PROFILE TECHNOLOGIES INC
Form 10KSB
September 28, 2006

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

FORM 10-KSB

|X| ANNUAL REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended June 30, 2006

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

For the transition period from ___________ to ___________

Commission file number 0-21151

PROFILE TECHNOLOGIES, INC.
(Name of Small Business Issuer in Its Charter)

Delaware	91-1418002
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2 Park Avenue, Suite 201 Manhasset, New York	11030
(Address of principal executive offices)	(Zip Code)

(516) 365-1909
(Issuer's Telephone Number, Including Area Code)

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

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

Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. |_|

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

Check if there is no disclosure of delinquent filers pursuant to Item 405 of Regulation S-B contained in this form, and no disclosure will 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-KSB or any amendment to this Form 10-KSB. |_|

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 issuer's revenues for the fiscal year ended June 30, 2006 were $0.

The aggregate market value, based on the average bid and asked prices on NASD's OTC Bulletin Board on September 7, 2006, of the voting common stock, $0.001 par value per share, held by non-affiliates of the issuer as of September 7, 2006 was approximately $12,141,427.

There were 12,456,445 shares of common stock, $0.001 par value per share, outstanding as of September 7, 2006.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Annual Report on Form 10-KSB incorporates certain information by reference to the issuer's Definitive Proxy Statement on Form 14A for its annual meeting of stockholders to be held on November 13, 2006.

Transitional Small Business Disclosure Format. Yes __ No |X|.

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Preliminary Note Regarding Certain Risks and Forward-Looking Statements

This Annual Report on Form 10-KSB contains "forward-looking" information within the meaning of the federal securities laws. 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 projected future results, future plans, objectives or goals or future conditions or events are also forward-looking statements. Actual results are inherently difficult to predict. Any such forward-looking statements are 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.

The forward-looking statements contained in this report are based on current expectations that involve a number of risks and uncertainties. Such forward-looking statements are based on assumptions that the Company will obtain or have access to adequate financing for each successive phase of its growth, that the Company will market and provide products and services on a timely basis, that there will be no material adverse competitive or technological change with respect to the Company's business, demand for the Company's products and services will significantly increase, that the Company's executive officers will remain employed as such by the Company, that the Company's forecast accurately anticipates market demand, and that there will be no material adverse change in the Company's operations, business or governmental regulation affecting the Company or its customers. The foregoing assumptions are based on judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond the Company's control. Although the Company believes the expectations reflected in the forward-looking statements are reasonable, the Company cannot guarantee future results, levels of activity, performance or achievements.

PART I

Item 1. Description of Business.

Business Overview

Profile Technologies, Inc. (the "Company"), a Delaware corporation, was incorporated in 1986 and commenced operations in fiscal year 1988. The Company is in the business of inspecting pipelines for corrosion and is in the final stages of researching and developing a patented, non-destructive and non-invasive, high speed scanning process using electro magnetic waves to remotely inspect buried, encased and insulated pipelines for corrosion (the "EMW Inspection Process").

During the summer of 1998, the Company completed work on its first commercial contract with ASCG Inspection, Inc. testing British Petroleum pipelines at approximately 100 road and caribou crossings located on the North Slope of Alaska. During the summer of 1999, the Company continued work testing pipelines under a contract with another large multi-national oil company related to the inspection of approximately 250 below-grade pipelines. During the summer of 2000, the Company expanded its Alaska efforts by testing a total of 372 below-grade pipelines. In 2001, the Company completed the testing of approximately 441 pipelines in Alaska. In 2002 and 2003, the Company inspected 364 and 250 below-grade pipelines, respectively.

As a result of the Company's experience in Alaska and in response to regulatory changes that occurred in 2003, the Company decided to improve its buried pipe inspection capabilities to meet the needs of a more significant portion of the buried-pipe market. The Company refocused its efforts on improving its current technology to take advantage of this opportunity. These efforts, which to some degree are still ongoing, refined our technology to specifically address the buried pipeline market by developing a new pulse (wave form) that is distorted by electrolysis i.e., active corrosion, in a specific way. The Company also refined the hardware underlying its inspection process by making its test system more powerful, portable and useful. Among other things, it eliminated the need for a cumbersome, external power source.

Industry Overview

Refineries, chemical plants, utilities, natural gas transmission companies and the petroleum industry have millions of miles of pipeline much of which may be exposed to harsh and severe environments subjecting such pipeline to higher incidence of corrosion. As a result of such environments these industries are continually challenged to ensure that the quality of its pipeline meets applicable standards established by relevant regulatory bodies to protect operating personnel and the environment.

When pipeline is not insulated and above ground, external corrosion can be identified visually. The petroleum and other related industries, however, insulate much of their piping to conserve energy and to prevent injury to personnel from high temperature levels on the pipelines. When pipeline is insulated, corrosion can occur underneath the insulation due to moisture or corrosive products that find their way through broken or poorly sealed insulation. Corrosion underneath the insulation of insulated pipelines is very

difficult and costly to locate. In the past, corrosion testing on insulated pipelines has been conducted on a limited sample basis and relied upon inspection processes that were both cumbersome and costly.

The two prevalent testing methods used to detect corrosion on insulated pipelines, X-ray and eddy current, detect defects by analyzing visual image and decay. These methods require the physical stripping away of the pipeline insulation to conduct visual inspection, depth gauges, ultrasonics and X-ray are then used to determine the severity of the visually located corrosion. The physical removal of insulation required by these methods is costly for various reasons including the assembly of scaffolding for testing otherwise inaccessible above ground pipe (particularly in refineries and petrochemical plants) or the actual dig-up on below ground pipe. The Company's technology enables it to test pipe segments in a refinery setting for a distance up to three hundred feet and to use "cherry pickers" instead of costly scaffolding.

Corrosion under the insulation of insulated pipelines presents a very complicated testing problem because corrosion cannot be easily identified by statistical sampling. If, for example, a small section of the insulation on a segment of insulated pipe is removed every ten feet for visual inspection using eddy current or x-ray techniques, there is no statistical basis to assume that the external condition of the piping between the removed sections of insulation is corrosion free.

The Company's EMW Inspection Process

The EMW Inspection Process provides a corrosion inspection method which does not require the inspector to physically remove the pipeline's insulation or otherwise dig up the pipeline to visually inspect for corrosion. In certain instances, limited access points to buried pipelines exist for reasons unrelated to corrosion inspection. As a result, corrosion inspection may be conducted at these access points. Where such access points are not already available, the EMW Inspection Process permits the inspection of pipelines with a minimal amount of disturbance to the coating or insulation on the pipeline. In addition, the EMW Inspection Process permits corrosion inspection over the entire pipeline, as opposed to other inspection methods, which only provide for spot point inspections. Such "spot inspections" are not necessarily accurate in indicating the overall condition of a pipeline.

The Company has developed two basic EMW Inspection Process techniques, namely, Dual Pulse or Pulse Propagation Analyzer and Single-Pulse or Calibration Mark Z. For above-grade piping, the Company has used both the Dual-Pulse and Single-Pulse techniques to determine the condition of a pipeline segment in the open field as well as in refineries, chemical plants and power plants. For below-grade piping under streets and road crossings, the Company has historically used only the Dual Pulse technique. However, for more than a year, the Company has been developing new hardware and software to permit the testing of direct buried pipe from a single location while, at the same time, capturing data from the pipe traveling in both directions. This new equipment has been tested at the Company's pipe test facility in Ferndale, Washington, and is now being field tested on natural gas pipelines in Pennsylvania with the cooperation and assistance of a host company engaged in the natural gas distribution business.

Correlating pipeline corrosion information using the Company's technology requires a combination of state-of-the-art instrumentation plus an understanding of the physical phenomena that are being measured. Management believes that the EMW measurement and analysis are on the leading edge of inspection technology.

The Company believes that its technology has at least two significant competitive advantages. First, it can inspect certain pipelines that are inaccessible to other testing methods. Second, with respect to facilities that

are accessible to other inspection methods, the Company's technology does not require the removal of much, if any, insulation, coatings or encasements or pipeline excavation as a prerequisite to testing. Accordingly the Company's technology will typically have a lower cost of site preparation that results in a significant cost advantage. The Company's ongoing research and development efforts are designed to produce new applications for the Company's technology in the oil, natural gas and other industries.

The New Test Set

To position the Company to address the buried pipeline market, the Company redesigned and improved the hardware underlying the EMW Inspection Process. The new hardware (the "New Test Set") provides a different pulse waveform specifically tailored to the buried pipe environment. This waveform has increased low frequency energy content, which enables efficient wave propagation through sand, soil, and moist earth.

The New Test Set is smaller than the previous more cumbersome generation hardware used in Alaska. The New Test Set weighs less than 12 pounds, including the data acquisition digitizer and battery power supply. The New Test Set can be hand-carried and operated by a single person and no longer requires an oscilloscope or a gasoline powered AC generator which were necessary with the previous generation hardware. This portable system is designed to allow testing of both underground and above-grade pipelines with one test set.

As noted above, initial testing of the new buried-pipe inspection hardware has been completed at the Company's Ferndale, Washington pipe test facility. This hardware has also been field tested on a natural gas pipeline in Washington and is now being tested on natural gas pipelines in Pennsylvania.

The results of all these tests should provide the Company with critical information as to the detection capabilities of its new hardware in different "real world" conditions and accelerate the commercial deployment of the Company's new hardware and software.

Although several important milestones have been achieved in the testing of the Company's new hardware and software, there can be no assurance that the field testing portion of this testing program can be funded or that the new hardware and software can be successfully tested and deployed on a commercial basis. Failure to do so could have a serious and material effect on the business and financial condition of the Company.

Regulatory Environment

A combination of federal, state, and industry rules combine to regulate corrosion protection. The U.S. Department of Labor, operating through the Occupational Safety and Health Administration has jurisdiction over numerous plants and facilities containing corrosion protected pipeline that, if breached, could cause serious bodily injury or death to on-site workers. The U.S. Department of Transportation has jurisdiction over interstate natural gas and hazardous liquids pipelines. Counterpart state agencies have jurisdiction over intrastate natural gas and hazardous liquids pipelines. In addition, the American Petroleum Institute has promulgated a comprehensive Piping Inspection Code which requires that extensive corrosion testing be done by all members (which includes the vast majority of the petroleum and petrochemical industries). As a result of extensive regulation and testing requirements, the industry is faced with the requirement to engage in extensive testing for corrosion. In 1993, the American Petroleum Institute imposed stricter test standards for corrosion under the insulation on pipelines.

The American Petroleum Institute testing standard adopted in 1993, in essence, mandates either the stripping of larger amounts of coating or using an alternate system that will identify corrosion under the insulation without stripping the coating on suspected and unsuspected pipe. Because of the enormous cost involved in using the stripping and visual testing process, the Company believes that the industry will be receptive to an alternate testing system that is reliable and less costly. The Company believes that its EMW Inspection Process provides an alternate testing system that could be widely accepted by the industry. However, while the Company has obtained some commercial contracts and prospects for expanded commercial contracts in the future appear strong, there can be no assurance that such acceptance will continue to grow or that competitors will not develop newer and better technologies.

On December 15, 2003, the U.S Department of Transportation ("DOT") issued regulations under the Pipeline Safety Improvement Act of 2002 requiring regulated companies to gather baseline integrity data on pipelines in so-called "high consequence areas" ("HCA's") (e.g., populated areas) initially over a ten-year period and then every seven years thereafter. Based on consultations with industry representatives, the Company believes that its new buried pipe inspection hardware will provide such regulated companies with a superior tool for gathering the baseline integrity data required under the DOT regulations.

Sales and Marketing

The Company's sales and marketing strategy has been to position the Company's EMW inspection process as the method of choice to detect pipeline corrosion where the pipelines are either inaccessible to other inspection tools or much more costly to inspect with tools other than the Company's EMW technology. Pipelines are commonly found in refinery and chemical plants (such as insulated, overhead pipes), natural gas distribution systems (such as pipes buried in city streets), and natural gas transmission systems (such as road, bridge and stream crossings and concrete-encased pipes).

As described above, the Company has fabricated new buried pipe inspection hardware and is actively seeking industry and other financing sources in order to rigorously field test that hardware (initial testing having been completed in Ferndale, WA). In order to obtain additional revenue generating contracts, the Company intends to emphasize the reliability of its buried pipeline testing method, the flexibility of the method's application, and its cost effectiveness as compared to other methods. In fiscal year 2007, the Company intends to continue its marketing efforts in the pipeline and utility buried pipe inspection markets in the lower-48 states, particularly in "high consequence areas" as defined in the federal Department of Transportation's regulations ("HCAs"). However, there can be no assurance that the Company will be successful in concentrating its marketing efforts for the EMW technology on natural gas utility and pipeline markets.

Revenues and Customers

The Company derives revenue solely from the sale of the EMW inspection technology service. The Company relies solely upon several employees, including the Chief Executive Officer and the Chief Operating Officer to conduct the Company's sales activities.

The Company did not have revenues during the years ended June 30, 2006 and 2005, respectively, as it was engaged solely in the redevelopment of its testing hardware and software. The testing of that hardware and software is nearing completion.

Patents, Intellectual Property and Licensing

The Company pursues a policy of generally obtaining patent protection both in the United States and abroad for patentable subject matter in its proprietary technology. As of June 30, 2006, the Company had ten issued U.S. patents, two issued foreign patents, one U.S. patent application pending, and five foreign patents pending.

The Company's success depends in large part upon its ability to protect its process and technology under United States and international patent laws and other intellectual property laws. U.S. patents have a term of 17 years from date of issuance or, for more recently filed patent applications, 20 years from the filing of such applications, and patents in most foreign countries have a term of 20 years from the proprietary filing date of the patent application. The first U.S. patent was issued in 1990; two patents were issued in 1993; one patent was issued in 1998; two patents were issued in 2000, two patents were issued in 2001, and two patents were issued in 2002.

The Company believes that it owns and has the right to use or license all proprietary technology necessary to license and market its EMW process under development. The Company is not aware of the issuance of any patents or the filing of any patent applications which relate to processes or products which utilize the Company's proprietary technology in a manner which could be similar to or competitive with the Company's products or processes. The Company has no knowledge that it is infringing on any existing patent such that it would be prevented from marketing or licensing products or services currently being developed by the Company.

The Company may decide for business reasons to retain a patentable invention as a trade secret. In such event or if patent protection is not available, the Company must rely upon trade secrets, internal knowledge and continuing technological innovation to develop and maintain its competitive position. The Company's employees and consultants have access to the Company's proprietary information and have signed confidentiality agreements. However, even inadvertent disclosure of such a trade secret without a promise of confidentiality could destroy trade secret protection. There can be no assurance that inadvertent disclosures might not occur. If the Company's proprietary information is disclosed to competitors, it may have a material adverse effect on the Company's business.

Competition

Although a number of inspection technologies have been developed to aid in ascertaining the condition of piping throughout the pipeline corrosion control industry, information needed to determine the integrity of these critical systems is often difficult and costly to acquire. The Company has numerous indirect competitors, but the Company believes that its inspection services have significant competitive advantages over other services provided by competitors.

The Company's EMW inspection service is designed to help pipeline operators quickly and less expensively screen buried, insulated, or hard to-access piping for external corrosion. Although its technology does not provide pipeline and plant operators with all the data they will require to manage and remediate corrosion, when used as a "front-end" screening tool in combination with one or more spot inspection tools, it can dramatically lower the cost of acquiring all

of the data necessary to manage corrosion risks to their piping systems. There can be no assurances, however, that the Company's competitors will not develop newer, more efficient and less costly technologies.

Employees

As of June 30, 2006, the Company had four employees.

Research and Development Expenditures

During the last year, the Company has re-developed and improved the hardware and software it uses to detect corrosion on direct-buried pipe. As a result of such re-development and improvement, the Company believes that its technology is now ready to obtain broad acceptance in the U.S pipeline and utility industry segments. However, additional funding and certifications must be acquired to gain significant market share in the Company's target markets.

Research and development expenses for the year ended June 30, 2006 and 2005 were $357,709 and $261,617, respectively.

Item 2. Description of Properties.

The Company's executive offices are located at 2 Park Avenue, Suite 201, Manhasset, NY 11030. The Company leases on a month-to-month basis approximately 500 square feet of office space from a non-affiliate. The rental payment is approximately $788 per month.

The Company's research and development facility is located in Ferndale, Washington. The Company leases 1,800 square feet of space from a non-affiliate at a monthly cost of approximately $2,107, pursuant to a lease that expires on January 31, 2007.

The Company does not own any real estate.

Item 3. Legal Proceedings.

The Company is not aware of any legal proceedings contemplated by any governmental authority or any other party involving the Company or its properties. As of the date of this report, no director, officer or affiliate is a party adverse to the Company in any legal proceeding or has an adverse interest to the Company in any legal proceedings. The Company is not aware of any other legal proceedings pending or that have been threatened against the Company or its properties.

Item 4. Submission of Matters to Vote of Security Holders.

No matters were submitted to a vote of the Company's security holders during the fourth quarter of the fiscal year ended June 30, 2006.

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PART II

Item 5. Market for Common Equity, Related Stockholder Matters, and Small Business Issuer Purchases of Equity Securities.

Market Information

The Company's common stock traded on the NASDAQ Small Cap market from the date it began to be publicly traded in February 1997 until August 10, 2001 under the symbol PRTK. On August 13, 2001, the Company's common stock was delisted from the NASDAQ Small Cap market and began trading on the NASD's Over the Counter Bulletin Board (the "OTCBB") under the same symbol. The Company's common stock continues to be traded on the OTCBB.

The following table sets forth the high and low bid prices for the Company's common stock for each quarter within the past two fiscal years as reported by the OTCBB. The quotations reflect inter-dealer prices, with retail mark-up, mark-down or commissions, and may not represent actual transactions.

	Range of Bid Prices

	High	Low
Fiscal Year 2006		
First Quarter	$1.40	$0.70
Second Quarter	$1.40	$0.80
Third Quarter	$1.89	$1.00
Fourth Quarter	$1.45	$0.70
Fiscal Year 2005		
First Quarter	$0.90	$0.35
Second Quarter	$1.55	$0.35
Third Quarter	$1.15	$0.60
Fourth Quarter	$0.90	$0.55

As of September 7, 2006, the Company had approximately 1,050 holders of record of the Company's common stock.

Dividends

The payment of dividends by the Company is within the discretion of its Board of Directors and depends in part upon the Company's earnings, capital requirements, debt covenants and financial condition. Since its inception, the Company has not paid any dividends on its common stock and does not anticipate paying such dividends in the foreseeable future. The Company intends to retain earnings, if any, to finance its operations.

Securities Authorized for Issuance Under Equity Compensation Plans

The following table sets forth certain information regarding the common stock that may be issued upon the exercise of options, warrants and other rights that have been or may be granted to employees, directors or consultants under all of the Company's existing equity compensation plans, as of June 30, 2006.

	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders (1)	385,000	$0.77	115,000

Equity compensation plans not approved by security holders(2)	3,924,600(3)	$1.53	N/A
Total	4,309,600	$1.46	115,000

(1) Consists of grants under the Company's 1999 Stock Plan.

(2) Consists of grants under individual compensation arrangements approved separately by the Board of Directors and are not part of any written or formal plan under which the Company will be obligated to issue equity compensation in the future.

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(3) Includes non-qualified stock options granted to officers, directors, and consultants to purchase 2,315,000 shares of common stock and warrants to purchase 1,609,600 shares of common stock.

The stock options granted to officers, directors, and consultants were granted with an exercise price at or greater than the fair value of the Company's common stock on the date of grant as reported by the NASD's Over the Counter Bulletin Board. Compensatory stock options granted outside of the 1999 Stock Plan consists of the following: (A) 15,000 options at an exercise price of $6.50 per share, expiring on October 31, 2007, (B) 15,000 options at an exercise price of $10.50 per share, expiring on October 31, 2007, (C) 1,850,000 options at an exercise price of $1.155, of which 1,600,000 expire on February 15, 2015 and 250,000 expire on February 15, 2010, (D) 200,000 options at an exercise price of $1.12 per share, expiring on December 12, 2015, (E) 150,000 options at an exercise price of $1.21 per share, expiring on December 12, 2015, and (F) 85,000 options at an exercise price of $1.12, expiring on December 12, 2010.

Compensatory warrants consists of the following: (A) 15,000 warrants at an exercise price of $0.55 per share, expiring on December 9, 2007, (B) 439,600 warrants at an exercise price of $0.60 per share, expiring on August 14, 2011, (C) 40,000 warrants at an exercise price of $0.70 per share, expiring on December 16, 2008, (D) 50,000 warrants at an exercise price of $1.00 per share, expiring on January 2, 2007, (E) 150,000 warrants at an exercise price of $1.05 per share, expiring on March 18, 2007, (F) 305,000 warrants at an exercise price of $1.125 per share, expiring on October 31, 2007, (G) 40,000 warrants at an exercise price of $1.50 per share, expiring on October 31, 2007, (H) 235,000 warrants at an exercise price of $3.00 per share, expiring on October 31, 2007, (I) 285,000 warrants at an exercise price of $3.50 per share, expiring on October 31, 2007, (J) 30,000 warrants at an exercise price of $7.20 per share, expiring on October 31, 2007, and (K) 20,000 warrants at an exercise price of $13.50 per share, expiring on October 31, 2007.

Recent Sales of Unregistered Securities

Convertible Debentures and Warrants

On June 19, 2003, the Board of Directors approved the offering (the "2003 Offering") of $1,000,000 in convertible debentures (the "Debentures"). The Debentures are convertible into that number of shares of the Company's common stock equal to the amount of the converted indebtedness divided by $0.50 per share. The Debentures bear interest at a rate of 5% per annum, payable quarterly. Delinquent interest payments bear interest at a rate of 12% per annum. The Company is required to redeem each Debenture on the 5th anniversary of the date of the Debenture. The Company may, in its discretion, redeem any Debenture at any time prior to the mandatory redemption date of the Debenture by providing no less than 60 days' prior written notice to the holder of the Debenture. Certain events of default will result in the Debentures being redeemable by the Company upon demand of the holder.

Upon the purchase of, and for each $0.50 of the Debenture's principal amount, the Company issued to each investor a warrant (the "Warrant") to purchase one (1) share of the Company's common stock at an exercise price of $0.75 per share. The Warrants are exercisable at any time prior to the 5th anniversary date of the redemption of the Debenture.

The 2003 Offering was exempt from the registration under Section 4(2) of the Securities Act of 1933, as amended (the "Securities Act"), and Rule 506 of Regulation D, promulgated by the SEC. In the 2003 Offering, no general solicitation was made by the Company or any person acting on behalf of the Company, the Debentures and Warrants were sold subject to transfer restrictions, and the certificates for the Debentures and Warrants contained an appropriate legend stating that such securities have not been registered under the Securities Act and may not be offered or sold absent registration or an exemption therefrom.

During the year ended June 30, 2006, six investors exercised their conversion right under the Debentures, pursuant to the terms of the 2003 Offering, and converted $228,369 of principal and accrued interest pursuant to the terms of the 2003 Offering. Accordingly, the Company issued 456,740 shares of common stock in accordance with the conversion terms of the Debentures.

Common Stock and Warrants

On January 19, 2005, the Board of Directors approved the offering (the "2005 Offering") of 2,000,000 units (the "Units") to accredited investors for a total offering price of $1,000,000. Each Unit consists of one share of common stock and a warrant to acquire common stock. On November 21, 2005, the Board of Directors approved an increase in the number of Units offered in the 2005 Offering to 6,000,000 Units, for a total offering price of $3,000,000. The purchase price of one Unit is $0.50. Each Unit consists of one share of common stock and a warrant to purchase one share of common stock at an exercise price of $0.75. The warrants are exercisable at any time prior to the fifth anniversary from the date of their issuance.

The 2003 Offering was exempt from the registration under Section 4(2) of the Securities Act of 1933, as amended (the "Securities Act"), and Rule 506 of Regulation D, promulgated by the SEC. In the 2003 Offering, no general solicitation was made by the Company or any person acting on behalf of the Company, the Debentures and Warrants were sold subject to transfer restrictions, and the certificates for the Debentures and Warrants contained an appropriate legend stating that such securities have not been registered under the Securities Act and may not be offered or sold absent registration or an exemption therefrom.

During the year ended June 30, 2006, the Company raised $1,738,500 and issued 3,477,000 shares of common stock and warrants to purchase up to 3,477,000 shares of common stock in accordance with the terms of the 2005 Offering.

During the year ended June 30, 2006, Murphy Evans, the Company's President, exercised a conversion right pursuant to the terms of an amended loan agreement with the Company, converting $1,276,000 of principal and accrued interest on his loan into Units in the 2005 Offering. Accordingly, the Company issued 2,552,000 shares of common stock and warrants to purchase up to 2,552,000 shares of common stock to Mr. Evans, in accordance with the terms of the 2005 Offering.

Warrants

During the year ended June 30, 2006, the Company issued a warrant to R.F. Larrerty & Co., Inc. ("Laffety"), a brokerage firm which provided consulting services to the Company, to purchase 427,100 shares of common stock at an exercise price of $0.60 per share. The warrant may be exercised for up to five years from the date of issuance. The warrant was issued to Lafferty pursuant to the terms of a consulting agreement that the Company executed with Lafferty on November 1, 2004. The issuance of the warrant was exempt from registration pursuant to Section 4(2) of the Securities Act.

Stock Options

On December 12, 2005, the Board approved the issuance of options exercisable for 435,000 shares of common stock to certain directors, officers, an employee and three consultants of the Company. The options were granted by

the Company on December 12, 2005. Directors, officers, and an employee were granted options exercisable for 350,000 shares of common stock that have a ten-year term. Options exercisable for the remaining 85,000 shares of common stock were granted to three of the Company's consultants and have a five-year term. The exercise price of the options granted to insiders owning or controlling more than ten percent of the Company's common stock was $1.21, which is ten percent over the closing bid price of the Company's common stock as quoted on the OTCB on the grant date, December 12, 2005. The exercise price of the stock options granted to non-insiders and insiders not owning more than 10% of the Company's common stock was $1.12.

Item 6. Management's Discussion and Analysis and Plan of Operation.

Plan of Operation

The Company is currently focused on the buried pipe market in the United States. Accordingly, the Company redesigned and improved the hardware underlying the EMW Inspection Process, which provides a different pulse waveform specifically tailored to the buried pipe environment.

Initial testing of the new buried-pipe inspection hardware has been completed at the Company's Ferndale, Washington pipe test facility. This hardware has also been field tested on a natural gas pipeline in Washington and is now being tested on natural gas pipelines in Pennsylvania.

The results of all these tests should provide the Company with critical information as to the detection capabilities of its new hardware in different "real world" conditions and accelerate the commercial deployment of the Company's new hardware and software.

Although several important milestones have been achieved in the testing of the Company's new hardware and software, there can be no assurance that necessary additional field testing can be funded or that the new hardware and software can be successfully deployed on a commercial basis. Failure to do so could have a serious and material effect on the business and financial condition of the Company.

Capital will be expended to support operations until the Company can generate sufficient cash flows from operations. In order for the Company to generate cash flows from operations, the Company must obtain revenue generating contracts. Management is currently directing the Company's activities towards obtaining service contracts, which, if obtained, will necessitate the Company attracting, hiring, training and outfitting qualified technicians. If service contracts are obtained, it will also necessitate additional field test equipment purchases in order to provide the services. The Company expects that if revenue contracts are secured, working capital requirements will increase. The Company will incur additional expenses as it hires and trains field crews and support personnel related to the successful receipt of commercial contracts. Additionally, the Company anticipates that cash will be used to meet capital expenditure requirements necessary to develop infrastructure to support future growth.

The Company has expended a significant amount of cash in developing its technology and patented processes. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management recognizes that in order to meet the Company's capital requirements, and continue to operate, additional financing, including seeking industry-partner investment through joint ventures or other possible arrangements, will be necessary. The Company is evaluating alternative sources of financing to improve

its cash position and is undertaking efforts to raise capital. If the Company is unable to raise additional capital or secure revenue contracts and generate positive cash flow, it is unlikely that the Company will be able to continue as a going concern.

Management's Discussion and Analysis

Revenue

The Company did not have revenues during the years ended June 30, 2006 and 2005, respectively, as it was engaged solely in the redevelopment of its testing hardware and software. The testing of that hardware and software is nearing completion.

Sales and Marketing

The Company's sales and marketing strategy has been to position the Company's EMW inspection process as the method of choice to detect pipeline corrosion where the pipelines are either inaccessible to other inspection tools or much more costly to inspect with tools other than the Company's EMW technology. Pipelines are commonly found in refinery and chemical plants (such as insulated, overhead pipes), natural gas distribution systems (such as pipes buried in city streets), and natural gas transmission systems (such as road, bridge and stream crossings and concrete-encased pipes).

As described above, the Company has fabricated new buried pipe inspection hardware and is actively seeking industry sources in order to rigorously field test that hardware (initial testing having been completed in Ferndale, WA). In order to obtain additional revenue generating contracts, the Company intends to emphasize the reliability of its buried pipeline testing method, the flexibility of the method's application, and its cost effectiveness as compared to other methods. In fiscal year 2007, the Company intends to continue its marketing efforts in the pipeline and utility buried pipe inspection markets in the lower-48 states, particularly in "high consequence areas" as defined in the federal Department of Transportation's regulations ("HCAs"). However, there can be no assurance that the Company will be successful in concentrating its marketing efforts for the EMW technology on natural gas utility and pipeline markets.

Critical Accounting Estimates and Policies

The discussion and analysis of financial condition and results of operations is based upon the Company's financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including contract revenue recognition and impairment of long-lived assets. The Company bases its estimates on historical experience and on various other assumptions that the Company believes to be reasonable under the circumstances, the results of which form its basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ materially from these estimates under different assumptions and conditions, and such variations may be adverse.

The Company recognizes revenue from service contracts using the percentage-of-completion method of contract accounting. Contract revenues earned are measured using either the percentage-of-contract costs incurred to date to total estimated contract costs or, when the contract is based on measurable units of completion, revenue is based on the completion of such units. Anticipated losses on contracts, if any, are charged to earnings as soon as such losses can be estimated. Changes in estimated profits on contracts are recognized during the period in which the change in estimate is known. The Company records claims for additional compensation on contracts upon revision of the contract to include the amount to be received for the additional work performed. Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools and repairs, and depreciation costs. Selling, general, and administrative costs are charged to expense as incurred. Service contracts generally extend no more than six months.

The Company reviews long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount which the carrying amount of the asset exceeds the fair value of the asset.

The Company estimates the value of warrants and option grants using a Black-Scholes pricing model based on management assumptions regarding the expected volatility and risk free interest rates.

Results of Operations

The Company's operating results depend exclusively on its ability to market its EMW inspection technology services. If the Company is not able to automate completely the EMW inspection process and fully implement its new technology, the Company may not be able to obtain future contracts to sell or license its EMW technology. Since the Company's revenues are derived solely from sales of its EMW technology, any failure to obtain future contracts will have a material adverse effect on the business and financial condition of the Company.

The Company did not generate any revenues during the years ended June 30, 2006 and June 30, 2005, as the Company was engaged solely in the redevelopment and improvement of its testing hardware and software.

The Company did not have any cost of revenues for the years ended June 30, 2006 and June 30, 2005. The Company did not have any employees working in the field because the Company did not have any revenue generating contracts during these periods.

Research and development expenses for the year ended June 30, 2006 were $357,709 as compared to $261,617 for the year ended June 30, 2005. The increase of $96,092 for the year ended June 30, 2006 as compared to the year ended June 30, 2005 is substantially the result of the Company retaining the services of two consultants and a scientist during the year ended June 30, 2006, to focus increased efforts on the design, fabrication, and testing of the Company's new hardware. Research and development related consulting fees were approximately $190,000 more during the year ended June 30, 2006 than during the year ended June 30, 2005. Offsetting the increase in the cash related consulting fees is a

decrease of $98,250 in the value of the stock options granted to a consultant and the scientist. Included in research and development for the year ended June 30, 2006, is $75,750 for the fair value of 75,000 options granted to a consultant and the scientist as partial compensation for their past services rendered. Included in research and development for the year ended June 30, 2005 is $174,000 for the fair value of 200,000 stock options granted to the scientist as partial compensation for past services rendered.

General and administrative expenses for the year ended June 30, 2006 were $633,156 as compared to $705,542 for the year ended June 30, 2005. The decrease of $72,386 for the year ended June 30, 2006 as compared to the year ended June 30, 2005 is the result of a general reduction of operating expenditures as the

Company focuses on reducing its overall burn rate. Contributing to the decrease in general and administrative expenses was a decrease in professional fees of approximately $3,100 and a decrease in insurance premiums of approximately $11,700 for the year ended June 30, 2006 as compared to the year ended June 30, 2005.

Loss from operations for the year ended June 30, 2006 was $990,865 as compared to $967,159 for the year ended June 30, 2005. The increase of $23,706, or 2%, is primarily due to the increase in research and development expenses resulting from an increase in equity compensation issued to the Company's consultants and a scientist during the year ended June 30, 2006 as compared to the year ended June 30, 2005. Offsetting the increase in research and development expense is a decrease in general and administrative expenses due to reductions in professional fees and insurance premiums as discussed above.

Interest expense for the year ended June 30, 2006 was $241,382 as compared to $179,857 for the year ended June 30, 2005. The increase of $61,525 for the year ended June 30, 2006 as compared to the year ended June 30, 2005 is substantially the impact of investors exercising their conversion right in accordance with the terms of the 2003 Offering. Six investors exercised their conversion right during the year ended June 30, 2006 as compared to five investors during the year ended June 30, 2005. However, the principal balance and related discount for the six investors that exercised their conversion right during the year ended June 30, 2006 was significantly higher than the principal balance and related discount for the five investors that exercised their conversion right during the year ended June 30, 2005. The unamortized discount recognized as interest expense upon conversion was approximately $198,000 during the year ended June 30, 2006 as compared to approximately $100,000 during the year ended June 30, 2005. This increase is offset by a decrease in interest expense on the Amended Evans Loan of approximately $31,100 for the year ended June 30, 2006 as compared to the year ended June 30, 2005 as a result of Mr. Evans converting the remaining outstanding principal balance and accrued interest of the Amended Evans Loan in January 2006. Also contributing to the overall decrease in interest expense is a reduction of interest expense related to the 5% interest bearing Debentures. Interest expense related to the 5% interest bearing Debentures decreased by approximately $8,500 for the year ended June 30, 2006 as compared to the year ended June 30, 2005 as a result of investors who previously exercised their conversion right, converting their Debentures to equity, thereby reducing the outstanding principal balance on the Debentures.

Recently Issued Accounting Standards

In February 2006, the FASB issued Statement No. 155, "Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140" (FASB No. 155). FASB No. 155 permits fair value remeasurement for any

hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of FASB Statement No. 133, and establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. In addition, FASB No. 155 clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives and amends FASB

No. 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. FASB No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company does not expect that this Statement will have a material impact on their financial position, results of operations or cash flows.

In March 2006, the FASB issued Statement No. 156, "Accounting for Servicing of Financial Assets--an amendment of FASB Statement No. 140" (FASB No. 156). FASB No. 156 requires that an entity separately recognize a servicing asset or a servicing liability when it undertakes an obligation to service a financial asset under a servicing contract in certain situations. Such servicing assets or servicing liabilities are required to be initially measured at fair value, if practicable. FASB No. 156 also allows an entity to choose either the amortization method or the fair value measurement method to account for servicing assets and servicing liabilities within the scope of this Statement. FASB No. 156 is effective after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company does not expect that this Statement will have a material impact on their financial position, results of operations or cash flows.

In April 2006, the FASB issued FASB Staff Position (FSP) FIN 46R-6, "Determining the Variability to Be Considered in Applying FASB Interpretation No. 46(R) (FIN 46R-6). FIN 46R-6 addresses certain implementation issues related to FASB Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities" (FIN 46R). Specifically, FSP FIN 46R-6 addresses how a reporting enterprise should determine the variability to be considered in applying FIN 46R. The variability that is considered in applying FIN 46R affects the determination of (a) whether an entity is a variable interest entity (VIE), (b) which interests are "variable interests" in the entity, and (c) which party, if any, is the primary beneficiary of the VIE. That variability affects any calculation of expected losses and expected residual returns, if such a calculation is necessary. The Company is required to apply the guidance in FIN 46R-6 prospectively to all entities (including newly created entities) and to all entities previously required to be analyzed under FIN 46R when a "reconsideration event" has occurred, beginning July 1, 2006. The Company will evaluate the impact of this FSP at the time any such "reconsideration event" occurs and for any new entities created.

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) No. 48, "Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109." This Interpretation provides guidance for recognizing and measuring uncertain tax positions, as defined in Statement of Financial Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes." FIN No. 48 prescribes a threshold condition that a tax position must meet for any of the benefit of an uncertain tax position to be recognized in the financial statements. Guidance is also provided regarding derecognition, classification and disclosure of uncertain tax positions. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. The Company does not expect that this Interpretation will have a material impact on their financial position, results of operations or cash flows.

Liquidity and Capital Resources

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. The Company incurred cumulative losses of $12,837,386 through June 30, 2006 and had negative working capital of $390,440 as of June 30, 2006. Additionally, the Company has expended a significant amount of cash in developing its technology and patented processes. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management recognizes that in order to meet the Company's capital requirements, and continue to operate, additional financing, including seeking industry-partner investment through joint ventures or other possible arrangements, will be necessary. The Company is evaluating alternative sources of financing to improve its cash position and is undertaking efforts to raise capital. If the Company is unable to raise additional capital or secure additional revenue contracts and generate positive cash flow, it is unlikely that the Company will be able to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Deferred Wages and Accrued Professional Fees

To reduce cash outflows, certain of the Company's employees, officers, consultants, and directors have agreed to defer a portion of their salaries and professional fees until the Company has sufficient resources to pay the amounts owed or to exchange such amounts into options as described below. At June 30, 2006, the Company has accrued $903,751 related to the deferred payment of salaries and professional fees of which $711,601 is included under deferred wages and $192,150 in accrued professional fees. On March 18, 2002, the Board approved a conversion right on all deferred wages and accrued professional fees deferred as of March 18, 2002. Pursuant to this conversion right, employees, officers, consultants, and directors may elect to convert $1.00 of fees owed to them as of March 18, 2002 for an option to purchase two shares of the Company's common stock, at an exercise price of $1.00 per share for a term of five years. Deferred salaries and fees as of March 18, 2002 were $111,500, resulting in the potential issuance of 223,000 options under the terms mentioned above. No conversions have occurred to date. At March 18, 2002, there was no intrinsic value associated with these exchange rights. As such, no additional compensation cost was recorded.

Convertible Debentures and Warrants

On June 19, 2003, the Board of Directors approved the offering (the "2003 Offering") of $1,000,000 in convertible debentures (the "Debentures"). The Debentures are convertible into that number of shares of the Company's common stock equal to the amount of the converted indebtedness divided by $0.50 per share. The Debentures bear interest at a rate of 5% per annum, payable quarterly. Delinquent interest payments bear interest at a rate of 12% per annum. The Company is required to redeem each Debenture on the 5th anniversary of the date of the Debenture. The Company may, in its discretion, redeem any Debenture at any time prior to the mandatory redemption date of the Debenture by providing no less than 60 days' prior written notice to the holder of the Debenture. Certain events of default will result in the Debentures being redeemable by the Company upon demand of the holder.

Upon the purchase of, and for each $0.50 of the Debenture's principal amount, the Company issued to each investor a warrant (the "Warrant") to

purchase one (1) share of the Company's common stock at an exercise price of $0.75 per share. The Warrants are exercisable at any time prior to the 5th anniversary date of the redemption of the Debenture.

Warrants issued in connection with the 2003 Offering were recorded based on their relative fair value as compared to the fair value of the debt at issuance. The relative fair value of the warrants was recorded as paid-in capital, estimated at $0 and $101,977 for the years ended June 30, 2006 and June 30, 2005, respectively. The fair value of the warrants issued during the year ended June 30, 2005, was determined based on an option pricing model with the following assumptions: warrant lives of 10 years, risk free interest rates ranging from 4.14% to 4.30%, volatility of 120%, and a zero dividend yield. The intrinsic value of the Debentures results in a beneficial conversion feature that reduces the book value of the convertible debt to not less than zero. Accordingly, the Company recorded a discount of $0 and $158,000 during the years ended June 30, 2006 and June 30, 2005, respectively, on the convertible debt issued under the 2003 Offering. The Company amortizes the discount using the effective interest method over the five-year life of the Debentures.

During the quarter ended March 31, 2005, the Board of Directors terminated the 2003 Offering. As of the closing date of the 2003 Offering, the Company had raised $503,000 from the 2003 Offering.

During the years ended June 30, 2006 and June 30, 2005, six and five investors, respectively, exercised their conversion right under the terms of the Debentures. Accordingly, the carrying value of the convertible debt was reclassified as equity upon conversion. Since the convertible debt instruments include a beneficial conversion feature, the remaining unamortized discount of approximately $198,000 and $100,000 at the conversion date was recognized as interest expense during the years ended June 30, 2006 and June 30, 2005, respectively.

As of June 30, 2006, accrued interest on the Debentures was $2,182. The Company recorded interest expense related to the accretion of the discount on the Debentures and amortization of the convertible debt discount as a result of the conversions discussed above of $198,128 and $100,061 for the years ended June 30, 2006 and June 30, 2005, respectively.. As of June 30, 2006 the carrying value of the long-term portion of the Debentures was $189, net of unamortized debt discount of $67,311.

Common Stock and Warrants

On January 19, 2005, the Board of Directors approved the offering (the "2005 Offering") of 2,000,000 units (the "Units") to accredited investors for a total offering price of $1,000,000. Each Unit consists of one share of common stock and a warrant to acquire common stock. On November 21, 2005, the Board of Directors approved an increase in the number of Units offered in the 2005 Offering to 6,000,000 Units, for a total offering price of $3,000,000. The purchase price of one Unit is $0.50. Each Unit consists of one share of common stock and a warrant to purchase one share of common stock at an exercise price of $0.75. The warrants are exercisable at any time prior to the fifth anniversary from the date of their issuance.

During the year ended June 30, 2006, the Company raised $1,738,500 under the terms of the 2005 Offering. Accordingly, the Company issued 3,477,000 shares of common stock and warrants to purchase up to 3,477,000 shares of common stock at an exercise price of $0.75 per share.

The 2005 Offering was terminated on June 9, 2006. As of the closing date of the 2005 Offering, the Company had raised $1,801,000 from the 2005 Offering.

The Company engaged a brokerage firm to help in the fund raising efforts of the 2005 Offering. Pursuant to the terms of the agreement with the brokerage firm, the Company will pay the brokerage firm a ten percent cash commission on all funds that the brokerage firm helps raise. Additionally, subsequent to the closing of the 2005 Offering, the brokerage firm and the Company agreed that the Company would issue warrants to purchase a total of 439,600 shares of common stock at $0.60 per share. The warrants may be exercised up to five years from the date of issuance, which is the date the proceeds are received under the 2005 Offering. During the years ended June 30, 2006 and June 30, 2005, the Company incurred $141,050 and $6,250, respectively, of cash fees to be paid to the brokerage firm and issued warrants to purchase 427,100 and 12,500, respectively, shares of common stock. During the year ended June 30, 2006, the Company recorded $355,531 as a reduction to paid-in capital for the fair value of the 427,100 warrant grants. The fair value of the warrants issued to the brokerage firm during the year ended June 30, 2006 were estimated using the Black-Scholes option pricing model with the following weighted average assumptions: expected volatility ranging from 79.12% to 376.15%, risk-free interest rates ranging from 4.14% to 5.10%, expected lives of five years, and a 0% dividend yield.

Other Commitments

The Company's other contractual obligations consist of commitments under an operating lease and repayment of loans payable to certain officers, directors and stockholders.

As of June 30, 2006, the Company had outstanding loans payable to certain stockholders with principal amounts, in the aggregate, equal to $57,500. The terms of the various notes are described above under "Note 6: Notes Payable - Stockholders."

As of June 30, 2006, the Company has future minimum lease payments of approximately $14,750 under its operating lease.

Capital will be expended to support operations until the Company can generate sufficient cash flows from operations. In order for the Company to generate cash flows from operations, the Company must obtain additional revenue generating contracts. Management is currently directing the Company's activities towards obtaining additional service contracts, which, if obtained, will necessitate the Company attracting, hiring, training and outfitting qualified technicians. If additional service contracts are obtained, it will also necessitate additional field test equipment purchases in order to provide the services. The Company's intention is to purchase such equipment for its field crews for the foreseeable future, until such time as the scope of operations may require alternate sources of financing equipment. The Company expects that if additional contracts are secured, and revenues increase, working capital requirements will increase. There can be no assurance that the Company's process will gain widespread commercial acceptance within any particular time frame, or at all. The Company will incur additional expenses as it hires and trains field crews and support personnel related to the successful receipt of commercial contracts. Additionally, the Company anticipates that cash will be used to meet capital expenditure requirements necessary to develop infrastructure to support future growth. There can be no assurance that the Company will be able to secure additional revenue generating contracts to provide sufficient cash.

Pending the deployment of the Company's new hardware and software and the receipt of new contracts, and in an effort to reduce its out-of-pocket expenses to the lowest practicable level, the Company has furloughed all of its field crews. If and when revenue-generating contracts are obtained, the Company will re-hire former crew personnel or may hire and train new crews. The Company was not obligated to make any severance payments for salaries, health benefits or accrued vacation and sick time related to the termination of any of its employees.

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

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Item 7. Financial Statements

Profile Technologies, Inc.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors
Profile Technologies, Inc.

We have audited the accompanying balance sheet of Profile Technologies, Inc. as of June 30, 2006, and the related statements of operations, stockholders' deficit, and cash flows for the years ended June 30, 2006 and 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company has determined that it is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Profile Technologies, Inc. as of June 30, 2006, and the results of its operations and its cash flows for the years ended June 30, 2006 and 2005, in conformity with accounting principles generally accepted in the United States.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 8 to the financial statements, the Company has incurred cumulative losses and had negative working capital of $390,440 at June 30, 2006. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management's plan regarding those matters is also described in Note 8. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/S/ PETERSON SULLIVAN PLLC

Seattle, Washington
September 6, 2006

PROFILE TECHNOLOGIES, INC.
Balance Sheet

	June 30, 2006

Assets	
Current assets:	
Cash	$ 852,468
Prepaid expenses and other current assets	12,722
Total current assets	865,190
Equipment, net of accumulated depreciation of $544,040	15,630
Deferred financing fees	840
Other assets	1,550
Total assets	$ 883,210
Liabilities and Stockholders' Deficit	
Current Liabilities:	
Accounts payable	$ 172,053
Notes payable to stockholders	57,500
Current portion of convertible debt	107,500
Deferred wages	711,601
Accrued professional fees	192,150
Accrued interest	2,182
Other accrued expenses	12,644
Total current liabilities	1,255,630
Long-term convertible debt, net of unamortized discount of $67,311	189
Stockholders' deficit:	
Common stock, $0.001 par value. Authorized 25,000,000 shares; issued and outstanding 12,111,445 shares	12,111
Common stock issuable; 345,000 shares	345
Additional paid-in capital	12,452,321
Accumulated deficit	(12,837,386)
Total stockholders' deficit	(372,609)
Commitments, contingencies and subsequent events	
Total liabilities and stockholders' deficit	$ 883,210

See accompanying notes to financial statements.

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PROFILE TECHNOLOGIES, INC.
Statements of Operations
For the years ended June 30, 2006 and 2005

	2006	2005

Revenue	$ --	$ --
Cost of revenues	--	--
Gross profit	--	--
Operating expenses:		
Research and development	357,709	261,617
General and administrative	633,156	705,542
Total operating expenses	990,865	967,159
Loss from operations	(990,865)	(967,159)
Interest expense	241,382	179,857
Net loss	$(1,232,247)	$(1,147,016)
Basic and diluted net loss per share	$ (0.13)	$ (0.20)
Weighted average shares outstanding used to calculate basic and diluted net loss per share	9,667,742	5,744,371

See accompanying notes to financial statements.

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PROFILE TECHNOLOGIES, INC.
Statements of Stockholders' Deficit
For the years ended June 30, 2006 and 2005

	Common Stock	
	Shares	Amount
Balance at June 30, 2004	5,494,661	$ 5,495
Issuance of common stock for services	150,000	150
Issuance of common stock warrants and options for services	--	--
Issuance of common stock warrants related to the convertible debt	--	--
Recording beneficial conversion feature on convertible debt	--	--
Issuance of common stock upon conversion of convertible debt to equity	201,044	201
Issuance of common stock warrants related to the 2005 Offering	--	--

Issuance of common stock related to the 2005 Offering		80,000	80
Common stock issuance costs		--	--
Common stock issuable related to the 2005 Offering		--	--
Net loss		--	--
Balance at June 30, 2005		5,925,705	$ 5,926
Issuance of common stock previously reported as "issuable"		45,000	45
Issuance of common stock warrants and options for services		--	--
Issuance of common stock upon conversion of stockholder loan and accrued interest to equity	2,552,000	2,552	--
Issuance of common stock upon conversion of convertible debt to equity		456,740	456
Issuance of common stock warrants related to the 2005 Offering		--	--
Issuance of common stock related to the 2005 Offering		3,132,000	3,132
Common stock issuance costs		--	--
Net loss		--	--
Balance at June 30, 2006		12,111,445	$ 12,111

PROFILE TECHNOLOGIES, INC.
Statements of Stockholders' Deficit (Continued)
For the years ended June 30, 2006 and 2005

	Additional Paid-in Capital	Accumu Defi
Balance at June 30, 2004	$ 8,669,341	$(10,4
Issuance of common stock for services	69,850	
Issuance of common stock warrants and options for services	224,525	
Issuance of common stock warrants related to the convertible debt	101,977	
Recording beneficial conversion feature on convertible debt	56,023	
Issuance of common stock upon conversion of convertible debt to equity	100,321	
Issuance of common stock warrants related to the 2005 Offering	33,059	
Issuance of common stock related to the 2005 Offering	18,439	
Common stock issuance costs	(13,275)	

Common stock issuable related to the 2005 Offering	10,877	
Net loss	--	(1,1
Balance at June 30, 2005	$ 9,271,137	$(11,6
Issuance of common stock previously reported as "issuable"	--	
Issuance of common stock warrants and options for services	441,381	
Issuance of common stock upon conversion of stockholder loan and accrued interest to equity 2,552,000	--	1,2
Issuance of common stock upon conversion of convertible debt to equity	227,913	
Issuance of common stock warrants related to the 2005 Offering	1,192,381	
Issuance of common stock related to the 2005 Offering	542,642	
Common stock issuance costs	(496,581)	
Net loss	--	(1,2
Balance at June 30, 2006	$ 12,452,321	$(12,8

See accompanying notes to financial statements.

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PROFILE TECHNOLOGIES, INC.
Statements of Cash Flows
For the years ended June 30, 2006 and 2005

Cash flows from operating activities:	
Net loss	$(1
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization	
Accreted discount on convertible debt	
Amortization of convertible debt discount included in interest expense	
Accrued interest on convertible debt converted to equity	
Accrued interest on notes payable to stockholders converted to equity	
Amortization of debt issuance costs	
Equity issued for services	
Changes in operating assets and liabilities:	
Prepaid expenses and other current assets	
Other assets	
Accounts payable	
Deferred wages	
Accrued professional fees	
Accrued interest	
Other accrued expenses	
Net cash used in operating activities	

Cash flows from investing activies:	
Purchase of fixed assets	

Net cash used in investing activities	

Cash flows from financing activies:	
Allocated proceeds from issuance of convertible debt	
Allocated proceeds from issuance of warrants attached to convertible debt	
Common stock issuance costs	
Allocated proceeds from issuance of common stock	
Allocated proceeds from issuance of warrants attached to issuance of common stock	1
Proceeds from issuance of notes payable to stockholders	
Repayments of note payable to stockholders	

Net cash provided by financing activities	1

Increase (decrease) in cash	
Cash at beginning of period	

Cash at end of period	$
	===
Supplemental disclosure of cash flow information:	
Debt discount recorded for beneficial conversion feature	$
Cash paid for interest	$
Convertible debt and related accrued interest converted into 456,740 and 201,044 shares of common stock during the twelve months ended June 30, 2006 and 2005, respectively	$
Notes payable to stockholder converted into 2,322,446 shares of common stock during the twelve months ended June 30, 2006	$ 1
Accrued interest on notes payable to stockholder converted into 229,554 shares of common stock during the twelve months ended June 30, 2006	$

See accompanying notes to financial statements.

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Note 1: Description of Business

Profile Technologies, Inc. (the "Company"), was incorporated in 1986 and commenced operations in fiscal year 1988. The Company is in the business of inspecting pipelines for corrosion and is in the final stages of researching and developing a patented, non-destructive and non-invasive, high speed scanning process, using electro magnetic waves to remotely inspect buried, encased and insulated pipelines for corrosion.

Note 2: Summary of Significant Accounting Policies

Cash

Cash includes highly liquid investments with original maturities of three months or less. On occasion, the Company has amounts deposited with financial institutions in excess of federally insured limits.

Fair Value of Financial Instruments

The Company has the following financial instruments: cash, accounts payable, notes payable to stockholders, and convertible debt. The carrying value of these instruments, other than the convertible debt, approximates fair value based on their liquidity. The fair value of the convertible debt was determined as the excess of the proceeds over the fair value of the warrants.

Deferred Financing Fees

The Company records costs incurred related to debt financings as deferred financing fees and amortizes, on a straight-line basis, the costs incurred over the life of the related debt. The amortization is recognized as interest in the financial statements. Upon conversion into equity or extinguishment of the related debt, the Company recognizes any unamortized portion of the deferred financing fees as interest expense.

Contract Revenue Recognition

The Company recognizes revenue from service contracts using the percentage of completion method of accounting. Contract revenues earned are measured using either the percentage of contract costs incurred to date to total estimated contract costs or, when the contract is based on measurable units of completion, revenue is based on the completion of such units. This method is used because management considers total cost or measurable units of completion to be the best available measure of progress on contracts. Because of the inherent uncertainties in estimating costs, it is at least reasonably possible that the estimates used may change in the near term.

Anticipated losses on contracts, if any, are charged to earnings as soon as such losses can be estimated. Changes in estimated profits on contracts are recognized during the period in which the change in estimate is known.

Cost of revenues include contract costs incurred to date as well as any idle time incurred by personnel scheduled to work on customer contracts.

The Company records claims for additional compensation on contracts upon revision of the contract to include the amount to be received for the additional work performed. Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor,

supplies, tools and repairs, and depreciation costs. Selling, general, and administrative costs are charged to expense as incurred. Service contracts generally extend no more than six months.

Research and Development

Research and development costs are expensed when incurred. During the years ended June 30, 2006 and June 30, 2005, the Company incurred $357,709 and $261,617, respectively, on research and development activities.

Equipment

Equipment is stated at cost and is depreciated using the straight-line method over estimated useful lives of three to seven years.

Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of

The Company reviews long-lived assets, such as equipment and intangibles, for impairment at least annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset.

Valuation of Warrants and Options

The Company estimates the value of warrants and option grants using a Black-Scholes pricing model based on management assumptions regarding the warrant and option lives, expected volatility, and risk free interest rates.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is recorded for deferred tax assets when it is more likely than not that such deferred tax assets will not be realized.

Net Loss Per Share

Basic net loss per share is computed by dividing the net loss by the weighted average number of common shares outstanding during the period. Diluted net loss per share is computed by dividing the net loss by the weighted average number of common and dilutive common equivalent shares outstanding during the period. As the Company had a net loss attributable to common shareholders in each of the periods presented, basic and diluted net loss per share are the same.

Excluded from the computation of diluted net loss per share for the year ended June 30, 2006, because their effect would be antidilutive, are options and warrants to acquire 12,643,418 shares of common stock with a weighted-average exercise price of $1.06 per share. Also excluded from the computation of diluted net loss per share for the year ended June 30, 2006 are 350,000 shares of common stock that may be issued if investors exercise their conversion right under the Debentures related to the 2003 Offering as discussed in Note 8 because their effect would be antidilutive.

Excluded from the computation of diluted net loss per share for the year ended June 30, 2005, because their effect would be antidilutive, are options and warrants to acquire 5,762,318 shares of common stock with a weighted-average exercise price of $1.40 per share. Also excluded from the computation of diluted net loss per share for the year ended June 30, 2005 are 806,000 shares of common stock that may be issued if investors exercise their conversion right under the Debentures related to the 2003 Offering as discussed in Note 8 because their effect would be antidilutive.

For the years ended June 30, 2006 and June 30, 2005, additional potential dilutive securities that were excluded from the diluted net loss per share computation are the exchange rights discussed in Note 8 that could result in options to acquire up to 223,000 shares of common stock with an exercise price of $1.00 per share at June 30, 2006 and June 30, 2005.

For purposes of earnings per share computations, shares of common stock that are issuable at the end of a reporting period are included as outstanding.

Use of Estimates

The preparation of 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 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.

Patents, Proprietary Technology, and Other Intellectual Property

The Company pursues a policy of generally obtaining patent protection both in the United States of America and abroad for patentable subject matter in its proprietary technology. The Company's success depends in a large part upon its ability to protect its products and technology under United States of America and international patent laws and other intellectual property laws. U.S. patents have a term of 17 years from date of issuance or, for more recently filed patent applications, 20 years from the filing of such applications, and patents in most foreign countries have a term of 20 years from the proprietary filing date of the patent application.

The Company believes that it owns and has the right to use or license all proprietary technology necessary to license and market its products under development. The Company is not aware of the issuance of any patents or the filing of any patent applications, which relate to processes or products which utilize the Company's proprietary technology in a manner which could be similar to or competitive with the Company's products or processes. The Company has no

knowledge that it is infringing on any existing patent such that it would be prevented from marketing or licensing products or services currently being developed by the Company.

Financial Instruments and Concentrations of Credit Risk

At June 30, 2006, the Company has the following financial instruments: notes payable to stockholders, convertible short-term and long-term debt, accounts payable and accrued expenses. The carrying value of these instruments, other than the convertible debt, approximate fair value based on their liquidity. The fair value of the convertible debt was determined as the excess of the proceeds over the fair value of the warrants. Credit is extended to customers based on an evaluation of their financial condition. The Company does not require any collateral.

Vendor Concentration

The Company relies on the expertise of a scientist to facilitate the development and testing of the Company's hardware and software. The scientist is also instrumental in interpreting the data captured during the testing of the hardware and software. The loss of the specialized knowledge provided by this scientist could have an adverse effect on the ability of the Company to reach marketability of its hardware and software. During the years ended June 30, 2006 and June 30, 2005, the Company incurred cash fees payable to the scientist of approximately $154,000 and $13,500, respectively, which are included in research and development expenses in the Company's statements of operations. As of June 30, 2006, the Company owed the scientist approximately $77,000, which is included in accounts payable at June 30, 2006.

As partial compensation for services rendered, the Company also granted stock options to the scientist. During the year ended June 30, 2006 the Company granted the scientist a stock option to purchase 50,000 shares of common stock at an exercise price of $1.12, expiring December 12, 2010. The 50,000 options had a fair value at the date of grant of $50,500, which is included in research and development expenses in the Company's statements of Operations for the year ended June 30, 2006.

During the year ended June 30, 2005 the Company granted the scientist a stock option to purchase 200,000 shares of common stock at an exercise price of $1.16, expiring February 15, 2010. The 200,000 options had a fair value at the date of grant of $174,000, which is included in research and development expenses in the Company's statements of operations for the year ended June 30, 2005.

Total cash and stock compensation expense incurred for settlement of services rendered by the scientist totaled $204,500 or approximately 57% of research and development expense for the year ended June 30, 2006. Total cash and stock compensation expense incurred for settlement of services rendered by the scientist totaled $187,500 or approximately 72% of research and development expense for the year ended June 30, 2005.

Stock-Based Compensation

Prior to January 1, 2006, the Company accounted for stock-based awards under the intrinsic value method, which followed the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations. The intrinsic value method of accounting resulted in compensation expense for stock options to the extent that the exercise prices were set below the fair market price of the Company's stock at the date of grant.

As of January 1, 2006, the Company adopted SFAS No. 123(R) using the modified prospective method, which requires measurement of compensation cost for all stock-based awards at fair value on date of grant and recognition of compensation over the service period for awards expected to vest. The fair value of stock options is determined using the Black-Scholes valuation model, which is consistent with the Company's valuation techniques previously utilized for options in footnote disclosures required under SFAS No. 123, Accounting for

Stock Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation--Transition and Disclosure. Such value is recognized as expense over the service period. To date, all stock option grants have been fully vested upon grant.

The application of SFAS 123(R) had the following effect on net loss as reported:

	For the years June 30
	2006
Net loss:	
As reported	$(1,232,247)
Plus: stock-based employee compensation expense included in reported net loss	--
Less: stock based compensation expense determined under fair value based method for all employee rewards	(352,000)
Pro forma net loss	$(1,584,247)
Net loss per share	
Basic and diluted - as reported	$ (0.13)
Basic and diluted - pro forma	$ (0.16)

The fair value of option and warrant grants is estimated using the Black-Scholes option pricing model with the following weighted average assumptions used for grants made during the year ended June 30, 2006: expected volatility of 150%, risk-free interest rate of 4.46%, expected lives of five years, and a 0% dividend yield. The weighted average assumptions used for grants made during the year ended June 30, 2005 were: expected volatility of 163%, risk free interest rate of 3.41%, expected lives of two years, and a 0% dividend yield.

Segment Reporting

The Company has one operating segment. Expenses incurred to date are reported according to their expense category.

Comprehensive Income(Loss)

Comprehensive income (loss) is equal to net income (loss) for the years ended June 30, 2006 and June 30, 2005.

Recently Issued Accounting Pronouncements

In February 2006, the FASB issued Statement No. 155, "Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140" (FASB No. 155). FASB No. 155 permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of FASB Statement No. 133, and establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. In addition, FASB No. 155 clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives and amends FASB No. 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. FASB No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company does not expect that this Statement will have a material impact on their financial position, results of operations or cash flows.

In March 2006, the FASB issued Statement No. 156, "Accounting for Servicing of Financial Assets--an amendment of FASB Statement No. 140" (FASB No. 156). FASB No. 156 requires that an entity separately recognize a servicing asset or a servicing liability when it undertakes an obligation to service a financial asset under a servicing contract in certain situations. Such servicing assets or servicing liabilities are required to be initially measured at fair value, if practicable. FASB No. 156 also allows an entity to choose either the amortization method or the fair value measurement method to account for servicing assets and servicing liabilities within the scope of this Statement. FASB No. 156 is effective after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company does not expect that this Statement will have a material impact on their financial position, results of operations or cash flows.

In April 2006, the FASB issued FASB Staff Position (FSP) FIN 46R-6, "Determining the Variability to Be Considered in Applying FASB Interpretation No. 46(R) (FIN 46R-6). FIN 46R-6 addresses certain implementation issues related to FASB Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities" (FIN 46R). Specifically, FSP FIN 46R-6 addresses how a reporting enterprise should determine the variability to be considered in applying FIN 46R. The variability that is considered in applying FIN 46R affects the determination of (a) whether an entity is a variable interest entity (VIE), (b) which interests are "variable interests" in the entity, and (c) which party, if any, is the primary beneficiary of the VIE. That variability affects any calculation of expected losses and expected residual returns, if such a calculation is necessary. The Company is required to apply the guidance in FIN 46R-6 prospectively to all entities (including newly created entities) and to all entities previously required to be analyzed under FIN 46R when a "reconsideration event" has occurred, beginning July 1, 2006. The Company will evaluate the impact of this FSP at the time any such "reconsideration event" occurs and for any new entities created.

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) No. 48, "Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109." This Interpretation provides guidance for recognizing and measuring uncertain tax positions, as defined in Statement of Financial Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes." FIN No. 48 prescribes a threshold condition that a tax position must meet for any of the benefit of an uncertain tax position to be recognized in the financial statements. Guidance is also provided regarding derecognition, classification and disclosure of uncertain tax positions. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. The Company does not expect that this Interpretation will have a material impact on their financial position, results of operations or cash flows.

Note 3: Related Parties

Notes Payable - Stockholders

In April 2002, the Company issued a non-interest bearing bridge note payable to an officer of the Company in the amount of $7,500. The note is payable in full when the Company determines it has sufficient working capital to do so. On September 29, 2002, the officer who was owed the $7,500 died.

The Company has entered into various loan agreements with Murphy Evans, President, a director and stockholder of the Company. On March 6, 2003, the Company's Board of Directors approved the Loan Amendment and Promissory Note (the "Amended Evans Loan") between the Company and Murphy Evans. The Amended Evans Loan aggregates all previous debt and supersedes and replaces all of the terms of the previous loans with Mr. Evans, including any conversion features. The Amended Evans Loan bears interest on the aggregate principal balance at a rate of 5% per annum, payable on June 30 and December 31 of each year, with the principal balance due and payable in full on December 31, 2003. The Amended Evans Loan is exempt from registration under Section 4(2) of the Securities Act.

During the year ended June 30, 2006, Mr. Evans loaned the Company an additional $89,733 pursuant to the terms of the Amended Evans Loan. During the year ended June 30, 2006, Mr. Evans converted the entire then outstanding $1,161,223 of principal and $114,777 of accrued interest of the Amended Evans Loan pursuant to the terms of the 2005 Offering as defined below. Accordingly, Mr. Evans received 2,552,000 shares of common stock and warrants to purchase 2,552,000 shares of common stock at an exercise price of $0.75 per share. The warrants are exercisable any time prior to the fifth anniversary from the date of grant.

Interest expense related to the Amended Evans Loan was $16,449 and $47,533 for the years ended June 30, 2006 and June 30, 2005, respectively.

In September 2002, the Company entered into two non-interest bearing bridge loans in the respective principal amounts of $40,000 and $10,000 (the "Stockholder Loans") payable to two stockholders of the Company. The terms of the Stockholder Loans provide for payment at such time as the Company determines it has sufficient working capital to repay the principal balances of the Stockholder Loans. The Stockholder Loans are convertible into 57,142 and 14,286 equity units, respectively, at any time prior to re-payment. Each equity unit is comprised of one share of the Company's common stock, with a detachable 5-year warrant to purchase one additional share at an exercise price of $1.05 per share. Neither stockholder has converted either Stockholder Loan into equity units.

On June 19, 2003, the Board of Directors approved a promissory note (the "2003 Gemino Note") in the principal amount of $34,047 payable to Henry E. Gemino, the Chief Executive Officer, Chief Financial Officer and a director and stockholder of the Company. From time to time, Mr. Gemino loaned the Company additional money and the Company repaid various amounts under the terms of the 2003 Gemino Note. The 2003 Gemino Note bears interest at the rate of 5% per annum, payable on June 30 and December 31 of each year. During the year ended June 30, 2005, the Company repaid the then outstanding principal balance of $48,270 and accrued interest to Mr. Gemino. Interest expense related to the 2003 Gemino Note was $0 and $892 for the years ended June 30, 2006 and June 30, 2005, respectively.

The following is a summary of notes payable to stockholders as of June 30, 2006:

Deceased Officer Note		7,500
Stockholder Loans		50,000
	Total	$57,500

Royalty Arrangement

In September, 1988, at the time Gale D. Burnett, a beneficial shareholder of more than 10% of the Company's common stock, first transferred certain technology, know-how and patent rights to the Company, a royalty interest of 4% of all pre-tax profits derived from the technology and know-how transferred was granted to Northwood Enterprises, Inc., a family-owned company controlled by Mr. Burnett. Northwoods Enterprises subsequently assigned such royalty interest back to Mr. Burnett. On April 8, 1996, Mr. Burnett assigned 2% of this royalty interest to certain shareholders of the Company, 1 1/4% of which was assigned to Henry Gemino, currently the Chief Executive Officer and Chief Financial Officer, and a director of the Company. This royalty arrangement also applies to all future patent rights and technology developed by Mr. Burnett and assigned to the Company. To date, no royalty payments have been made or earned under the above described arrangement.

Note 4: Income Taxes

Federal income taxes reported by the Company differ from the amount computed by applying the statutory rate due primarily to an increase in the valuation allowance for deferred tax assets.

The tax effect of temporary differences that give rise to federal deferred tax assets are comprised of the following at June 30, 2006:

Deferred tax assets:	
Net operating loss carryforwards	$ 3,613,330
Depreciation and amortization	2,586
Wages and professional fees	269,365

Stock compensation	442,000
Research and development credit carryforwards	86,033
Gross deferred tax assets	4,413,314
Less: valuation allowance	(4,413,314)
Net deferred tax assets	$ --

The net increase in the valuation allowance for deferred tax assets was $394,586 and $389,123 for the years ended June 30, 2006 and June 30, 2005, respectively. The increases were primarily due to net operating loss carry forwards, the realization of which was uncertain.

For federal income tax purposes, the Company has net operating loss carry forwards at June 30, 2006 available to offset future federal taxable income, if any, of approximately $10,627,440 which expire during the fiscal year ended June 30, 2005 through the fiscal year ended June 30, 2026. In addition, the Company has research and development tax credit carry forwards of approximately $86,033 at June 30, 2006, which are available to offset federal income taxes and began to expire during the year ended June 30, 2006.

The utilization of the tax net operating loss carry forwards may be limited due to ownership changes that have occurred as a result of sales of common stock.

The effects of state income taxes were insignificant for the years ended June 30, 2006 and June 30, 2005.

Note 5: Common Stock

During the year ended June 30, 2006, six investors exercised their conversion right in accordance with the terms of the 2003 Offering. As a result, 456,740 restricted shares of common stock were issued. Additionally, pursuant to the terms of the 2005 Offering, the Company issued 3,477,000 restricted shares of common stock during the year ended June 30, 2006.

During the year ended June 30, 2006, Mr. Evans converted the entire then outstanding $1,161,223 of principal and $114,777 of accrued interest of the Amended Evans Loan pursuant to the terms of the 2005 Offering. Accordingly, Mr. Evans received 2,552,000 shares of common stock and warrants to purchase 2,552,000 shares of common stock at an exercise price of $0.75 per share. The warrants are exercisable any time prior to the fifth anniversary from the date of grant.

During the year ended June 30, 2005, the Company recorded stock compensation expense totaling $70,000 for the fair market value of 150,000 shares of restricted common stock issued to third parties in exchange for services. The restricted common stock was valued based on the market price of

the Company's common stock, as traded on the NASD's Over the Counter Bulletin Board, on the day of grant.

During the year ended June 30, 2005, five investors exercised their conversion right in accordance with the terms of the 2003 Offering. As a result, 201,044 restricted shares of common stock were issued. Additionally, pursuant to the terms of the 2005 Offering, the Company issued 125,000 restricted shares of common stock during the year ended June 30, 2005.

Note 6: Stockholders' Equity

Stock Option Plan

The Company has granted stock options to compensate key employees, consultants, and board members for past and future services. During 1999, the Company adopted a stock option plan (the "Plan"). The Plan provides for both incentive and nonqualified stock options to be granted to employees, officers, directors, and consultants. In accordance with the Plan, the Company may grant stock options to purchase up to 500,000 shares of common stock. The Plan allows incentive and nonqualified stock options to be granted with an expiration date of a maximum of five years from the date of grant. Since the inception of the Plan, the Company has made various stock option grants that have expiration dates exceeding five years from the date of grant. These stock option grants are deemed to be granted outside of the Plan.

Subsequent to June 30, 2006, the Board adopted amendments to the Plan increasing the period of time for which stock options are exercisable from a period of five years to ten years from the date of grant and to increase the aggregate number of shares of common stock which may be issued pursuant to the Plan from 500,000 to 3,500,000. The Board is seeking approval by the Stockholders as part of the 2006 proxy statement, which will be mailed to Stockholders on or before October 17, 2006.

A summary of stock option-related activity follows:

		Options outstandi
	Shares available for grant (1)	Number of shares
Balance at June 30, 2004	25,000	505,000
Grants	--	1,850,000
Cancellations	15,000	(15,000)
Expiraions	35,000	(35,000)
Balance at June 30, 2005	75,000	2,305,000
Grants	--	435,000
Expirations	40,000	(40,000)
Balance at June 30, 2006	115,000	2,700,000

(1) Consists of stock options available for grant under the Company's 1999 Stock Option Plan.

(2) Consists of stock options outstanding under the Company's 1999 Stock Option Plan and stock options outstanding that were granted outside of the 1999 Stock Option Plan.

The following is a summary of all stock options outstanding, all of which are exercisable at June 30, 2006:

	Options outstanding		
Exercise price	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price
$ 0.50	30,000	2.56	$ 0.50
0.55	90,000	1.75	0.55
0.70	130,000	2.46	0.70
1.00	5,000	0.51	1.00
1.05	140,000	0.37	1.05
1.12	285,000	7.97	1.12
1.16	1,850,000	7.96	1.16
1.21	150,000	9.46	1.21
6.50	15,000	1.34	6.50
10.50	15,000	1.34	10.50
$ 0.50-10.50	2,700,000	7.06	1.18

The aggregate intrinsic value of stock options outstanding at June 30, 2006 is $82,000.

Prior to January 1, 2006, the Company accounted for stock-based awards under the intrinsic value method, which followed the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations.

As of January 1, 2006, the Company adopted SFAS No. 123(R) using the modified prospective method. Subsequent to January 1, 2006 and as of the date of this report, the Company has not made any stock option grants to employees.

During the year ended June 30, 2006, the Company recorded stock compensation expense totaling $85,850 for the fair market value of 85,000 options granted to third-parties in exchange for services. The options were valued using the Black-Scholes option pricing model with the following assumptions: Expected volatility of 150%, risk free interest rate of 4.46%, expected lives of five years, and a 0% dividend yield.

During the year ended June 30, 2005, the Company recorded stock compensation expense totaling $217,500 for the fair market value of 250,000 options granted to third-parties in exchange for services. The options were valued using the Black-Scholes option pricing model with the following assumptions: Expected volatility of 120.%, risk free interest rate of 3.78%, expected lives of five years, and a 0% dividend yield.

The weighted average fair value per share of the option grants made during the years ended June 30, 2006 and June 30, 2005 were $1.01 and $0.80, respectively.

Warrants

The Company has granted warrants to compensate key employees, consultants, and board members for past and future services and as incentives during placements of stock and convertible debt.

A summary of warrant-related activity follows:

	Number of warrants outstanding	Weighted average exercise price
Outstanding at June 30, 2005	3,088,818	$ 1.57
Grants	453,500	0.75
Expirations	(55,000)	5.31
Outstanding at June 30, 2005	3,487,318	1.57
Grants	6,456,100	0.74
Outstanding at June 30, 2006	9,943,418	1.03

The following is a summary of warrants outstanding, all of which are exercisable at June 30, 2006:

Exercise price	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price
$0.55 - 0.70	494,600	4.80	$ 0.61
0.75	7,160,000	4.93	0.75
1.00 - 1.50	1,718,818	0.75	1.05
3.00 - 3.50	520,000	1.34	3.27
7.20	30,000	1.34	7.20
13.50	20,000	1.34	13.50
$0.55 - 13.50	9,943,418	4.00	1.03

During the year ended June 30, 2006, the Company recorded $355,531 as a reduction to paid-in capital for the fair value of the 427,100 warrants granted to a brokerage firm. The fair value of the warrants issued to the brokerage firm during the year ended June 30, 2006 were estimated using the Black-Scholes option pricing model with the following weighted average assumptions: expected volatility ranging from 79.12% to 376.15%, risk-free interest rates ranging from 4.14% to 5.10%, expected lives of five years, and a 0% dividend yield.

During the year ended June 30, 2005, the Company recorded $7,025 as a reduction to paid-in capital for the fair market value of 12,500 warrants granted to a brokerage firm. The fair value of the warrants issued to the

brokerage firm during the year ended June 30, 2005 were estimated using the Black-Scholes option pricing model with the following weighted average assumptions: expected volatility ranging from 133% to 183%, risk free interest rates ranging from 3.63% to 3.88%, expected lives of five years, and a 0% dividend yield.

The weighted average fair value per share of the warrant grants made during the years ended June 30, 2006 and June 30, 2005 were $1.08 and $0.31, respectively.

Note 7: Operating Leases

The Company's research and development facility is located in Ferndale, Washington under a lease that renewed on January 31, 2003 for a one-year term. The lease automatically renews thereafter for one year-terms. The lease may be terminated upon ninety days written notice. The future minimum payments under the lease extension are at the same monthly rate of approximately $2,107 per month as under the terms of the original lease.

The Company's executive office is located in Manhasset, New York under a lease agreement that is month to month.

The Company expects to continue to incur costs on leased properties, as the Company has extended such leases in the past or will use alternate facilities.

Total rent expense under operating leases with third parties was $35,718 and $33,521 during the years ended June 30, 2006 and 2005, respectively.

Note 8: Liquidity

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. The Company incurred cumulative losses of $12,837,386 through June 30, 2006 and had negative working capital of $390,440 as of June 30, 2006. Additionally, the Company has expended a significant amount of cash in developing its technology and patented processes. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management recognizes that in order to meet the Company's capital requirements, and continue to operate, additional financing, including seeking industry-partner investment through joint ventures or other possible arrangements, will be necessary. The Company is evaluating alternative sources of financing to improve its cash position and is undertaking efforts to raise capital. If the Company is unable to raise additional capital or secure additional revenue contracts and generate positive cash flow, it is unlikely that the Company will be able to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Deferred Wages and Accrued Professional Fees

To reduce cash outflows, certain of the Company's employees, officers, consultants, and directors have agreed to defer a portion of their salaries and professional fees until the Company has sufficient resources to pay the amounts owed or to exchange such amounts into options as described below. At June 30, 2006, the Company has accrued $903,751 related to the deferred payment of salaries and professional fees of which $711,601 is included under deferred wages and $192,150 in accrued professional fees. On March 18, 2002, the Board

approved a conversion right on all deferred wages and accrued professional fees deferred as of March 18, 2002. Pursuant to this conversion right, employees, officers, consultants, and directors may elect to convert $1.00 of fees owed to them as of March 18, 2002 for an option to purchase two shares of the Company's common stock, at an exercise price of $1.00 per share for a term of five years. Deferred salaries and fees as of March 18, 2002 were $111,500, resulting in the potential issuance of 223,000 options under the terms mentioned above. No conversions have occurred to date. At March 18, 2002, there was no intrinsic value associated with these exchange rights. As such, no additional compensation cost was recorded.

Convertible Debentures and Warrants

On June 19, 2003, the Board of Directors approved the offering (the "2003 Offering") of $1,000,000 in convertible debentures (the "Debentures"). The Debentures are convertible into that number of shares of the Company's common stock equal to the amount of the converted indebtedness divided by $0.50 per share. The Debentures bear interest at a rate of 5% per annum, payable quarterly. Delinquent interest payments bear interest at a rate of 12% per annum. The Company is required to redeem each Debenture on the 5th anniversary of the date of the Debenture. The Company may, in its discretion, redeem any Debenture at any time prior to the mandatory redemption date of the Debenture by providing no less than 60 days' prior written notice to the holder of the Debenture. Certain events of default will result in the Debentures being redeemable by the Company upon demand of the holder.

Upon the purchase of, and for each $0.50 of the Debenture's principal amount, the Company issued to each investor a warrant (the "Warrant") to purchase one (1) share of the Company's common stock at an exercise price of $0.75 per share. The Warrants are exercisable at any time prior to the 5th anniversary date of the redemption of the Debenture.

Warrants issued in connection with the 2003 Offering were recorded based on their relative fair value as compared to the fair value of the debt at issuance. The relative fair value of the warrants was recorded as paid-in capital, estimated at $0 and $101,977 for the years ended June 30, 2006 and June 30, 2005, respectively. The fair value of the warrants issued during the year ended June 30, 2005, was determined based on an option pricing model with the following assumptions: warrant lives of 10 years, risk free interest rates ranging from 4.14% to 4.30%, volatility of 120%, and a zero dividend yield. The intrinsic value of the Debentures results in a beneficial conversion feature that reduces the book value of the convertible debt to not less than zero. Accordingly, the Company recorded a discount of $0 and $158,000 during the years ended June 30, 2006 and June 30, 2005, respectively, on the convertible debt issued under the 2003 Offering. The Company amortizes the discount using the effective interest method over the five-year life of the Debentures.

During the quarter ended March 31, 2005, the Board of Directors terminated the 2003 Offering. As of the closing date of the 2003 Offering, the Company had raised $503,000 from the 2003 Offering.

During the years ended June 30, 2006 and June 30, 2005, six and five investors, respectively, exercised their conversion right under the terms of the Debentures. Accordingly, the carrying value of the convertible debt was reclassified as equity upon conversion. Since the convertible debt instruments include a beneficial conversion feature, the remaining unamortized discount of approximately $198,000 and $100,000 at the conversion date was recognized as interest expense during the years ended June 30, 2006 and June 30, 2005, respectively.

As of June 30, 2006, accrued interest on the Debentures was $2,182. The Company recorded interest expense related to the accretion of the discount on the Debentures and amortization of the convertible debt discount as a result of the conversions discussed above of $198,128 and $100,061 for the years ended June 30, 2006 and June 30, 2005, respectively.. As of June 30, 2006 the carrying value of the long-term portion of the Debentures was $189, net of unamortized debt discount of $67,311.

Common Stock and Warrants

On January 19, 2005, the Board of Directors approved the offering (the "2005 Offering") of 2,000,000 units (the "Units") to accredited investors for a total offering price of $1,000,000. Each Unit consists of one share of common stock and a warrant to acquire common stock. On November 21, 2005, the Board of Directors approved an increase in the number of Units offered in the 2005 Offering to 6,000,000 Units, for a total offering price of $3,000,000. The purchase price of one Unit is $0.50. Each Unit consists of one share of common stock and a warrant to purchase one share of common stock at an exercise price of $0.75. The warrants are exercisable at any time prior to the fifth anniversary from the date of their issuance.

During the year ended June 30, 2006, the Company raised $1,738,500 under the terms of the 2005 Offering. Accordingly, the Company issued 3,477,000 shares of common stock and warrants to purchase up to 3,477,000 shares of common stock at an exercise price of $0.75 per share.

The 2005 Offering was terminated on June 9, 2006. As of the closing date of the 2005 Offering, the Company had raised $1,801,000 from the 2005 Offering.

The Company engaged a brokerage firm to help in the fund raising efforts of the 2005 Offering. Pursuant to the terms of the agreement with the brokerage firm, the Company will pay the brokerage firm a ten percent cash commission on all funds that the brokerage firm helps raise. Additionally, subsequent to the closing of the 2005 Offering, the brokerage firm and the Company agreed that the Company would issue warrants to purchase a total of 439,600 shares of common stock at $0.60 per share. The warrants may be exercised up to five years from the date of issuance, which is the date the proceeds are received under the 2005 Offering. During the years ended June 30, 2006 and June 30, 2005, the Company incurred $141,050 and $6,250, respectively, of cash fees to be paid to the brokerage firm and issued warrants to purchase 427,100 and 12,500, respectively, shares of common stock. During the year ended June 30, 2006, the Company recorded $355,531 as a reduction to paid-in capital for the fair value of the 427,100 warrant grants. The fair value of the warrants issued to the brokerage firm during the year ended June 30, 2006 were estimated using the Black-Scholes option pricing model with the following weighted average assumptions: expected volatility ranging from 79.12% to 376.15%, risk-free interest rates ranging from 4.14% to 5.10%, expected lives of five years, and a 0% dividend yield.

Note 9. Subsequent Events

In July 2006, the Board approved an option grant to a consultant to purchase 100,000 shares of the Company's common stock at an exercise price of $1.05 per share. The option is in consideration for work the consultant is performing for the Company. The option is fully vested upon grant and is exercisable until July 13, 2011.

Item 8. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Item 8A. Controls and Procedures.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in the Company's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. The Company's executive officers, including the Company's Chief Executive Officer, who also serves as Chief Financial Officer, and the Chief Operating Officer, are responsible for establishing and maintaining disclosure controls and procedures for the Company. These executives have designed such controls to ensure that all material information related to the Company is made known to them by others within the organization. As of June 30, 2006, the Company's Chief Executive Officer and Chief Operating Officer completed an evaluation of the Company's disclosure controls and procedures and have determined that such disclosure controls and procedures are functioning properly and effectively. They did not discover any significant deficiencies or material weaknesses within the controls and procedures that require modification. There were no changes in the Company's internal control over financial reporting identified in connection with the Company's evaluation that occurred during the Company's fourth fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 8B. Other Information.

None.

PART III

Item 9. Directors and Executive Officers.

Directors, Executive Officers, Promoters and Control Persons

The information regarding directors contained under the caption "Proposal One: Election of Directors" in the Company's Proxy Statement for the 2006 Annual Meeting of Shareholders, which will be filed with the Commission not later than 120 days after the end of the fiscal year covered by this report, is incorporated herein by reference.

Executive Officers of the Company

In addition to Murphy Evans and Henry Gemino, who also serve as directors, the following constitutes the executive officer of the Company:

Name	Age	Positions Held and Principal Occupations During the Past 5 Years
Philip L. Jones	63	Mr. Jones has served as the Chief Operating Officer and Executive Vice President for the Company during the past five years. Previous to his employment with the Company, he provided energy consulting services to certain utility companies for a period of one year. Prior to that time, Mr. Jones held various executive positions with Consolidated Natural Gas Company before retiring in April 2000.

Compliance with Section 16(a) of the Exchange Act

The information regarding reports required under Section 16(a) of the Securities Exchange Act of 1934, as amended, contained under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" in the Company's Proxy Statement for the 2006 Annual Meeting of Shareholders, which will be filed with the Commission not later than 120 days after the end of the fiscal year covered by this report, is incorporated herein by reference.

Code of Ethics

The Company has adopted a Code of Ethics applicable to its chief executive officer, chief operating officer, chief financial officer, president and other finance leaders. A copy of the Code of Ethics may be obtained by any person without charge, upon request, by contacting the principle office of the Company.

Audit Committee

The information contained under the caption "Board of Directors and Committees" in the Company's Proxy Statement for the 2006 Annual Meeting of Shareholders, which will be filed with the Commission not later than 120 days after the end of the fiscal year covered by this report, is incorporated herein by reference.

Item 10. Executive Compensation.

The information contained under the caption "Executive Compensation" in the

Company's Proxy Statement for the 2006 Annual Meeting of Shareholders, which will be filed with the Commission not later than 120 days after the end of the fiscal year covered by this report, is incorporated herein by reference.

Item 11. Security Ownership of Certain Beneficial Owners and Management.

The information contained under the caption "Security Ownership of Certain Beneficial Owners and Management" in the Company's Proxy Statement for the 2006 Annual Meeting of Shareholders, which will be filed with the Commission not later than 120 days after the end of the fiscal year covered by this report, is incorporated herein by reference.

Information regarding securities authorized for issuance under equity compensation plans is hereby incorporated by reference to Item 5 of Part II of this Annual Report on Form 10-KSB, under the heading "Securities Authorized for Issuance Under Equity Compensation Plans."

Item 12. Certain Relationships and Related Transactions.

The information contained under the caption "Certain Relationship and Related Transactions" in the Company's Proxy Statement for the 2006 Annual Meeting of Shareholders, which will be filed with the Commission not later than 120 days after the end of the fiscal year covered by this report, is incorporated herein by reference.

Item 13. Exhibits.

The following exhibits were filed with or incorporated by reference into this report.

Exhibit No.	Description of Exhibit
Exhibit 3.1	Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Registration Statement on Form SB-2 filed with the Commission on May 10, 1996).

Exhibit No.	Description of Exhibit
Exhibit 3.2	Bylaws of the Company (incorporated by reference to Exhibit 3.3 to the Company's Registration Statement on Form SB-2 filed with the Commission on May 10, 1996).
Exhibit 3.3	Amendment to Certificate of Incorporation (incorporated by reference to Exhibit A to the Company's Definitive Proxy Statement filed with the Commission on October 28, 2002).
Exhibit 3.4	Amendment to Certificate of Incorporation (incorporated by reference to Exhibit A to the Company's Preliminary Proxy Statement filed with the Commission on September 13, 2006).
Exhibit 10.1	Service Agreement dated as of August 16, 2001 between

	Profile Technologies, Inc. and BP Exploration (Alaska) Inc. (incorporated by reference to Exhibit 10.1 to the Company's Annual Report on Form 10-KSB filed with the Commission on September 28, 2001).
Exhibit 10.2	Loan Agreement dated March 6, 2003, by and between the Company and Murphy Evans (incorporated by reference to Exhibit 4.1 to the Company's Quarterly Report on Form 10-QSB filed with the Commission on May 15, 2003).
Exhibit 10.3	Loan Amendment and Promissory Note dated March 6, 2003, by and between the Company and Murphy Evans (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-QSB filed with the Commission on May 20, 2003).
Exhibit 10.4	Lease Agreement dated January 26, 2001 by and between the Company and Fatum LLC. (incorporated by reference to Exhibit 10.4 to the Company's Annual Report on Form 10-KSB filed with the Commission on October 12, 2004).
Exhibit 10.5	Lease Extension dated February 26, 2003 by and between the Company and Fatum LLC. (incorporated by reference to Exhibit 10.5 to the Company's Annual Report on Form 10-KSB filed with the Commission on October 12, 2004).
Exhibit 10.6	Royalty Agreement (incorporated by reference to Exhibit 10.1 to the Company's Registration Statement on Form SB-2 filed with the Commission on May 10, 1996).

Exhibit No.	Description of Exhibit
Exhibit 10.7	Assignment of Patent Rights (incorporated by reference to Exhibit 10.2 to the Company's Registration Statement on Form SB-2 filed with the Commission on May 10, 1996).
Exhibit 10.8	ConocoPhillips Alaska, Inc., Contract No. AK 990156, Amendment No. 3 dated February 1, 2003, by and between the Company and ConocoPhillips Alaska, Inc. (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-QSB filed with the Commission on May 20, 2003).
Exhibit 10.9	1999 Stock Option Plan (incorporated by reference to Exhibit 10.9 to the Company's Annual Report on Form 10-KSB filed with the Commission on October 12, 2004).
Exhibit 10.10	First Amendment to the 1999 Stock Option Plan (incorporated by reference to Appendix B to the Company's Preliminary Proxy Statement filed with the Commission on September 13, 2006).
Exhibit 14.1	Code of Ethics (incorporated by reference to Exhibit 14 to the Company's Annual Report on Form 10-KSB filed with the Commission on October 12, 2004).
Exhibit 31.1	Rule 13a-14(a)/15d-14(a) Certification of Henry E. Gemino,

as Chief Executive Officer and Chief Financial Officer of the Company.

Exhibit 31.2	Rule 13a-14(a)/15d-14(a) Certification of Philip L. Jones, as Chief Operating Officer and Executive Vice President of the Company.
Exhibit 32.1	Certification under Section 906 of the Sarbanes-Oxley Act of 2002 by Henry E. Gemino, as Chief Executive Officer and Chief Financial Officer of the Company.
Exhibit 32.2	Certification under Section 906 of the Sarbanes-Oxley Act of 2002 by Philip L. Jones, as Chief Operating Officer and Executive Vice President of the Company.

Item 14. Principal Accountant Fees and Services.

The information required by this item is incorporated by reference to the sections entitled "Independent Public Accountants" and "Principal Accountant Fees and Services" in the Company's Proxy Statement for the 2006 Annual Meeting of Shareholders, which will be filed with the Commission not later than 120 days after the end of the fiscal year covered by this report, is incorporated herein by reference.

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SIGNATURES

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

PROFILE TECHNOLOGIES, INC.

By /s/ Henry E. Gemino

Henry E. Gemino
Chief Executive Officer
and Chief Financial Officer

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant in the capacities and as of the dates indicated:

Signature	Title	Date
/s/Charles Christenson Charles Christenson	Director	September 28, 2006
/s/Murphy Evans Murphy Evans	Director	September 28, 2006

/s/Henry E. Gemino ------------------ Henry E. Gemino	Director	September 28, 2006
/s/William A. Krivsky --------------------- William A. Krivsky	Director	September 28, 2006

Exhibit Index

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