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COMMODORE APPLIED TECHNOLOGIES INC

Form 10-Q

November 14, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2003

OR

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

Commission File Number 1-11871

COMMODORE APPLIED TECHNOLOGIES, INC.

(Exact name of Registrant as specified in its charter)

Delaware

11-3312952

(State or other jurisdiction of
incorporation or organization)

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

150 East 58th Street, Suite 3238
New York, New York

10155

(Address of principal executive office)

(Zip Code)

Registrant's telephone number, including area code: (212) 308-5800

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 whether the registrant is an accelerated filer
(as defined by Exchange Act Rule 12b-2). Yes No X .

The number of shares the common stock outstanding at November 14, 2003
was 117,702,134.

COMMODORE APPLIED TECHNOLOGIES, INC.

FORM 10-Q

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## 1

## PART I - FINANCIAL INFORMATION

## ITEM 1: Financial Statements

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## COMMODORE APPLIED TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEET  
(Dollars in Thousands, except per share data)

ASSETS	September 30, 2003 ----- unaudited)	December 31, 2002 -----
Current Assets:		
Cash and cash equivalents	\$          2	\$          59
Accounts receivable, net	82	92
Prepaid assets and other current receivables	86	167
	-----	-----
Total Current Assets	170	318
Property and equipment, net	196	358
Patents and completed technology, net of		

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accumulated amortization of \$70 and \$40, respectively	30	60
	-----	-----
Total Assets	\$ 396	\$ 736
	=====	=====

See notes to condensed consolidated financial statements.

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COMMODORE APPLIED TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEET  
(Dollars in Thousands, except per share data)

	September 30, 2003	December 31, 2002
	-----	-----
LIABILITIES AND STOCKHOLDERS' DEFICIT	(unaudited)	
Current Liabilities:		
Accounts payable	\$ 1,084	\$ 1,077
Related party payable	-	80
Notes payable	1,595	714
Other accrued liabilities	3,699	2,723
	-----	-----
Total Current Liabilities	6,378	4,594
Long term debt	--	431
	-----	-----
Total Liabilities	6,378	5,025
Commitments and contingencies	--	--
Stockholders' Deficit		
Convertible Preferred Stock, Series E, F & H par value \$0.001 per share, 5% to 12% cumulative dividends, series E and F, 3% dividends for Series H, 1,561,700 authorized, 1,038,200 shares and 1,213,700 shares issued and outstanding as of September 30, 2003 and December 31, 2002, respectively. The shares had an aggregate liquidation value of \$4,206 and \$6,716 at September 30, 2003 and December 31, 2002, respectively.	1	1
Common Stock, par value \$0.001 per share, 300,000,000 shares authorized, 115,675,107 and 59,027,062 issued and outstanding, at September 30, 2003 and December 31, 2002, respectively.	115	59
Additional paid-in capital	67,247	67,129
Accumulated deficit	(73,082)	(71,215)
	-----	-----
Treasury Stock, 3,437,500 shares	(5,719)	(4,026)
	(263)	(263)

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Total Stockholder's Deficit	(5,982)	(4,289)
Total Liabilities and Stockholders' Deficit	\$ 396	\$ 736

See notes to condensed consolidated financial statements.

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COMMODORE APPLIED TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS  
(Unaudited - Dollars in Thousands, except per share data)

	Three months ended Sept 30, 2003	Sept 30, 2002	Nine months Sept 30, 2003
Contract revenues	\$ 166	\$ 1,104	\$ 462
Costs and expenses:			
Cost of sales	212	728	615
Research and development	4	37	63
General and administrative	383	373	1,069
Depreciation and amortization	65	97	203
Total costs and expenses	664	1,235	1,950
Loss from operations	(498)	(131)	(1,488)
Other income (expense):			
Interest expense	(221)	(15)	(379)
Net other income (expense)	(221)	(15)	(379)
Loss before income taxes	(719)	(146)	(1,867)
Income taxes	--	--	--
Loss from continuing operations	(719)	(146)	(1,867)
Loss from discontinued operations of component DRM (including loss on disposal of \$4,134 during the nine months ended September 30, 2002)	--	--	--
Net loss	\$ (719)	\$ (146)	\$ (1,867)
Loss per share - from continuing operations - basic and diluted	\$ (0.01)	\$ (0.00)	\$ (0.02)
Loss per share - from discontinued operations - basic and diluted	\$ (0.00)	\$ (0.00)	\$ (0.00)

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Loss per share - basic and diluted	\$ (0.01)	\$ (0.00)	\$ (0.02)	\$
Number of weighted average shares outstanding (000's)	94,834	52,895	83,462	

See notes to condensed consolidated financial statements.

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COMMODORE APPLIED TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS  
(Unaudited - Dollars in Thousands, except per share data)

	Nine months ended	
	September 30, 2003	September 30, 2002
	----	----
Cash flows from operating activities:		
Net loss	\$ (1,867)	\$ (5,464)
Add: net loss from discontinued operations	--	4,802
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	203	210
Amortization of debt discount	35	18
Changes in assets and liabilities:		
Accounts receivable, net	10	(175)
Prepaid assets	81	235
Accounts payable	7	(119)
Other liabilities	614	175
Net cash used in continuing operations	(917)	(318)
Net cash provided by discontinued operations	--	184
Net cash used in operating activities	(917)	(134)
Cash flows from investing activities:		
Purchase of equipment	(11)	(3)
Advances to related parties	(80)	(23)
Net cash used in continuing operations	(91)	(26)
Net cash used in discontinued operations	-	(4)
Net cash used in investing activities	(91)	(30)
Cash flows from financing activities:		
Increase in (repayment of) line of credit	--	249
Increase in notes and loans payable	991	--
Payments on notes payable and long-term debt	(40)	(183)
Net cash provided by financing activities	951	66
Increase (decrease) in cash	(57)	(98)
Cash, beginning of period	59	170

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Cash, end of period	----- \$ 2 =====	----- \$ 72 =====
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See notes to condensed consolidated financial statements.

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## COMMODORE APPLIED TECHNOLOGIES, INC. AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2003

#### Note A - Basis of Presentation

The accompanying unaudited condensed consolidated financial statements for Commodore Applied Technologies, Inc. and subsidiaries (the "Company" or "Applied") have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. The financial statement information was derived from unaudited financial statements unless indicated otherwise. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements.

In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine month periods ended September 30, 2003 are not necessarily indicative of the results that may be expected for the year ending December 31, 2003.

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited financial statements included in the Company's annual report on Form 10-K for the year ended December 31, 2002.

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

The accompanying financial statements have been prepared under the assumption that Applied will continue as a going concern. Such assumption contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. For the nine-month period ended September 30, 2003, and the years ended December 31, 2002, 2001 and 2000, Applied incurred losses of (\$1,867,000), (\$5,972,000), (\$6,554,000) and (\$11,441,000), respectively. For the nine month period ended September 30, 2003, and for the years ended December 31, 2002, 2001 and 2000, Applied has also experienced net cash inflows (outflows) from operating activities of \$(917,000), \$(123,000), \$965,000 and \$(2,629,000). The financial statements do not include any adjustments that might be necessary should Applied be unable to continue as a going concern. Applied's continuation as a going concern is dependent upon its ability to generate sufficient cash flow to meet its obligations on a timely basis, to obtain additional financing as may be required, and ultimately to attain profitability. Potential sources of cash include new contracts, external debt and the sale of new shares of company stock or alternative methods such as mergers or sale transactions. No assurances can be given, however, that Applied will be able to obtain any of these potential sources of cash.

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Anticipated losses on contracts are provided for by a charge to income during the period such losses are identified. Changes in job performance, job conditions, estimated profitability (including those arising from contract penalty provisions) and final contract settlements may result in revisions to cost and income and are recognized in the period in which the revisions are determined. Allowances for anticipated losses totaled \$376,000 and \$238,000 at September 30, 2003 and December 31, 2002, respectively. These allowances are included in other accrued liabilities in the accompanying financial statements.

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In as much as Applied rescinded certain options during 2002 and reissued new options to the option holders, the options are considered variable options and will be revalued each quarter to determine the effect on operations, if any. During the quarter ended September 30, 2003, no expense has been recognized for the variable options as the fair market value of Applied's common stock at September 30, 2003 was lower than the exercise price of the variable options.

The consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. All significant intercompany balances and transactions have been eliminated. The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the 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. Actual results could differ from those estimates.

The Company accounts for stock-based compensation under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations. No stock-based employee compensation cost is reflected in net income (loss), as all options vested had an exercise price equal to the market value of the underlying common stock on the date of grant or the date of repricing. No options were issued or vested during the quarters ended September 30, 2003 and 2002, therefore, there would be no effect on net income and earnings per share if the company had applied the fair value recognition provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation.

### Note B - Supplemental Cash Flow Information

During the three and nine month periods ended September 30, 2003, 29,500 and 158,000 shares of Series E Preferred Stock were converted into 14,360,995 and 38,889,128 shares of the Company's common stock, respectively. During the three and nine month periods ended September 30, 2003, the Company paid dividends on the Series E Preferred Stock conversions of \$0 and \$141,929, respectively, by converting into 0 shares and 1,566,989, shares of the Company's common stock, respectively. The Company accrued dividends on Preferred Stock Series E for the three and nine-month periods ended September 30, 2003, of \$40,721 and \$171,240, respectively, which is included in Other Accrued Liabilities.

During the three and nine month periods ended September 30, 2003, 0 and 17,500 shares of Preferred Stock Series F were converted into 0 shares and 2,450,514, shares of the Company's common stock, respectively. During the three and nine month periods ended September 30, 2003, the Company paid dividends on the Series E Preferred Stock conversions of \$0 and \$39,387, respectively, by converting into 0 shares and 551,571, shares of the Company's common stock, respectively. The Company accrued dividends on Preferred Stock Series F for the

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three and nine-month periods ended September 30, 2003, of \$36,836 and \$105,621, respectively, which is included in Other Accrued Liabilities.

During the three and nine month periods ended September 30, 2003, no shares of Preferred Stock Series H were converted into shares of common stock. The Company paid no accrued dividends on Preferred Stock Series H. The Company accrued dividends on Preferred Stock Series H for the three and nine-month periods ended September 30, 2003, of \$6,000 and \$18,000, respectively, which is included in Other Accrued Liabilities.

During March 2003, a shareholder and officer agreed to convert his \$250,000 note payable and approximately \$37,000 of accrued interest due from the Company into 13,189,841 shares of the Company's common stock.

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### Note C - Other Accrued Liabilities

Other accrued liabilities consist of the following:

	September 30, 2003	December 31, 2002
Dividend payable	\$ 1,324	\$ 1,210
Compensation and employee benefits	1,219	842
Loss reserve	376	238
Exit and forbearance fees on notes payable	220	--
Related parties	185	185
Accrued interest	286	155
Other	89	93
	-----	-----
	\$ 3,699	\$ 2,723
	=====	=====

### Note D - Segment Information

The Company has identified three reportable segments in which it operates, based on the guidelines set forth in the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 131. These three segments are as follows: (i) Commodore Advanced Sciences, Inc. ("Advanced Sciences"), which primarily provides various engineering, legal, sampling, and public relations services to Government agencies on a cost plus basis; (ii) Commodore Solution Technologies, Inc. ("Solution"), which is commercializing technologies to treat mixed and hazardous waste; and (iii) Corporate overhead and other miscellaneous activities.

Dispute Resolution Management, Inc. ("DRM"), from August 30, 2000 (date of acquisition of 81% of DRM by the Company) to May 16, 2002 (date of dissolution of 81% of DRM by the Company), provided a package of services to help companies recover financial settlements from insurance policies to defray costs associated with environmental liabilities. Loss from DRM is recorded in the discontinued operations section of the segment information.

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Applied evaluates segment performance based on the segment's net income (loss). Applied's foreign and export sales and assets located outside of the United States are not significant. Summarized financial information concerning



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Applied's reportable segments is shown in the following tables.

Three Months Ended September 30, 2003  
(Dollars in Thousands)

	Total	Advanced Sciences	Solution
Contract revenues	\$ 166	\$ 149	\$ 17
Costs and expenses			
Cost of sales	212	195	17
Research and development	4	--	4
General and administrative	383	119	30
Depreciation and amortization	65	9	56
Total costs and expenses	664	323	107
Income (loss) from operations	(498)	(174)	(90)
Interest income	--	--	--
Interest expense	(221)	--	--
Income taxes	--	--	--
Income (loss) from continuing operations	(719)	(174)	(90)
Loss from discontinued Operations	--	--	--
Net income (loss)	\$ (719)	\$ (174)	\$ (90)
Total assets	\$ 396	\$ 168	\$ 200
Expenditures for long-lived assets	\$ 5	\$ 5	\$ --

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Nine Months Ended September 30, 2003  
(Dollars in Thousands)

	Total	Advanced Sciences	Solution
--	-------	----------------------	----------

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Contract revenues	\$	462	\$	445	\$	17	\$
Costs and expenses							
Cost of sales		615		598		17	
Research and development		63		--		63	
General and administrative		1,069		344		127	
Depreciation and amortization		203		35		168	
		-----		-----		-----	
Total costs and expenses		1,950		977		375	
		-----		-----		-----	
Income (loss) from operations		(1,488)		(532)		(358)	
Interest income		--		--		--	
Interest expense		(379)		(3)		--	
Income taxes		--		--		--	
		-----		-----		-----	
Income (loss) from continuing operations		(1,867)		(535)		(358)	
Loss from discontinued Operations		--		--		--	
		-----		-----		-----	
Net Income (loss)	\$	(1,867)	\$	(535)	\$	(358)	\$
		=====		=====		=====	
Total assets	\$	396	\$	168	\$	200	\$
Expenditures for long-lived assets	\$	11	\$	11	\$	--	\$

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Three Months Ended September 30, 2002  
(Dollars in Thousands)

	Total	Advanced Sciences	Solution
Contract revenues	\$ 1,104	\$ 989	\$ 115
Costs and expenses			
Cost of sales	728	655	73
Research and development	37	--	37
General and administrative	373	160	33
Depreciation and amortization	97	40	57
	-----	-----	-----
Total costs and expenses	1,235	855	200
	-----	-----	-----
Income (loss) from operations	(131)	134	(85)

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Interest income	--	--	--
Interest expense	(15)	(7)	--
Income taxes	--	--	--
	-----	-----	-----
Loss from continuing operations	(146)	127	(85)
Loss from discontinued	--	--	--
	-----	-----	-----
Net income (loss)	\$ (146)	\$ 127	\$ (85)
	=====	=====	=====
Total assets	\$ 1,428	\$ 952	\$ 356
Expenditures for long-lived assets	\$ --	\$ --	\$ --

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Nine Months Ended September 30, 2002  
(Dollars in Thousands)

	Total	Advanced Sciences	Solution
Contract revenues	\$ 3,381	\$ 3,233	\$ 148
Costs and expenses			
Cost of sales	2,359	2,106	253
Research and development	150	--	150
General and administrative	1,241	555	85
Depreciation and amortization	210	62	148
	-----	-----	-----
Total costs and expenses	3,960	2,723	636
	-----	-----	-----
Income (loss) from operations	(579)	510	(488)
Interest income	--	--	--
Interest expense	(83)	(59)	--
Income taxes	--	--	--
	-----	-----	-----
Income (loss) from continuing operations	(662)	451	(488)
Loss from discontinued operations	(4,802)	--	--
	-----	-----	-----
Net Income (loss)	\$ (5,464)	\$ 451	\$ (488)
	=====	=====	=====
Total assets	\$ 1,428	\$ 952	\$ 356
Expenditures for long-lived assets	\$ 4	\$ --	\$ --

Note E - Net Loss per Common Share

Basic net loss per common share ("Basic EPS") excludes dilution and is computed by dividing net loss available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted net loss per common share ("Diluted EPS") reflects the potential dilution that could occur if stock options or other contracts to issue common stock were exercised or converted into common stock. The computation of Diluted EPS does not assume exercise or conversion of securities that would have an anti-dilutive effect on net loss per common share.

Options and warrants to purchase 34,274,905 and 26,485,113 shares of common stock as of September 30, 2003 and 2002, respectively, were not included in the computation of Diluted EPS. The inclusion of the options would have been anti-dilutive, thereby decreasing net loss per common share.

Note F - Contingencies

Applied has matters of litigation arising in the ordinary course of business which in the opinion of management will not have a material adverse effect on its financial condition or results of operations.

Note G - Subsequent Events

Issuance of Common Stock subsequent to September 30, 2003

The Company issued a total of 2,027,027 shares of its common stock during the period from September 30, 2003 to November 14, 2003, in connection with various conversion notices from the holders of the Company's Series E Convertible Preferred Stock, par value (\$0.001) per share (the "Series E Preferred") and the holders of the Company's Series F Convertible Preferred Stock, par value (\$0.001) per share (the "Series F Preferred").

ITEM 2. Management's Discussion and Analysis of Financial Condition  
-----  
and Results of Operations  
-----

Overview

Commodore Applied Technologies, Inc. and subsidiaries (the "Company" or "Applied"), is engaged in providing a range of engineering, technical, and financial services to the public and private sectors related to (i) remediating contamination in soils, liquids and other materials, and disposing of or reusing certain waste by-products by utilizing SET; and (ii) providing services related to environmental management for on-site and off-site identification, remediation and management of hazardous, mixed and radioactive waste.

The Company is currently working on the commercialization of these technologies through development efforts, licensing arrangements and joint ventures. Through Advanced Sciences, formerly Advanced Sciences, Inc., a subsidiary acquired on October 1, 1996, the Company has contracts with various

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government agencies and private companies in the U.S. As some government contracts are funded in one-year increments, there is a possibility for cutbacks as these contracts constitute a major portion of Advanced Sciences' revenues, and such a reduction would materially affect the operations. Advanced Sciences has experienced a significant decrease in revenue caused by fewer contracts and overall, less work being performed by Advanced Sciences. However, management believes its existing client relationships will allow the Company to obtain new contracts in the future.

Applied discontinued the operations of its previously 81% owned subsidiary DRM, on May 16, 2002 as a result of Applied's inability to meet the terms and conditions of the Stock Purchase Agreement with DRM. The loss from the disposition of DRM is recorded at \$4,134,000 to Applied. The Company currently requires additional cash to sustain existing operations and to meet current obligations and ongoing capital requirements. The Company's current monthly operating expenses exceed cash revenues by approximately \$86,000.

The Company held its 2002 Annual Meeting at The Fitzpatrick Hotel located at 687 Lexington Avenue, New York, NY 10015 on September 12, 2003 - 11:00 a.m. EST. The results of the meeting were as follows:

The stockholders owning a majority of the issued and outstanding shares of the Company's Common Stock have voted:

1. to elect Bentley J. Blum, Shelby T. Brewer, Frank E. Coffman, James M. DeAngelis, Paul E. Hannesson, Michael P. Kalleres and William A. Wilson as Directors;
2. to amend the Certificate of Incorporation to increase the number of authorized shares of common stock from 125,000,000 shares to 300,000,000 shares.
3. to approve the Company's Short Term Incentive Plan.
4. to ratify the Company's 1998 Stock Option Plan, as amended.
5. to approve options issued to the Chief Executive Officer outside the Company's 1998 Stock Option Plan, as amended.
6. to approve options issued to the Chief Financial Officer outside the Company's 1998 Stock Option Plan, as amended.
7. to ratify Tanner + Co. as the Company's independent auditors for the year ended December 31, 2003.

### RESULTS OF OPERATIONS

Three and Nine Months Ended September 30, 2003 Compared to Three and Nine Months Ended September 30, 2002

Revenues from continuing operations were \$166,000 and \$462,000 for the three and nine months ended September 30, 2003 compared to \$1,104,000 and \$3,381,000 for the three and nine months ended September 30, 2002. Such revenues were primarily from the Company's subsidiary Advanced Sciences.

In the case of Advanced Sciences, revenues were \$149,000 and \$445,000 respectively for the three and nine months ended September 30, 2003 as compared with \$989,000 and \$3,233,000 for the three and nine months ended September 30, 2002. Advanced Sciences has experienced a significant decrease in revenue caused by fewer contracts and overall, less work being performed by Advanced Sciences. The revenues from Advanced Sciences consisted of engineering and scientific services performed for the United States government under a variety of contracts, most of which provide for reimbursement of cost plus fixed fees. Revenue under cost-reimbursement contracts is recorded under the percentage of completion method as costs are incurred and include estimated fees in the proportion that costs to date bear to total estimated costs. Advanced Sciences has two major customers, each of which represent more than 10% of total revenue.

The combined revenue for these two customers was \$149,000 and \$445,000 respectively (100% of total revenues) for the three and nine months ended September 30, 2003. Cost of sales was \$195,000 and \$598,000 respectively for the three and nine months ended September 30, 2003 compared to \$655,000 and \$2,106,000 respectively for the three and nine months ended September 30, 2002. The decrease in cost of sales is due to greater efficiencies in staffing and further reduction of sales associated expenses in the three and nine months ended September 30, 2003.

In the case of Solution, revenues were \$17,000 and \$17,000 respectively for the three and nine months ended September 30, 2003 as compared with \$115,000 and \$148,000 respectively for three and nine months ended September 30, 2002. There were marginal revenues recorded for the three and nine month period ended September 30, 2003 due to (i) SET processing contracts being negotiated but not yet initiated, (ii) United States Environmental Protection Agency (the "USEPA") demonstration of the SL-2 system at a client location in Oak Ridge, Tennessee for inclusion to the Company's nationwide permit for PCB destruction; and (iii) the relocations of the SET equipment to Hanford, Washington. Revenues, when recognized, are primarily from remediation services performed for engineering and waste treatment companies in the U.S. under a variety of contracts. Cost of sales was \$17,000 and \$17,000 respectively for the three and nine months ended September 30, 2003 as compared to \$73,000 and \$253,000 respectively for the three and nine months ended September 30, 2002. The cost of sales, when incurred, is attributable to installation, set-up, supplies and salary expenses for the SET technology. The cost of sales also includes other direct sales and marketing expenses when incurred. Anticipated losses on engagements, if any, will be provided for by a charge to income during the period such losses are first identified.

For the three and nine months ended September 30, 2003, the Company incurred research and development costs of \$4,000 and \$63,000 respectively as compared to \$37,000 and \$150,000 respectively for the three and nine months ended September 30, 2002. Research and development costs include salaries, wages, and other related costs of personnel engaged in research and development activities, contract services and materials, test equipment and rent for facilities involved in research and development activities. Research and development costs are expensed when incurred, except those costs related to the design or construction of an asset having an economic useful life are capitalized, and then depreciated over the estimated useful life of the asset. The decrease in research and development expense is due to the continued commercialization focus of the Company.

General and administrative expenses for continuing operations for the three and nine months ended September 30, 2003 were \$383,000 and \$1,069,000 respectively as compared to \$373,000 and \$1,241,000 respectively for the three and nine months ended September 30, 2002. There is no material difference between the compared operational periods.

Interest expense for continuing operations for the three and nine months ended September 30, 2003 was \$221,000 and \$379,000, respectively as compared to \$15,000 and \$83,000, respectively for the three and nine months ended September 30, 2002. The increase in interest expense is primarily related to amortization of interest costs associated with the Blum Demand Note, the amortization of interest costs associated with the Weiss Group Note and the amortization of interest costs, forbearance fees and exit fees associated with the Milford/Shaar Bridge Loan Note.

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### LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2003 and December 31, 2002 Advanced Sciences had a \$0 and \$0 outstanding balance, respectively, on its revolving line of credit.

For the three and nine month periods ended September 30, 2003, the Company incurred a net loss of (\$719,000) and (\$1,867,000), respectively as compared to a net loss of (\$146,000) and (\$5,464,000), respectively for the three and nine months ended September 30, 2002. For the nine-month period ended September 30, 2003, and for the years ended December 31, 2002, 2001, and 2000, Applied incurred losses of (\$1,867,000), (\$5,972,000), (\$6,554,000) and (\$11,441,000), respectively. Applied has also experienced net cash (outflows) inflows from operating activities of \$(123,000), \$965,000, and \$(2,629,000) for the years ended December 31, 2002, 2001, and 2000, respectively.

During the three and nine month periods ended September 30, 2003, the Company converted 29,500 and 158,000, respectively, shares of Series E Preferred for 14,360,995 and 40,456,117 shares of the Company's common stock, respectively. During the three and nine month periods ended September 30, 2003, the Company converted 0 and 17,500, respectively, shares of Series F Preferred for 0 and 3,002,085 shares of the Company's common stock, respectively. The Company issued no shares of the Company's common stock with respect to accrued dividends pertaining to the Series E and Series F Preferred conversions from the period February 21, 2003 through September 30, 2003.

During the three and nine month periods ended September 30, 2003, the Company converted no shares of Series H Preferred and issued no stock with respect to accrued dividends pertaining to the Series H Preferred.

On June 28, 1996, the Company issued common stock and warrants at initial public offering prices of \$6.00 per share and \$0.10 per warrant. The Company's warrants, previously extended from June 16, 2001, expired on June 16, 2002. On March 6, 2003, the Company's common stock ceased to be listed on the American Stock Exchange ("AMEX") and began trading in the over-the-counter market in the so-called "pink sheets" of the National Quotation Bureau, Inc. and the OTC Bulletin Board of the National Association of Securities Dealers, Inc. (the "OTCBB"), where it is currently traded under the symbol CXII.

The Company currently requires additional cash to sustain existing operations and to meet current obligations and ongoing capital requirements. The Company's current monthly operating expenses exceed cash revenues by approximately \$86,000 at September 30, 2003.

In November 1999, the Company completed \$2.5 million in financing through private placement. The Company issued 335,000 shares of a new Series E Convertible Preferred Stock (the "Series E Preferred"), convertible into common stock at the market price, after September 30, 2000 and up through April 30, 2004 at which time it automatically converts to common stock. The Series E Preferred has a variable rate dividend averaging 8.15% over the term of the security. There are 120,000 shares of Series E Preferred with a face value of \$1,200,000 outstanding as of September 30, 2003. There is \$802,160 of accrued dividends payable on the Series E Preferred as of September 30, 2003.

In March 2000, the Company completed \$2.0 million in financing through private placement. The Company issued 266,700 shares of a new Series F Convertible Preferred Stock (the "Series F Preferred"), convertible into common stock at the market price, after September 30, 2000 and up through April 30, 2004 at which time it automatically converts to common stock. The Series F Preferred has a variable rate dividend averaging 8.15% over the term of the security. There are 118,200 shares of Series F Preferred with a face value of

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\$1,182,000 outstanding as of September 30, 2003. There is \$494,939 of accrued dividends payable on the Series F Preferred as of September 30, 2003.

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In September 2000, the Company completed \$500,000 in financing in the form of a loan (the "Brewer Note") from S. Brewer Enterprises, Inc. ("SB Enterprises"), which is owned by one of its officers and directors, Shelby T. Brewer. The Brewer Note bears a 9.75% interest rate, payable monthly, with a balloon principal payment at the end of the term. The Brewer Note was due and payable on March 15, 2001 and was extended under the same terms and conditions until December 31, 2001. The Brewer Note was convertible into Common Stock at the market price up through December 31, 2001.

On March 15, 2001, SB Enterprises executed an Amended and Restated Promissory Note (the "Restated Brewer Note"), that extended the maturity date of the note until December 31, 2001. Additionally, the conversion price feature of the Restated Brewer Note was changed to the 5-day average closing price of the Company's common stock prior to a conversion notice. On April 9, 2001, SB Enterprises issued a conversion notice for \$250,000 of the outstanding principal of the Brewer Restated Note. The conversion price was calculated based upon the previous 5-day average of the closing price of the Company's common stock, and the Restated Brewer Note was converted into 1,041,667 shares of the Company's common stock. The Company believes that this transaction is exempt from the registration requirements of the Securities Act of 1933, as amended (the "Securities Act"), under Section 4(2) thereof as a transaction not involving any public offering of securities.

On December 12, 2002, SB Enterprises executed an Amended and Restated Promissory Note Extension (the "Restated Brewer Note Extension"), which extended the maturity date of the Restated Brewer Note until January 1, 2004. In connection with the Restated Brewer Note Extension, the Company issued SB Enterprises a 2-year warrant for 1,000,000 shares of the Company's common stock at an exercise price of \$0.05 per share. On March 14, 2003, SB Enterprises issued a conversion notice for the remaining principal balance of \$250,000 plus accrued interest of \$36,563. The conversion price was calculated based upon the previous 5-day average of the closing price of the Company's common stock, and the Restated Brewer Note was converted into 13,189,842 shares of the Company's common stock. The shares of common stock were issued to S. B. Enterprises on September 30, 2003. The Company believes that this transaction is exempt from the registration requirements of the Securities Act, under Section 4(2) thereof as a transaction not involving any public offering of securities.

In October 2001, Advanced Sciences refinanced their line of credit with Commerce Funding Corporation (the "Commerce Credit Line"). The Commerce Credit Line is not to exceed 85 percent of eligible receivables or \$1,000,000 and is due October 2002, and subsequently extended until November 2003, with interest payable monthly at prime plus 2 percent (6.75 percent as of December 31, 2002). The Commerce Credit Line is collateralized by the receivables of Advanced Sciences and is guaranteed by the Company. The Commerce Credit Line contains certain financial covenants and restrictions including minimum ratios that Advanced Sciences must satisfy. Advanced Sciences was in compliance with the covenants of the Commerce Credit Line at November 14, 2003.

In addition, the Commerce Credit Line agreement stipulates that no payments shall be made by Advanced Sciences to the Company other than monthly scheduled payments of principal with respect to the \$8,280,000 subordinated indebtedness owed by Advanced Sciences to the Company (which is eliminated in consolidation) and intercompany indebtedness not to exceed \$20,000 in any month. In addition, Advanced Sciences shall not incur indebtedness in excess of \$25,000, other than trade payables, the above subordinated indebtedness and



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other contractual obligations to suppliers and customers incurred in the ordinary course of business.

In November 2000, the Company completed \$500,000 in financing in the form of a loan (the "Weiss Group Note") from a group of four investors; \$75,000 of which was borrowed from the son of Paul E. Hannesson, our former President and Chief Executive Officer, and \$25,000 of which was borrowed from Stephen A. Weiss, a shareholder of Greenberg Traurig, LLP, our former corporate and securities counsel. The Weiss Group Note bears interest at 12% per annum, was due and payable on February 12, 2001, and is secured by the first \$500,000 of

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loans or dividends that the Company may receive from DRM. As consideration for such loan, Environmental, one of the Company's principal stockholders owning approximately 9.25% of the Company's common stock, transferred to the investors a total of 1,000,000 shares of the Company's common stock. The current principal balance of the Weiss Group Note is \$253,603 and remains unpaid as of November 14, 2003. All have granted payment extensions until January 1, 2004.

Effective April 16, 2001, the Company issued warrants to purchase 1,000,000 shares of its common stock at an exercise price of \$0.22 per share (the closing price of our common stock on the AMEX on such date) to all holders of the Weiss Group Note in consideration of the extension of the due date of the Weiss Group Note from February 12, 2001 to June 30, 2001. The Company believes that this transaction is exempt from the registration requirements of the Securities Act, under Section 4(2) thereof as a transaction not involving any public offering of securities.

Effective January 24, 2002, the Company issued warrants to purchase 500,000 shares of its common stock at an exercise price of \$0.15 per share (the closing price of our common stock on the AMEX on such date) to all holders of the Weiss Group Note in consideration of the extension of the due date of such loans by such persons from June 30, 2001 to May 31, 2002. The Company believes that this transaction is exempt from the registration requirements of the Securities Act, under Section 4(2) thereof as a transaction not involving any public offering of securities.

Effective October 29, 2002, the lenders under the Weiss Group Note voluntarily cancelled all warrants, issued on April 16, 2001, to purchase 1,000,000 shares at an exercise price of \$0.22 per share of the Company's common stock in connection with the Weiss Group Note. Effective October 29, 2002, the lenders under the Weiss Group Note voluntarily cancelled all warrants, issued on January 24, 2002, to purchase 500,000 shares at an exercise price of \$0.15 per share of the Company's common stock in connection with the Weiss Group Note.

Effective October 29, 2002, the Company issued warrants to purchase 1,500,000 shares of its common stock at an exercise price of \$0.05 per share (the closing price of our common stock on the AMEX on such date) to all holders of the Weiss Group Note in consideration of the extension of the due date of such loans by such persons from May 31, 2002 to January 1, 2004. The Company believes that this transaction is exempt from the registration requirements of the Securities Act, under Section 4(2) thereof as a transaction not involving any public offering of securities.

On June 13, 2001, the Company issued and sold to Milford Capital Management, Inc. and the Shaar Fund, Ltd. (hereinafter known as "Milford/Shaar") one-year, 15% Senior Secured Promissory Notes (the "Milford/Shaar Bridge Loan Notes") in the aggregate principal amount of \$1,000,000. In connection with the Milford/Shaar Bridge Loan Notes, the Company issued to Milford/Shaar a five-year warrant for 333,334 shares of the Company's common stock at an exercise price of

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\$0.22 per share. The Company pledged its equipment and SET related intellectual property as collateral for the Milford/Shaar Bridge Loan Notes. The Company shall pay Milford/Shaar principal and interest on a monthly basis in arrears. The Milford/Shaar Bridge Loan Notes may be prepaid at any time without penalty. The Company believes that this transaction is exempt from the registration requirements of the Securities Act, under Section 4(2) thereof as a transaction not involving any public offering of securities.

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The Company made all payments on the Milford/Shaar Bridge Loan Notes until November 13, 2001. The Company asked for and received a forbearance of payments on the Milford/Shaar Bridge Loan Notes from November 13, 2001 until August 13, 2002. The Shaar Fund, Ltd., through the Shaar Bridge Loan, continues to provide cash installments on a periodic basis in the form of additional principal. The current principal balance of the Milford/Shaar Bridge Loan Notes is \$1,104,999 as of September 30, 2003 and remains unpaid as of November 14, 2003. Additionally, as of November 14, 2003, there is \$119,073 in accumulated forbearance fees and \$100,000 due in exit fees on the Milford/Shaar Bridge Loan Notes. The Company has not been notified of a default of the Milford/Shaar Bridge Loan Notes as of November 14, 2003.

On October 2, 2002, Mr. Bentley Blum, a director of the Company, had previously loaned the Company \$125,000 in cash installments over the period of one year (the "Blum Loan"). The Company elected to convert the Blum Loan to the Company's common stock under the conversion feature of the Blum Loan, based upon the 5-day average closing price of the Company's common stock prior to October 2, 2002. On October 2, 2002, Blum issued a conversion notice for \$125,000 of the outstanding principal of the Blum Loan into 2,500,000 shares. Mr. Blum continues to provide cash installments in the form of a demand note ("Blum Demand Note") to the Company. The Blum Demand Note bears interest at 9% per annum. The current principal balance of the Blum Demand Note is \$232,032 as of September 30, 2003 and remains unpaid as of November 14, 2003. The Company believes that this transaction is exempt from the registration requirements of the Securities Act, under Section 4(2) thereof as a transaction not involving any public offering of securities.

On August 30, 2000, the Company entered into a Stock Purchase Agreement (the "Agreement") Applied completed a stock purchase agreement with Dispute Resolution Management, Inc. (DRM) and its two shareholders, William J. Russell ("Russell") and Tamie B. Speciale ("Speciale").

On May 16, 2002, William J. Russell and Tamie B. Speciale (the "Pledges") issued a Notice of Default and Right to Pursue Remedies (the "Notice") to the Company claiming that the Company is in default under the Agreement and the related Stock Pledge Agreement (the "Stock Pledge"). As of May 16, 2002, the Company no longer owned an 81% interest in DRM.

On August 19, 2002, the Company entered into a settlement agreement with DRM (the "DRM Settlement Agreement"). Under terms of the DRM Settlement Agreement, the Company acknowledged that it had previously received back 4,750,000 shares of its common stock from DRM and its shareholders. As part of the DRM Settlement Agreement, the Company received an additional 1,187,500 shares of its common stock from DRM and its shareholders.

Under the DRM Settlement Agreement, as of September 30, 2002, the Company also issued 800,000 shares of Series H Preferred stock, par value \$0.001 per share (the "Series H Preferred Stock"), each such share of Series H Preferred Stock having a stated value of \$1.00 per share, to DRM, Russell and Speciale in satisfaction of the remaining liabilities relating to the purchase

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and working capital of DRM. The Series H Preferred Stock has the following rights, privileges, and limitations:

- a) No Series H Preferred Stock may be converted prior to June 30, 2003. Until July 31, 2005, only 80,000 shares of the Series H Preferred Stock shall be convertible in any calendar quarter. The balance of any unconverted shares of Series H Preferred Stock may be converted at any time on or after August 1, 2005.
- b) The conversion price of the Series H Preferred Stock shall be determined by the average closing price of Company's common stock in the previous 30 trading days, but in no event shall the conversion price be less than \$0.20 per share.

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- c) The Series H Preferred Stock shall have a non-cumulative annual dividend of 3%, payable in cash or shares of Series H Preferred Stock within 30 days of the end of the Company's fiscal year, at the Company's election.
- d) The Series H Preferred Stock shall not be transferable.

There are 800,000 shares of Series H Preferred with a face value of \$800,000 outstanding as of September 30, 2003. There is \$26,762 of accrued dividends payable on the Series H Preferred as of September 30, 2003.

The financial information included in the accompanying form 10Q for the period ending September 30, 2003 reflects the terms of the DRM Settlement Agreement. For the year ended December 31, 2002 the Company recorded a loss on the disposal of DRM in the amount of \$4,134,000. The Company's loss of the DRM subsidiary has had, and may continue to have, a material adverse effect on the financial condition of the Company and its cash flow problems. The Company currently requires additional cash to sustain existing operations and to meet current obligations and ongoing capital requirements. The Company's current monthly operating expenses exceed cash revenues by approximately \$86,000.

The Company's auditor's opinion on our fiscal 2002 financial statements contains a "going concern" qualification in which they express doubt about the Company's ability to continue in business, absent additional financing.

The Company currently is negotiating with a lender to obtain debt financing, to supplement funds generated from operations, to meet the Company's cash needs over the next 12 months. The Company intends to meet its long-term capital needs through obtaining additional contracts that will generate funds from operations and obtaining additional debt or equity financing as necessary or engaging in merger or sale transactions. There can be no assurance that such sources of funds will be available to the Company or that it will be able to meet its short or long-term capital requirements.

### NET OPERATING LOSS CARRYFORWARDS

The Company has net operating loss carryforwards of approximately \$32,000,000. The amount of net operating loss carryforward that can be used in any one year will be limited by the applicable tax laws which are in effect at the time such carryforward can be utilized. A full valuation allowance has been established to offset any benefit from the net operating loss carryforwards. It cannot be determined when or if the Company will be able to utilize the net operating losses.

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## FORWARD-LOOKING STATEMENTS

Certain matters discussed in this Quarterly Report are "forward-looking statements" intended to qualify for the safe harbors from liability established by Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These forward-looking statements can generally be identified as such because the context of the statement will include words such as the Company "believes," "anticipates," "expects" or words of similar import. Similarly, statements that describe the Company's future plans, objectives or goals are also forward-looking statements. Such statements may address future events and conditions concerning, among other things, the Company's results of operations and financial condition; the consummation of acquisition and financing transactions and the effect thereof on the Company's

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business; capital expenditures; litigation; regulatory matters; and the Company's plans and objectives for future operations and expansion. Any such forward-looking statements would be subject to the risks and uncertainties that could cause actual results of operations, financial condition, acquisitions, financing transactions, operations, expenditures, expansion and other events to differ materially from those expressed or implied in such forward-looking statements. Any such forward-looking statements would be subject to a number of assumptions regarding, among other things, future economic, competitive and market conditions generally. Such assumptions would be based on facts and conditions as they exist at the time such statements are made as well as predictions as to future facts and conditions, the accurate prediction of which may be difficult and involve the assessment of events beyond the Company's control. Further, the Company's business is subject to a number of risks that would affect any such forward-looking statements. These risks and uncertainties include, but are not limited to, the ability of the Company to commercialize its technology; product demand and industry pricing; the ability of the Company to obtain patent protection for its technology; developments in environmental legislation and regulation; the ability of the company to obtain future financing on favorable terms; and other circumstances affecting anticipated revenues and costs. These risks and uncertainties could cause actual results of the Company to differ materially from those projected or implied by such forward-looking statements.

### ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

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Not applicable.

### ITEM 4. Controls and Procedures

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- a) Evaluation of disclosure controls and procedures. As required by Rule 13a-15 under the Exchange Act, as of September 30, 2003, the Company carried out an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures. This evaluation was carried out under the supervision and with the participation of the Company's management, including the Company's President, and the Company's Chief Financial Officer and Chief Accounting Officer. Based upon that evaluation, the Company's President, and Chief Financial Officer and Chief Accounting Officer have concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company required to be included in the Company's periodic SEC filings. Disclosure controls and procedures are controls and other procedures that are

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designed to ensure that information required to be disclosed in Company reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rule and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in Company reports filed under the Exchange Act is accumulated and communicated to management, include the Company's Chief Executive Officer, and Chief Financial Officer and Chief Accounting Officer as appropriate, to allow timely decisions regarding required disclosures.

- b) Changes in internal controls. There have been no changes in internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

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### PART II - OTHER INFORMATION

#### ITEM 1. Legal Proceedings

There have been no material legal proceedings to which the Company is a party which have not been disclosed in previous filings with the Securities and Exchange Commission. There are no material developments to be reported in any previously reported legal proceedings.

#### ITEM 2. Change in Securities

Not applicable.

#### ITEM 3. Defaults among Senior Securities

Not applicable.

#### ITEM 4. Submission of Matters to a Vote of Security Holders

Not applicable.

#### ITEM 5. Other Events

Not applicable.

#### ITEM 6. Exhibits and Reports on Form 8 - K

##### (a) Exhibits.

1. Exhibit 31.1 - Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
2. Exhibit 31.2 - Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
3. Exhibit 32 - Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the

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Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K.

1. The Company filed a Current Report on Form 8-K, dated August 15, 2003, announcing its June 30, 2003 Quarterly earnings and the Company's 2002 Annual Meeting to be held on September 12, 2003.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 14, 2003

COMMODORE APPLIED TECHNOLOGIES, INC.  
(Registrant)

By /s/ James M. DeAngelis

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James M. DeAngelis - Senior  
Vice President and Chief  
Financial Officer (as both  
a duly authorized officer  
of the registrant and the  
principal financial officer  
of the registrant)

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