered to consumers in multiple channels of distribution, both directly and through partnerships with established corporate players. We expect that this will provide the opportunity to further monetize our existing customers and customers of our subsidiaries by broadening the product offering, enhancing the convenience of ordering (at kiosk, online or at retail), and expanding presence both online and at retail.

Further, we expect that the combination will give us the ability to acquire customers both business partners and consumers -- by providing an integrated online, kiosk and fulfillment service.

Specifically, the combination creates a single group of companies that:

- Brings together experienced management teams.
- Leverages additional capital resources to expand each of our existing businesses, and enter new markets, especially “Web Stores on Demand.”
- Can provide a complete, integrated solution for retail customers, offering a single stop partner providing any or all of the following:
  - a hardware kiosk that offers a wide variety of image-based prints and gifts that customers can order in-store
  - a web store that integrates with the same account and permits the customer to order from home
  - a wide variety of products that can be made and delivered quickly and cost effectively by the same company

How we address the competitive opportunity

We believe we can compete effectively by offering a set of integrated solutions -- one that includes web services, kiosks, in-house product fulfillment, and a nationwide service network. Management is focused on offering these components, on a standalone basis or integrated as a complete system, to nontraditional markets which we define as those businesses that historically have not done significant business in the type of photo products and services that we offer.

Our new PropellStores service permits artists, consumers and businesses to instantly create an online store for merchandise featuring their images, with our company or its manufacturing partners performing all fulfillment, manufacturing, shipping and billing. This system provides a special web site at which a customer -- whether a business, group, or individual -- can design and set up a web store featuring their own logos, photos or other artwork. That web store can then be embedded into the customer s own web site. We then operate that store for the customer, taking orders, manufacturing and shipping product and paying a share of the revenue to the customer.

Our kiosks offer a companion web-based service that allows customers to access photos uploaded at the kiosk, and images uploaded to the web can be accessed from select kiosks.

Additionally, our management has experience in retail fulfillment. One of our founders previously created PhotoTLC, a photo merchandise company serving major retail customers including Walgreens, Wal-Mart, CVS, Rite Aid and Meijer stores. Our Crystal Magic subsidiary was a major supplier to PhotoTLC, as well as other retail customers.

Finally, through our Crystal Magic operation, we have experience in the promotional products category. The creation, manufacturing and distribution of promotional products use the same expertise and facilities as our other product offerings. We believe that the expanded offerings created by our recent merger further enhance the company s ability to address the promotional products market, including offering web stores to corporate customers as well as expanded product line of imaging products and the introduction of kiosks to corporate locations.

In each of our partnerships, we seek to maintain branding for our product offerings wherever possible, and create exclusive partnerships. We intend to both co-brand (Powered by Propell) and build direct relationships with consumers so that our own brand can stand alone in specific categories of business, building brand loyalty at multiple touch points (for example, a retail kiosk and web offering) and increasing margins by removing middlemen. Given large enough opportunities such as our existing relationship with Disney theme parks, the company will continue to co-brand or offer its service on a private label basis, which means providing our services or products under our customers brand names instead of our own.

<u>Our product and service offerings</u>

Web solutions (including PropellStores and Web Direct.)

In PropellStores, we offer a turnkey photo gift web site. PropellStores permits a partner whether a rock band, a business, or classroom to create a complete web store with up to 200 items of personalized photo merchandise. The partner sets the prices, and we create the store, make the products on demand, ship them, collect the revenues, and send the partner a check for the profits. We are currently targeting a number of partnerships for the PropellStores service with existing social network and other web sites with large user bases.

With Web Direct, Crystal Magic maintains its own online web photo sites where consumers can upload, print and create gifts with their photos. Crystal Magic currently maintains a direct web site for consumers at www.thebestphotogifts.com, as well as a promotional products web site at <u>www.uspromoproducts.com</u>.

Our PropellStores, including its transmission of digital images over the Internet, are subject to regulation by the U.S. Postal Service, the Federal Trade Commission and various states, local, and private consumer protection and other regulatory authorities. In general, these regulations govern privacy, the manner in which orders may be solicited, the form and content of advertisements, information which must be provided to prospective customers, the time within which orders must be filled, obligations to customers if orders are not shipped within a specified period of time, and the time within which refunds must be paid if the ordered merchandise is unavailable or returned. Congress has enacted legislation to specifically regulate online commerce and communications and has addressed such issues as the transmission of certain materials to children, intellectual property protection, and taxation. Other legislation could result in additional regulation or prohibition of the transmission of certain types of content over the Internet. This regulation could limit the type of business we and Crystal Magic pursue or increase the costs to ensure compliance.

Kiosk solutions

We offer Arrow Media Solutions-branded and co-branded and partner-branded kiosks through a distribution model. We are currently selling products to a distributor who in turn sells them to the customer. Prior to the beginning of this fiscal year all of our sales were made directly to customers as opposed to through distributors and we sold the kiosk to the partner at a profit, and then made additional revenues by selling supplies to the partner. Most profits were then retained by the partner. We had considered switching to a placement model in which we would own the kiosks but share revenue with the operator of the location -- but instead have decided to use a third party distributor for sales of kiosk products and to focus on sales of PropellStores.

Consumer photo products

Subsurface laser etched crystal and photo gifts, delivered through web and kiosk, but also through third party channels, including independent retail and online resellers and promotional products distributors.

Retail stores

Crystal Magic s own stores inside of Disney World and Universal Studios theme parks.

Support network

In an effort to ensure success in our kiosk installations our support division has access to a network of 3,500 independent contractors who can assist in the maintenance and repair of our hardware in the field.

Channels

We deliver our products and services through a diverse set of retail, wholesale and online channels. We believe having several sales channels will maximize sales potential while minimizing the risk that any underperforming channel will jeopardize the overall business.

We break down our major channels as follows:

Web Stores on Demand (now marketed as PropellStores)

Our newest initiative, PropellStores is designed to allow web or corporate partners to create a web site offering over 200 photo gifts.

Web direct

We operate our own web sites, targeting the advertising specialty and consumer markets, that sell a broad spectrum of photo merchandise.

Kiosk Partnerships and Placements

Our Kiosk Solutions division currently sells kiosks to distributors who sell them both to partners in retail and other brick & mortar settings. (See Resellers and Strategic OEMs sections below).

Theme parks

Primarily subsurface laser crystal, sold at retail locations within Disney World and Universal Studios theme parks in Florida.

Resellers   big box

This category includes major mass market retailers such as Walgreens or CVS. Historically, Crystal Magic has served this market and selectively may re-enter it.

Resellers independent

These include small online retailers, independent gift and award stores. Crystal Magic currently provides photo gifts, crystals and kiosks to these customers.

Promotional sales

Crystal Magic s subsurface crystal products are sold to the promotional products industry, both directly to large corporate clients and through resellers. Historically Crystal Magic has provided such products for a wide range of end customers including Ford Motor Company, UBS, Starwood Hotels, Martin Marietta, NASA, and Major League Baseball, NFL and the NBA. We plan to expand our photo merchandise and kiosk offerings into this category.

Government sales

Through specialty resellers, we historically have sold subsurface products to a wide range of government and military customers including the Pentagon, Army, Air Force, NASA and the White House.

Strategic OEMs

In special channels, we partner strategically to bring a customized offering to market. An example is our partnership with AmerisourceBergen, in which our kiosk division provides custom offerings for this pharmaceutical company and its Good Neighbor Pharmacy and Family Pharmacy member stores.

Key relationships

We and Crystal Magic currently maintain strategic or distribution relationships with several companies, including the Walt Disney Co., Universal Studios and AmerisourceBergen.

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Walt Disney Co.

Through its Crystal Magic operations, Crystal Magic has been doing business in Disney theme parks since 1999, with multiple operations now at Disney World.

Crystal Magic has two staffed facilities within the Disney parks, including Epcot Center and Magic Kingdom. Including the nine years since Crystal Magic was founded, Steven Rhodes, Crystal Magic s founder, has been a supplier to Disney for more than 20 years.

Crystal Magic, Inc. also has a Concession Agreement with Walt Disney World Co. that grants Crystal Magic a license to generate guest portraits and sculpture reproductions using Disney 3-D characters, logos and/or names inside optically transparent material at Epcot and Magic Kingdom located at Walt Disney World Resort. This agreement, which expired on October 30, 2008, had been extended until January 24, 2009, and negotiations for a new agreement are currently in progress. Crystal Magic had an agreement with Disneyland resorts that expired on November 30, 2008 which we elected not to renew due to economic conditions.

Universal

Since 2001, Crystal Magic has maintained its own facilities as the only supplier of subsurface laser etched photo crystals at the Universal Orlando Resort s theme parks.

Crystal Magic has staffed locations at Islands of Adventure and Universal Studios Florida parks.

As with Disney, including the seven years since Crystal Magic first began business with Universal, Propell cofounder Steven Rhodes has been a supplier to Universal for more than 18 years.

Crystal Magic, Inc. has an agreement with Universal City Development Partners, L.P. pursuant to which Crystal Magic may operate multiple carts/kiosks in Universal Studios Florida and Universal Studios Islands of Adventure. This agreement expires on January 2, 2010, unless renewed.

AmerisourceBergen

Our Arrow Media Solutions division is the exclusive provider of digital kiosks to AmerisourceBergen, a pharmaceutical distributor to the drug store channel in the U.S. This division has a Marketing Representative Agreement with AmerisourceBergen Corporation that appoints Arrow Media Solutions as the exclusive marketing representative for the sale of kiosks to transfer digital images to customers of AmerisourceBergen Corporation. The agreement expires in July 2009, with a one- year renewal option.

AmerisourceBergen has 11,000 pharmacy customers consisting of 3,000 stores in two independent networks that it manages under the brands Good Neighbor Pharmacy and Family Pharmacy. There are an additional 8,000 independent stores in the AmerisourceBergen customer base.

Laser Design International LLC

Through our Crystal Magic subsidiary, we are one of fewer than 10 U.S. companies that hold a worldwide license from Laser Design International LLC to the subsurface laser etching technology used in our photo crystal product line. The agreement is perpetual, until such time as the LDI patent expires.

Crystal Magic s operating results with these key relationships will fluctuate in large part due to the seasonality of consumer photographic activity and the seasonality of the theme parks in which we sell our products.

Competition

We and our subsidiaries have competition in various aspects of our business, including subsurface laser etched crystal, wholesale and retail photo gifts, photo kiosks and online photo prints and merchandise.

Subsurface etching

The subsurface laser etched crystal portion of the business represented by the Crystal Magic division competes in a fragmented market. Since most of Crystal Magic s competitors are privately held and there is no published industry data that we are aware of for this category, we cannot determine the overall market size, or our relative position in the market or those of Crystal Magic s competitors, with the exception of Seaena Inc., a public company that had total revenues in 2007 of $3.3 million with a total loss in 2007 of $3.4 million. Our competitors here include Seaena Inc., GW Crystal, Jaffa Giftware, and Laser Crystal Works.

Crystal Magic distinguishes itself from the competition in several ways. In its subsurface laser crystal business, it is one of fewer than 10 companies with a worldwide license from Laser Design International LLC (LDI). To our knowledge, the patented technology controlled by LDI is required to compete in this segment, since it is the only way to legally create products using subsurface etching in transparent materials. Crystal Magic s license is perpetual, so long as the patent remains in force. To our knowledge, there is no other way to create such products without violating the patent. Since we believe a license under this patent is required, Crystal Magic having this license provides a competitive advantage against other companies that might seek to enter the business.

Crystal Magic has a longstanding relationship with Disney and Universal Studios permitting it to distribute its products at both companies theme parks. We believe this permits a larger operation than Crystal Magic s competitors, one that run 365 days a year and serves multiple channels of distribution, including the theme parks, promotional products industry, through resellers, and online.

Photo gifting

We believe the photo merchandise business is fragmented among a number of suppliers. In the wholesale channel, we believe the only major supplier is the PhotoThis division of traditional photo processor District Photo, along with a number of smaller players such as EZ Prints and Imagine Your Photos. Since these companies are privately held, we cannot determine the overall market size, or our relative position in the market.

Eastman Kodak Co. has its own photo gift operation whose largest customer, we believe, is its own web site at www.kodakgallery.com as well as the CVS drug chain. Fujicolor Labs, which primarily serves Wal-Mart and the Longs Drug chain, has a limited in-house photo gift facility but, we believe, largely outsources its production work to third parties. Many large chains, including Walgreens, rely on the District Photo service.

On the online side, many of the leading players, including Shutterfly, rely on both internal resources and outsource suppliers. Shutterfly, for instance, has a significant infrastructure to handle gifting and other photo merchandise internally (along with its extensive in-house photo printing capacity) but relies on others for seasonal capacity. Both Zazzle and Cafepress maintain internal capacity but do not to our knowledge provide third-party services to retailers.

We historically have served as an outsource supplier to major retailers, and believe we have the infrastructure, software and systems to handle significant volume across a broad spectrum of photo gifts. In fact, as a supplier to PhotoTLC, formerly a leader in providing wholesale gifts to mass market retailers, our Crystal Magic division supplied a significant percentage of PhotoTLC s production for over 19,000 retail locations.

Crystal Magic s order system, unlike those of its competitors, also permits us to serve as an aggregator for major retailers. In the aggregator model, both our products and designated third-party products can be run through the same system. This permits, for instance, a retailer to send a single image to Crystal Magic that it can use to manufacture an in-house product, and then it can also forward that image to a specialty manufacturer of the retailer s choice if that item is not made by us. Crystal Magic s system tracks the third-party order as well as its own, and handles all billing and communication with the retailer. We believe that this system meets a complex but very real need for retailers during peak demand periods (particularly the December holidays), since consumers frequently submit a single photo for a single order that includes multiple types of product that require separate factories.

While we have in the past used these systems to serve large, mass-market retailers, we do not currently do so but believe these capabilities are equally useful in serving smaller niche markets where the same principles apply.

Kiosks

There are a number of competitors in the kiosk industry with a variety of different business models. Major competitors approach the market from a variety of angles including brand, software and aftermarket service. The largest competitors in the kiosk space focus on so-called big-box retailers with store counts in excess of 1,000.

These companies, including Kodak and Fuji, use kiosks as a way to extend their brand franchises. We believe they are less focused on kiosk hardware design and service than on using kiosks to drive customer awareness and sales of supplies. Their kiosk operating systems are designed in a closed loop manner, which makes them more difficult to service and scale. Due to their size, these companies have been successful at deploying large numbers of kiosks in stores such as Wal-Mart, Target, CVS and Rite Aid. Together, management estimates that these companies have an estimated 80,000 units in the field.

Our Arrow Media Solutions division competes with these large players on the basis of what we believe is superior service, product design, a willingness to cobrand, and hardware and software reliability. Our kiosks also offer a second display screen for advertising, unlike competitors, and are built modularly, permitting quick and simplified field service by swapping components.

Other competitors who are smaller than Kodak and Fuji, such as Lucidium and Pixel Magic, have been successful in gaining some share of the big box retail market as well as the non-traditional market. Lucidium is a primarily a software development company that offers a kiosk product that is less expensive than competing units.

Other competitors include Witech, Pixology, and to a limited extent Sony and Mitsubishi, who are suppliers to us but also provide third-party kiosk solutions to some of their own customers.

We began as a service organization that installs and supports kiosks and other hardware for Fortune 500 (and smaller) companies nationwide. Although we no longer derive revenue from the provision of such services to third parties, through our service division, we have a network of over 3,500 technicians who are independent contractors that can respond seven days a week to ensure our kiosks are operating properly with as little interruption of service as possible. This service offering includes remote monitoring of kiosks, in-house help desk, and a modular hardware design that permits rapid service in the field.

To reduce fixed costs, we have chosen a third-party distributor to assume most of our responsibilities in selling and supporting our current kiosks. We have begun exploring introduction of lower-cost kiosks and other alternatives to our existing kiosk business model.

<u>Online</u>

Competition in online photo and merchandise space takes several forms. Photo sharing web sites are designed for consumers and are optimized for sharing and printing photos, and creating photo merchandise from those images. Competitors include Kodak Gallery, Shutterfly, Snapfish, Photobucket, Webshots, and to some extent Myspace, Facebook and other social networking sites, as well as the web sites of photo retailers such as Walgreens, Wal-Mart and CVS.

Image merchandise sites allow artists, consumers and small businesses to create their own custom Web Stores featuring selected images. Competitors include Zazzle, Cafepress and Threadless.

After analyzing existing online players in the photo merchandise category, we believe we identified a significant underserved opportunity to partner with key business partners to provide a Web Stores on Demand service that most closely competes with the image merchandise companies such as Zazzle and Cafepress, but has what we believe are advantages in product quality, pricing, ease of setup and turnaround times. In particular, Zazzle and Cafepress focus on the artist and small-group market, where we believe a large, underserved market exists in partnering with a broader range of customers including corporate, special interest and medium large organizations.

Intellectual property

We and our subsidiaries have created or licensed a variety of proprietary software, hardware and operational systems that we believe distinguishes us and our subsidiaries from competitors. Neither we nor our subsidiaries have any patents on any of this software, hardware or operational systems.

In Crystal Magic s subsurface laser crystal business, Crystal Magic is one of fewer than 10 companies with a worldwide license necessary to manufacture and distribute products based on this patented technology. The license is perpetual, so long as the patent remains in force, and is required to produce products using subsurface etching in transparent materials. To our knowledge, there is no other way to create such products without violating the patent.

As stated previously, in our Crystal Magic division we have developed proprietary software and systems that integrate into each of our customers data processing systems. In Crystal Magic s theme park operations, Crystal Magic has developed in-house software that lets it capture photos from specialty cameras, and put the photos into a format so they can be reviewed and selected by the consumer, and then converts them into a format that can be used for manufacturing.

Crystal Magic has also developed in-house a system that lets it track customer orders, batch them for manufacturing, and identify where they are in each stage of manufacturing and shipment. Crystal Magic has also developed various specialized reporting systems so that it can manage our revenues and expenses.

In Crystal Magic s production lab, it has developed software to convert a two-dimensional photo into two and a half D our name for software techniques that alters a photograph to create a perception of depth in the final image when it is engraved inside glass.

Crystal Magic has developed a web-based portal in which wholesale customers can place orders directly into Crystal Magic s manufacturing queue. Crystal Magic also has developed a system that monitors orders that are ready to be shipped, and appropriately batches them with other orders in process, in an effort to save costs for both our customer and us. Crystal Magic has developed its own Electronic Data Interchange (EDI) software that translates order data into a format that can be understood by its customers systems.

In our kiosk business, we have developed an integrated system including remote monitoring of kiosks in the field, help desk and a technician-dispatch system. Additionally, we contract for custom kiosk software development depending on the OEM or retail partner s needs.

Our Web Stores on Demand web services were created using our own technology, as well as proprietary enhancements to open source software tools.

Insurance

We have insurance for general commercial liability with the Zurich Group in an amount of $2 million. We have worker s compensation insurance with The Hartford in an amount equal to 100% of our payroll for the current year. We have products and completed operations insurance in the aggregate amount of $2 million.

Operations

The company has offices in Orlando, Fla., Brea (Orange County), Calif.; and the San Francisco Bay Area.

Activities in the Orlando office include finance, management of the theme park locations, as well as subsurface laser and gift manufacturing.

Kiosk, design, staging and assembly are done in Brea.

The San Francisco area office is primarily focused on PropellStores, including software development, sales, strategic partnerships and business development.

Laser and gift materials are sourced from overseas. Kiosks are assembled, primarily in Brea, using components from several outsource vendors including those providing kiosk hardware, computer units, printers and software. Currently, our distribution partner is collocated with us in Brea, and is performing most sales, support and warranty fulfillment.

In addition, Crystal Magic maintains the following company-staffed retail locations in Florida:

- Disney World (Florida)
  - A location at Epcot (Disney World Florida) consisting of a 600-sq-ft retail and production facility at the Imagination Institute:
  - A retail location at Space Mountain in the Magic Kingdom
- Universal Orlando Resort (Florida)
  - A Retail location at Islands of Adventure theme park, in the Trading Company
  - A Retail location at Universal Studios Orlando theme park, located in Jimmy Neutron store

Item 1A. Risk factors

You should carefully consider the following risk factors and other information included in this Annual Report. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not currently known to us or that we currently deem immaterial may also impair our business operations. If any of the following risk factors occur, our business, financial condition, operating results and cash flows could be materially adversely affected.

RISKS RELATED TO OUR COMPANY

An investment in our securities is highly speculative and involves a high degree of risk. Therefore, in evaluating us and our business you should carefully consider the risks set forth below, which are only a few of the risks associated with investing in our common stock. You should be in a position to risk the loss of your entire investment.

We may not be able to retain existing customers or acquire new customers.

Our future revenues and profitability and the revenue and profitability of our subsidiary, Crystal Magic, Inc. and the value of our investment in Crystal Magic, Inc. depend in large part on our ability and the ability of Crystal Magic, Inc. to retain our current relationships with our customers, including the Walt Disney Co., AmerisourceBergen and several e-commerce websites. Our relationships with these customers depend on our satisfactorily performing our contracted services. If we do not successfully retain our current customers, or market successfully against competitors, our business, financial condition and operating results could be harmed.

Dependence on a limited number of clients.

A significant portion of our digital photo business and Crystal Magic s theme park businesses depend on a limited number of partners. Specifically, our kiosk business depends largely on our relationship with AmerisourceBergen, and our subsidiary, Crystal Magic s, theme park business depends largely on its contracts with the Walt Disney Co. and Universal Studios. Because we are not including financial statements that consolidate the revenue of all of our subsidiaries, a large portion of our revenue was derived from our business with AmerisourceBergen, which accounted for \$1.14 million, or approximately 97% of our consolidated revenues, in 2008. Our kiosk sales team is now focused on our Internet offerings, with kiosk sales efforts being managed by a third party, over which we have little control. It is anticipated that revenue from the kiosk business will decrease. While we expect the revenues from our Internet offerings to offset the resulting reduction in kiosk revenues, we can provide no assurance they will do so. While Crystal Magic expects to renew its agreements with the Walt Disney Co. and while our agreements with the other entities expire within one year from the date hereof, we can provide no assurance that the agreements with any of these entities will be renewed. The non-renewal of any of these relationships could have a material adverse effect on our business and results of operations.

We may not be able to continue as a going concern.

On a pro forma basis, for the twelve months ended December 31, 2008, Propell had $456,263 in gross profit but incurred $1,775,956 in operating expenses and at December 31, 2008 had an accumulated deficit of $1,317,962 with an operating loss of $1,319,694. Our actual audited financial statements, which include our AMS subsidiary from the date of acquisition to December 31, 2008, report a 2008 operating loss of $(1,076,119) and a net loss of $(1,107,257). We had a working capital deficit of $(1,707,763). The opinion of our independent registered accounting firm on our audited financial statements as of and for the period ended December 31, 2008 for Propell was qualified subject to substantial doubt as to our ability to continue as a going concern. See Report of Independent Registered Public Accounting Firm and the notes to our Financial Statements. In addition, the opinion of our independent registered accounting firm for the years ended December 31, 2007 and 2008 for Crystal Magic was qualified subject to substantial doubt as to Crystal Magic s ability to continue as a going concern due to its continued losses and lack of liquidity. We are also subject to the risk that our liquidity will be impacted by our obligation to fund expenses of Crystal Magic. For the year ended December 31, 2008 and December 31, 2007, Crystal Magic had revenue of $2,681,656 and $4,129,182, respectively, cost of goods sold of $ 451,497 and $761,425, respectively, operating expenses of $2,909,654 and $3,676,452, respectively, and incurred a loss of $561,657 and $302,850, respectively.

Our future plans and operations are dependent on our raising additional capital.

To date, we have not generated enough revenue from operations to pay all of our expenses. In fact, we have used money raised in prior financings to pay some of our costs. We have used $1.94 million of the $2.16 million we raised over the last twelve months in the form of convertible notes and a recent rights offering. We do not believe that our existing resources will be sufficient to allow us to implement our anticipated plan of operations or meet our future anticipated cash flow requirements. We believe that we and our Crystal Magic subsidiary can generate additional revenue through e-commerce initiatives; and that Crystal Magic can generate additional revenue at our theme park stores by updating our displays, refreshing product offerings and training additional staff. In addition, we intend to increase our sales of promotional products by broadening our customer base for our promotional products, which will require us to incur additional marketing and advertising expenses. However, we may not be able to implement any of these revenue- generating measures until we raise sufficient capital to support them.

We rely on key vendors, suppliers and foreign sourcing.

Our ability to sustain satisfactory levels of sales is dependent in part upon the ability of our suppliers and vendors to properly perform their function. We have no significant long-term purchase contracts or agreements to ensure continued supply, pricing or access to raw materials and equipment used in our business. While we believe that alternate sources of third-party providers are available, it is possible that our vendors might not be able to continue to meet our requirements for services or supplies, or purchase services or supplies in sufficient quantities or on terms as favorable to us as those currently available. The failure of our suppliers to supply our raw materials on a timely basis or at satisfactory prices could have a material adverse effect on our business, results of operations and financial condition. Also, changing to an alternate vendor or supplier may cause delays, reduced quality or other problems.

We may be adversely affected by actions of competitors.

The market for personalized products, photo kiosks and other digital imaging services is highly competitive and still emerging. Many of our competitors have substantially greater financial, technical and other resources than we have. We face competition in personalized products, photo kiosks and other digital imaging services from other direct marketers, online companies, and competitors in other distribution channels, including much larger companies. Many of our competitors offer similar products and services. Our ability to compete effectively depends on our ability to differentiate our services by offering innovative services and products and exemplary customer service. Although we believe we are a leader in developing and marketing innovative personalized photo-related services and other products, competitors can and do provide similar services and products. There can be no assurance we will continue to compete effectively through development of innovative services and products or the provision of exemplary customer service and experience or that we will respond appropriately to industry trends or to activities of competitors.

We have shifted the focus of one of our subsidiaries and cannot guarantee the success of this new business model.

The shift in Arrow Media s business model from the sale of kiosk to the sale of PropellStores may not be successful. In an effort to reduce costs, we have changed the focus of Arrow Media s sales. During the year ended December 31, 2008, we derived approximately 100% of our revenue form sales of kiosk and related products on a consolidated basis. There can be no guarantee that this shift will be accepted by our customers. If not accepted, our financial results will suffer.

We experience fluctuations in quarterly results.

Our quarterly operating results and the value of our investment in Crystal Magic, Inc. will fluctuate for many reasons, including:

- Seasonality of consumer photographic activity,
- Seasonality of the theme parks in which Crystal Magic sells products,
- Changes in attendance or consumer spending at these theme parks,
- The mix of products we sell,
- Promotional activities we conduct,
- Price increases by our suppliers,
- Our introduction of new products,
- Our research and development activities,
- Our competitors' actions,
- Fluctuations in the direct-to-consumer market,
- Changes in usage of digital services and online commerce,
- Changes in the photofinishing industry,
- Changes in the promotional products industry,
- General economic influences and conditions.

As a result of the above conditions, our operating results for any period do not necessarily indicate the results that can be expected for any future period. Our operating results in a future period may be below the expectations of public market analysts and investors which may cause the price of our common stock to decline.

We have no independent audit committee. Our full board of directors functions as our audit committee and is composed of three directors, two of whom are not considered independent. This may hinder our board of directors effectiveness in fulfilling the functions of the audit committee.

Currently, we have no separate audit committee. Our full Board of Directors functions as our audit committee and is comprised of three directors, two of whom are not considered to be "independent" in accordance with the requirements of Rule 10A-3 under the Securities Exchange Act of 1934. An independent audit committee plays a crucial role in the corporate governance process, assessing the Company's processes relating to its risks and control environment, overseeing financial reporting, and evaluating internal and independent audit processes. The lack of an independent audit committee may prevent the board of directors from being independent from management in its judgments and decisions and its ability to pursue the committee's responsibilities without undue influence. We may have difficulty attracting and retaining directors with the requisite qualifications. If we are unable to attract and retain qualified, independent directors, the management of our business could be compromised.

Our board of directors, which consists of three directors, acts as our compensation committee, which presents the risk that compensation and benefits paid to these executive officers who are board members and other officers may not be commensurate with our financial performance.

A compensation committee consisting of independent directors is a safeguard against self-dealing by company executives. Our board of directors acts as the compensation committee and determines the compensation and benefits of our executive officers, administers our employee stock and benefit plans, and reviews policies relating to the compensation and benefits of our employees. Although all board members have fiduciary obligations in connection with compensation matters, our lack of an independent compensation committee presents the risk that our executive officers on the board may set their personal compensation and benefits at levels that are not commensurate with our financial performance.

Governmental regulation could limit our business opportunities and increase costs.

Our operations, including our transmission of digital images over the Internet, are subject to regulation by the U.S. Postal Service, the Federal Trade Commission and various states, local, and private consumer protection and other regulatory authorities. In general, these regulations govern privacy, the manner in which orders may be solicited, the form and content of advertisements, information which must be provided to prospective customers, the time within which orders must be filled, obligations to customers if orders are not shipped within a specified period of time, and the time within which refunds must be paid if the ordered merchandise is unavailable or returned. Congress has enacted legislation to specifically regulate online commerce and communications and has addressed such issues as the transmission of certain materials to children, intellectual property protection, and taxation. We believe that we are in compliance with applicable statutes and regulations, however, should such statutes and regulations be amended or interpreted more stringently, we may be unable to remain in compliance and may incur penalties and fines for noncompliance. Other legislation could result in additional regulation or prohibition of the transmission of certain types of content over the Internet. If such legislation were deemed to apply to our business, it could limit the type of business that we could pursue or increase the costs to ensure compliance.

There is no assurance that our common stock will be cleared to trade on the Over-the-Counter Bulletin Board.

A market maker has filed a Form 211 with the National Association of Securities Dealers (the NASD) to have our Common Stock quoted on the OTC Bulletin Board. However, we cannot assure you that our common stock will ever be quoted on the OTC Bulletin Board or any other exchange or electronic medium.

Trading on the OTC Bulletin Board may be sporadic because it is not a stock exchange, and stockholders may have difficulty reselling their shares.

We expect that our common stock will be quoted on the OTC Bulletin Board. Trading in stock quoted on the OTC Bulletin Board is often thin and characterized by wide fluctuations in trading prices, due to many factors that may have little to do with the our operations or business prospects. Moreover, the OTC Bulletin Board is not a stock exchange, and trading of securities on the OTC Bulletin Board is often more sporadic than the trading of securities listed on a quotation system like NASDAQ or a stock exchange like NYSE. Accordingly, you may have difficulty reselling any of the shares you purchase from the selling stockholders.

Some of our existing stockholders can exert control over us and may not make decisions that are in the best interests of all stockholders.

As of March 31, 2009, officers, directors, and stockholders holding more than 5% of our outstanding shares collectively controlled approximately 61.38% of our outstanding common stock, without taking into account shares of common stock issuable upon conversion of any convertible securities. As a result, these stockholders, if they act together, would be able to exert a significant degree of influence over our management and affairs and over matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions. Accordingly, this concentration of ownership may harm the market price of our shares by delaying or preventing a change in control of us, even if a change is in the best interests of our other stockholders. In addition, the interests of this concentration of ownership may not always coincide with the interests of other stockholders, and accordingly, they could cause us to enter into transactions or agreements that we would not otherwise consider.

Under certain circumstances we will be responsible for the payment of certain of Crystal Magic s debts.

We could be responsible for the payment of Crystal Magic currently outstanding debt owed to US Small Business Loans (the SBA) and the Orlando National Bank in the amount of approximately $843,181. We have entered into an agreement with Steve Rhodes whereby we agreed to reimburse Crystal Magic for the interest payments on certain debt of Crystal Magic under loans issued by the Orlando National Bank under the approval of the SBA and the monthly payments owed by Crystal Magic so long as the monthly payments remain at $2193, until certain shares of Mr. Rhodes are released from escrow. We also agreed to assume the payment for these loans in the event of the bankruptcy of Crystal Magic and the demand of the SBA or the Orlando National Bank of payment under Mr. Rhodes guarantee. Mr. Rhodes has agreed to place 2,000,000 shares of our stock owned by him in escrow to be used by us in our discretion at any time after one year to pay the amounts owed by Crystal Magic under these loans. The indemnification agreement that we had previously entered into with Mr. Rhodes and his wife with respect to payment of the loans if a demand was made against either of them under the guarantee, has been terminated. However, there can be no assurance that the shares held in escrow will have sufficient value to satisfy such debt. There is also no guarantee that Crystal Magic will generate enough revenue to offset any of the expense we agreed to incur prior to the year that we can access the escrowed shares or even thereafter if the value of the escrowed shares is not sufficient to repay the debt. For the year ended December 31, 2008 and December 31, 2007, Crystal Magic had revenue of $2,681,656 and $4,129,182, respectively, cost of goods sold of $451,497 and $761,425, respectively, operating expenses of $2,909,654 and $3,676,452, respectively, and incurred a loss of $561,657 and $302,850, respectively

We cannot guarantee that an active trading market will develop for our common stock.

There is no public market for our Common Stock and there can be no assurance that a regular trading market for our Common Stock will ever develop or that, if developed, it will be sustained. Therefore, purchasers of our Common Stock should have a long-term investment intent and should recognize that it may be difficult to sell the shares, notwithstanding the fact that they are not restricted securities. We cannot predict the extent to which a trading market will develop or how liquid a market might become.

There may be future dilution of our common stock.

If we sell additional equity or convertible debt securities, those sales could result in additional dilution to our stockholders.

We have incurred operating losses in the past and may not be able to sustain profitability in the future. Recent accounting changes may make it more difficult for us to sustain profitability.

Each of our subsidiaries and their predecessors have periodically experienced operating losses. If we are unable to produce our products and provide our services at commercially reasonable costs, if revenues decline or if our expenses exceed our expectations, we may not be able to sustain or increase profitability on a quarterly or annual basis. Also, we are a publicly traded company, and are therefore subject to the Sarbanes-Oxley Act of 2002, which requires that our internal controls and procedures comply with Section 404 of the Sarbanes-Oxley Act. We expect compliance to be costly and it could impact our results of operations in future periods. In addition, the Financial Accounting Standards Board now requires us to follow Statement No. 123, Share Based Payment, or SFAS No. 123R. Under SFAS No. 123R, companies must calculate and record in their statement of operations the cost of equity instruments, such as stock options or restricted stock, awarded to employees for services. We expect that we will use stock options to attract, incentivize and retain our employees and will therefore incur the resulting stock-based compensation expense. This will continue to adversely affect our operating results in future periods.

We have a limited operating history as a combined entity, which makes it difficult to evaluate our business and prospects for the future.

We have only a limited operating history as a combined entity on which investors can base an evaluation of our business and future prospects. We face many risks, uncertainties, expenses and difficulties. To address these risks and uncertainties, we must do the following:

- maintain and increase our number of customers;
- maintain and enhance our brand;
- maintain and grow our website and customer operations;
- continue to enhance and innovate our digital photo kiosk offerings to remain competitive;
- expand our penetration in the promotional products industry;
- market and expand Crystal Magic s theme park offerings;
- successfully execute our business and marketing strategy;
- continue to develop and upgrade our technology and information processing systems;
- continue to enhance our service to meet the needs of a changing market;
- provide superior customer service;
- respond to competitive developments; and
- attract, integrate, retain and motivate qualified personnel.

We may be unable to accomplish one or more of these things, which could cause our business to suffer.

Interruptions to our information technology systems, availability of retail facilities, kiosk manufacturing, personalized--product production processes or customer service operations could damage our reputation and brand and substantially harm our business and results of operations.

The satisfactory performance, reliability and availability of our information technology systems, personalized-product production processes and customer service operations are critical to our reputation, and our ability to attract and retain customers and maintain adequate customer satisfaction. Any interruptions that result in reduced order fulfillment performance or customer service could result in negative publicity, damage our reputation and brand and cause our business and results of operations to suffer.

For Crystal Magic s theme park sales, Crystal Magic depends in part on its partners to make available and maintain certain aspects of its retail locations, such as facilities at Disney World and Universal Studios theme parks. Remodeling or other activities at these theme parks may result in Crystal Magic s inability to sell products for the duration of such activities. In January 2008, Walt Disney World closed one of Crystal Magic s stores for renovation for a period of 28 days, which adversely affected Crystal Magic s revenue for the first quarter of 2008. Crystal Magic may not be informed in advance or offered other locations to sell its products during such remodeling. Our business interruption insurance policies do not address all potential causes of business interruptions that we may experience, and any proceeds we may receive from these policies in the event of a business interruption may not fully compensate us for the revenues we may lose.

We may have difficulty managing our growth and expanding our operations successfully.

As a result of our merger in April 2008 and acquisitions in May 2008, we and our subsidiaries have website operations, manufacturing facilities, business offices and retail locations in Orlando, Florida, and northern and southern California. Our growth has placed, and will continue to place, a strain on our and their administrative and operational infrastructure. Our ability to manage our operations and growth will require us and each of our subsidiaries to continue to refine our operational, financial and management controls, human resource policies and reporting systems.

If we or our subsidiaries are unable to manage future expansion, neither we nor they may be able to implement improvements to our or their controls, policies and systems in an efficient or timely manner and may discover deficiencies in existing systems and controls. Our and their ability to provide high-quality products, service and customer support could be compromised, which would damage our reputation and brand and substantially harm our and their business and results of operations.

Competitive pricing pressures may harm our business and results of operations.

Demand for our products and services and those of our subsidiaries is sensitive to price. Many external factors, including our production and personnel costs and our competitors pricing and marketing strategies, can significantly impact our pricing strategies. If we or our subsidiaries fail to meet our customers price expectations, we or they could lose customers, which would harm our and their business and results of operations.

The loss of key personnel and an inability to attract and retain additional personnel could affect our ability and the ability of our subsidiaries to successfully grow our and their business.

We and our subsidiaries are highly dependent upon the continued service and performance of our senior management team and key technical, marketing and production personnel, some of whom have formed critical relationships with the companies with whom we and our subsidiaries have contracts. The loss of these key employees, several of whom is at will and may terminate his or her employment relationship with us or our subsidiaries at any time, may significantly delay or prevent the achievement of our business objectives and the business objectives of our subsidiaries.

We believe that our future success and the success of our subsidiaries will also depend in part on our and their continued ability to identify, hire, train and motivate qualified personnel. We and they face intense competition for qualified individuals from numerous technology, marketing, financial services, manufacturing and e-commerce companies. Neither we nor our subsidiaries may be able to attract and retain suitably qualified individuals who are capable of meeting our or our subsidiaries growing operational and managerial requirements, or we or our subsidiaries may be required to pay increased compensation in order to do so. Our failure or the failure of our subsidiaries to attract and retain qualified personnel could impair our or our subsidiaries ability to implement our or their business plan.

Crystal Magic s net revenues and results of operations are affected by the level of vacation and other travel by our customers, particularly in our theme park operations, and any declines or disruptions in the travel industry could harm its business.

Because vacation and other travel is one of the primary occasions in which Crystal Magic s customers visit theme parks as well as utilize their digital cameras, the revenue of Crystal Magic is affected by the level of vacation and other travel by its customers. Accordingly, downturns or weaknesses in the travel industry or the economy in general can harm Crystal Magic s business. In fact, during the last quarter of its past fiscal year Crystal Magic experienced and expects to continue to experience in the near future a significant reduction in theme park sales in the upcoming quarter as a result of economic conditions in general. Travel expenditures are sensitive to business and personal discretionary spending levels and tend to decline during general economic downturns. Events or weakness that could negatively affect the travel industry and related spending include economic conditions, price escalation in the airline industry or other travel-related industries, airline or other travel related strikes, safety concerns, including terrorist activities, incleme