GENERAL KINETICS INC
Form 10-Q
January 17, 2006

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the quarter ended November 30, 2005

Commission File No. 0-1738
GENERAL KINETICS INCORPORATED
(Exact Name of Registrant as specified in its Charter)

Virginia	54-0594435
(State of Incorporation)	(IRS Employer Identification No)
110 Sunray Dr, Johnstown, PA	15905
(Address of principal executive offices)	(Zip Code)
Registrant's telephone number	(814) 255-6891

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES X NO

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act):

YES NO X

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

YES NO X

The number of shares outstanding of Registrant's Common Stock, $0.25 par value, as of January 13, 2006 was 7,118,925.

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CAUTIONARY STATEMENT REGARDING FORWARD LOOKING STATEMENTS

Certain statements contained in this Quarterly Report on Form 10-Q constitute "forward-looking statements". In some cases, forward-looking statements can be identified by the use of forward-looking terminology such as "may," "will," "estimate," "intend," "continue," "believe," "expect" or "anticipate" or the negatives thereof, variations thereon or similar terminology. The forward-looking statements contained in this Quarterly Report are generally located in the material set forth under the headings “Business” and "Management's Discussion and Analysis of Financial Condition and Results of Operations," but may be found in other locations as well. These forward-looking statements generally relate to plans and objectives for future operations and are based upon management's reasonable estimates of future results or trends. Although the Company believes that the plans and objectives reflected in or suggested by such forward-looking statements are reasonable, such plans or objectives may not be achieved. Actual results may differ from projected results due, but not limited, to unforeseen developments, including developments relating to the following:

- the risk that the Company will not be able to manufacture and complete the order backlog as scheduled and on budget in order to maintain a positive cash flow;
- the risk that the Company may not be able to obtain sufficient new orders to achieve positive cash flow;
- the risk that the Company may not maintain its present financing facility or obtain additional financing, if necessary;
- the risk that it will not be able to repay, restructure or refinance in full the approximately $7.32 million principal amount of its outstanding convertible debentures which matured on August 14, 2004;
- the risk that the Company may not be able to continue the necessary development of its operations, including maintaining or increasing sales and production levels, on a profitable basis;
- the risk the Company may, in the future, have to comply with more stringent environmental laws or regulations or more vigorous enforcement policies of regulatory agencies, and that such compliance could require substantial expenditures by the Company;
- the risk that U.S. defense spending may be substantially reduced; and
- the risk that the Company’s Common Stock will not continue to be quoted on the NASD Over The Counter Bulletin Board.

You should read this Quarterly Report completely and with the understanding that actual future results may be materially different from what the Company expects. All subsequent written and oral forward-looking statements attributable to the Company or to persons acting on the Company’s behalf are expressly qualified in their entirety by the foregoing factors. These forward-looking statements speak only as of the date of the document in which they are made. The Company disclaims any obligation or undertaking to provide any updates or revisions to any forward-looking statement to reflect any change in the Company’s expectations or any change in events, conditions or circumstances in which the forward-looking statement is based.

PART I FINANCIAL INFORMATION

Item 1 - Financial Statements

The unaudited financial statements of General Kinetics Incorporated ("GKI" or the "Company") set forth below have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in the annual financial statements prepared in accordance with Generally Accepted Accounting Principles (GAAP) have been condensed or omitted pursuant to those rules and regulations. Revenues, expenses, assets and liabilities vary during the year and GAAP requires the Company to make estimates and assumptions in preparing the interim financial statements. The Company has made its best effort in establishing good faith estimates and assumptions. However, actual results may differ. The Company believes that the disclosures made are adequate to make the information presented not misleading. The information as of May 31, 2005 is derived from audited financial statements.

In the opinion of management of the Company, the accompanying financial statements reflect all adjustments (consisting only of normal recurring adjustments) that are necessary for a fair presentation of results for the periods presented. These financial statements should be read in conjunction with the audited financial statements for the fiscal years ended May 31, 2005 and 2004 set forth in the Company's annual report on Form 10-K, as amended, for the fiscal year ended May 31, 2005.

General Kinetics Incorporated
Balance Sheets
(Unaudited)
(In Hundreds, except share and per share data)

ASSETS		Nov 30, 2005		May 31, 2005
Cash and cash equivalents	$	13,200	$	301,500
Marketable securities - trading		84,000		68,700
Accounts receivable, net of allowance of $20,000		880,600		531,900
Inventories, net		1,270,400		1,072,800
Prepaid expenses and other		24,100		53,100
Total Current Assets		2,272,300		2,028,000
Property, Plant and Equipment		2,231,700		2,285,400
Less: Accumulated Depreciation and Amortization		(1,973,800)		(1,989,700)
		257,900		295,700
Other Assets		26,600		100,600
Total Assets	$	2,556,800	$	2,424,300
LIABILITIES AND STOCKHOLDERS' DEFICIT				
Current Liabilities:				
Advances from Factor	$	566,900	$	149,400
Current maturities of long-term debt		7,315,000		7,315,000
Current maturities of capital lease		48,400		60,000
Accounts payable, trade		618,400		669,500
Accrued expenses and other payables		875,800		741,600
Deferred gain on sale of building		104,100		104,100
Total Current Liabilities		9,528,600		9,039,600
Long-Term Liabilities:				
Capital lease - less current maturities		85,200		102,500
Other long-term liabilities		234,200		253,600
Deferred gain on sale of building		260,200		312,200
Total Long-Term Liabilities		579,600		668,300
Total Liabilities		10,108,200		9,707,900
Stockholders' Deficit:				
Common Stock, $0.25 par value, 50,000,000 shares authorized, 7,645,557 shares issued, 7,118,925 shares outstanding		1,911,400		1,911,400
Additional Contributed Capital		7,337,300		7,337,300
Accumulated Deficit		(16,349,900)		(16,082,100)
		(7,101,200)		(6,833,400)
Less: Treasury Stock, at cost (526,632 shares)		(450,200)		(450,200)

Total Stockholders' Deficit		(7,551,400)		(7,283,600)
Total Liabilities and Stockholders' Deficit	$	2,556,800	$	2,424,300

General Kinetics Incorporated
Statements of Operations
(Unaudited)
(In Hundreds, except share and per share data)

	Six Months Ended				Three Months Ended			
	November 30, 2005		November 30, 2004		November 30, 2005		November 30, 2004	
Net Sales	$ 4,514,300	100.0%	$3,788,000	100.0%	$2,229,800	100.0%	$2,066,300	100.0%
Cost of Sales	3,970,500	88.0%	3,150,300	83.2%	2,003,500	89.9%	1,737,700	84.1%
Gross Profit	543,800	12.0%	637,700	16.8%	226,300	10.1%	328,600	15.9%
Selling, General & Administrative	705,600	15.6%	695,700	18.4%	352,700	15.8%	358,100	17.3%
Total Operating Expenses	705,600	15.6%	695,700	18.4%	352,700	15.8%	358,100	17.3%
Operating Income/ (Loss)	(161,800)	-3.6%	(58,000)	-1.5%	(126,400)	-5.7%	(29,500)	-1.4%
Other Income (Expense):								
Interest Expense	(106,000)	-2.3%	(59,400)	-1.6%	(65,600)	-2.9%	(11,700)	-0.6%
Gain on Settlement of Debt		0.0%	1,346,400	35.5%	-	0.0%	1,346,400	65.2%
Total Other Income (Expense)	(106,000)	-2.3%	1,287,000	34.0%	(65,600)	-2.9%	1,334,700	64.6%
Net Income (Loss)	$ (267,800)	-5.9%	$1,229,000	32.4%	$ (192,000)	-8.6%	$1,305,200	63.2%
Earnings per common share:								
Basic Income (Loss) per share	($0.04)		$ 0.17		($0.03)		$ 0.18	
Basic	7,118,925		7,118,925		7,118,925		7,118,925	

The accompanying notes are an integral part of the financial statements.

General Kinetics Incorporated
Statement of Stockholders' Deficit
For the Quarter Ended November 30, 2005
(Unaudited)
(In hundreds, except per share data)

	Common Stock Shares	Common Stock Amount	Additional Contributed Capital	Accumulated Deficit	Treasury Stock	Total Stockholders' Deficit
Balance 5/31/04	7,645,557	$ 1,911,400	$ 7,337,300	$ (17,390,900)	$ (450,200)	$ (8,592,400)
Net Gain				1,229,000		1,229,000
Balance 11/30/04	7,645,557	$ 1,911,400	$ 7,337,300	$ (16,161,900)	$ (450,200)	$ (7,363,400)
Balance 5/31/05	7,645,557	$ 1,911,400	$ 7,337,300	$ (16,082,100)	$ (450,200)	$ (7,283,600)
Net Loss				(267,800)		(267,800)
Balance 11/30/05	7,645,557	$ 1,911,400	$ 7,337,300	$ (16,349,900)	$ (450,200)	$ (7,551,400)

The accompanying notes are an integral part of the financial statements.

General Kinetics Incorporated
Statements of Cash Flows
(Unaudited)
(In hundreds)

	For The Quarter Ended November 30, 2005		For The Quarter Ended November 30, 2004	
Cash Flows From Operating Activities:				
Net Income (Loss)	$	(267,800)	$	1,229,000
Adjustments to reconcile net income (loss)				
to net cash provided by (used in) operating activities:				
Gain on sale of building		(52,000)		(52,000)
Unrealized (gain) loss on marketable equity securities		(15,300)		(2,800)
Depreciation and amortization		41,500		43,400
Amortization of bond discount		-		15,100
Gain from the retirement of debt		-		(1,346,400)
Provision for doubtful accounts		-		-
Provision for inventory obsolescence		-		-
(Increase) Decrease in Assets:				
Accounts receivable		(348,700)		179,800
Inventories		(197,600)		(318,100)
Prepaid expenses		29,000		(20,100)
Other assets		74,000		10,400
Increase (Decrease) in Liabilities:				
Accounts payable - trade		(51,100)		22,900
Accrued expenses and other payables		134,200		30,700
Other long term liabilities		(19,400)		(1,200)
Net cash used in Operating Activites		(673,200)		(209,300)
Cash Flows from Investing Activities:				
Acquisition of property, plant and equipment		(3,700)		(36,500)
Proceeds from sale of building		-		-
Net cash used in Investing Activities		(3,700)		(36,500)
Cash Flows from Financing Activities:				
Factor/Borrowings on Demand Notes Payable		417,500		(198,600)
Principal payments under capital lease		(28,900)		(22,300)
Repayments on long term debt		-		(27,200)
Net cash provided by (used in) Financing Activities		388,600		(248,100)
Net decrease in cash and cash equivalents	$	(288,300)	$	(493,900)
Cash and Cash Equivalents: Beginning of Period		301,500		670,000
Cash and Cash Equivalents: End of Period	$	13,200	$	176,100
Supplemental Disclosures of Cash Flow Information:				
Cash paid during the quarter for:				

Interest	$	22,200	$	21,500
Non-cash investing and financing activities:				
Assets acquired under capital lease	$	-	$	163,000

The accompanying notes are an integral part of the financial statements.

Notes to Unaudited Condensed Financial Statements

Note 1 - Basis of Presentation

The unaudited condensed financial statements at November 30, 2005, and for the six months ended November 30, 2005 and November 30, 2004, include the accounts of General Kinetics Incorporated ("GKI" or the "Company").

The financial information included herein is unaudited. In addition, the financial information does not include all disclosures required under Generally Accepted Accounting Principles (GAAP) because certain note information included in the Company's Annual Report has been omitted. However, such information reflects all adjustments (consisting solely of normal recurring adjustments) which are, in the opinion of management, necessary to a fair presentation of the results of the interim periods.

The results of operations for the three-month period ended November 30, 2005 are not necessarily indicative of the results to be expected for the full year.

Note 2 - Earnings Per-Share

Earnings per-share is based on the weighted average number of shares of common stock and dilutive common stock equivalents outstanding. Basic earnings per share includes no dilution and is computed by dividing net income (loss) available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution of securities that could share in the earnings.

Note 3 - Notes Payable

At November 30, 2005, convertible debentures were outstanding in an aggregate principal amount of approximately $7.32 million. The debentures matured on August 14, 2004, and were stated to be convertible into common stock at a conversion price of $0.50 per share, and to bear interest at 1% per annum, payable annually. The Company continues to accrue interest on the debentures. Shares issuable upon conversion were also subject to certain rights to registration under the Securities Act of 1933, as amended.

On March 12, 2003, Manassas Partners LLC, a Delaware limited liability company of which Larry Heimendinger, Chairman of the Board of Directors of the Company, is the managing member, purchased from third parties, at a significant discount, a portion of the Company's outstanding convertible debentures in an aggregate principal amount of $5,800,000. On July 18, 2005, an additional $290,000 of the Company's principal outstanding convertible debentures was purchased by Manassas Partners LLC, from third parties, at 3% of face value.

In October 2004, the Company purchased $1.36 million aggregate principal amount of debentures from certain debenture holders for a total price (including accrued interest) equal to 3% of the principal amount. The Company made a final payment to the debenture holders in January 2005. In a separate transaction, in January 2005, the Company purchased an additional $160,000 aggregate principal amount of debentures from certain debenture holders for a total price (including accrued interest) equal to 3% of the principal amount. As a result of these transactions, the Company recognized a gain on the settlement of debt of $1,346,400 during the second quarter of fiscal 2005 and $158,400 during the third quarter of fiscal 2005.

The Company's cash flow, capital resources, and overall financial condition will not be sufficient to repay or refinance in full the approximately $7.32 million principal amount of outstanding debentures which matured on August 14, 2004. At present, the Company is in discussion with certain other debenture holders, but has decided on no specific plans with respect to the repayment or refinancing of the debentures. The Company is continuing to review the

situation and considering its potential alternatives. There can be no assurance, however, that the Company will be able to come to agreement with the other debenture holders with respect to repayment or refinancing of the debentures.

Note 4 - Income Taxes

The Company’s estimated effective tax rate for fiscal 2006 is 0%. This estimated effective tax rate is lower than the statutory rate due to the existence of net operating loss carry forwards.

Note 5 - Recent Accounting Pronouncements

In March 2005, the FASB issued FIN 47, Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143 ("FIN 47"), which requires an entity to recognize a liability for the fair value of a conditional asset retirement obligation when incurred if the liability's fair value can be reasonably estimated. FIN 47 is effective for fiscal years ending after December 15, 2005. The Company does not anticipate that the adoption FIN 47 will have a material impact on its financial statements.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections." SFAS No. 154 replaces APB No. 20, "Accounting Changes," and SFAS No. 3, "Reporting Accounting changes in Interim Financial Statements," and establishes retrospective application as the required method for reporting change in accounting principle. SFAS No. 154 provides guidance for determining whether retrospective application of a change in accounting principle is impracticable and for reporting a change when retrospective application is impracticable. The reporting of a correction of an error by restating previously issued financial statements is also addressed. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company does not anticipate that the adoption of SFAS No. 154 will have a material impact on its financial statements.

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

Three Months Ended November 30, 2005 Compared to Three Months Ended November 30, 2004

Net sales for the quarter ended November 30, 2005 were approximately $2.2 million compared to net sales of approximately $2.1 million for the quarter ended November 30, 2004. The increase in sales was due primarily to an increase in orders under large blanket contracts with prime contractors to the U.S. Department of Defense (DOD), in addition to an overall increase of orders from customers involved in projects related to the U.S. DOD compared to the prior fiscal year.

The gross margin percentage decreased from 15.9% for the quarter ended November 30, 2004 to 10.1% for the quarter ended November 30, 2005. The decrease in the gross profit percentage was caused by the mix of jobs for the quarter ended November 30, 2005 as compared to the corresponding quarter of the prior fiscal year and an increased need for the use of overtime to compensate for work performed during the Thanksgiving holiday period. The Company operates as a job shop, making a mix of build-to-print enclosures, assembles and parts, standard enclosures, and special orders, all with variable quantities depending on the current contracts. Therefore, the mix of orders and margins associated with those orders can vary significantly between quarters.

Selling, general and administrative costs were approximately $352,700 for the quarter ended November 30, 2005 as compared to approximately $358,100 for the quarter ended November 30, 2004. The small decrease was principally due to a decrease in salary costs related to the relocation of positions in Johnstown, Pennsylvania.

For the quarter ended November 30, 2005, the Company had an operating loss of $126,400 compared to an operating loss of $29,500 for the corresponding quarter of the prior year. The increase in operating loss was due principally to an erosion of gross profit percentage as a result of changes in the types of orders produced during the quarter ended November 30, 2005. Management believes that margins will increase in future quarters due to changes in operational procedures that will increase efficiencies.

Interest expense increased from $11,700 in the second quarter of fiscal 2005 to $65,600 in the second quarter of fiscal 2006. The increase was due to more a extensive use of factoring, service fees related to the cancellation of the Key Financial factoring agreement and the instatement of the new agreement with Presidential Financial Capital Partners.

The Company’s estimated effective tax rate for fiscal 2006 is 0%. This estimated effective tax rate is lower than the statutory rate due to the existence of net operating loss carry forwards.

Six Months Ended November 30, 2005 Compared to Six Months Ended November 30, 2004

Net sales for the six months ended November 30, 2005 were approximately $4.5 million compared to net sales of approximately $3.8 million for the six months ended November 30, 2004. The increase in sales was due primarily to

an increase in orders under large blanket contracts with prime contractors to the U.S. Department of Defense (DOD), in addition to an overall increase of orders from customers involved in projects related to the U.S. DOD compared to the prior fiscal year.

The gross margin percentage decreased from 16.8% for the six months ended November 30, 2004 to 12.0% for the six months ended November 30, 2005. The decrease in the gross profit percentage was caused by the mix of jobs for the six months ended November 30, 2005 as compared to the corresponding six months of the prior fiscal year and an increased need for the use of overtime to compensate for work performed during the Thanksgiving holiday period. The Company operates as a job shop, making a mix of build-to-print enclosures, assembles and parts, standard enclosures, and special orders, all with variable quantities depending on the current contracts. Therefore, the mix of orders and margins associated with those orders can vary significantly between quarters.

Selling, general and administrative costs were approximately $705,600 for the six months ended November 30, 2005 as compared to approximately $695,700 for the six months ended November 30, 2004. The small increase was principally due to changes in commission structure and a greater proportion of sales from the outside sales force.

For the six months ended November 30, 2005, the Company had an operating loss of $161,800 compared to an operating loss of $58,000 for the corresponding six months of the prior year. The increase in operating loss was due principally to an erosion of gross profit percentage because of changes in the types of orders produced during the six months ended November 30, 2005. Management believes that margins will increase in future quarters due to changes in operational procedures that will increase efficiencies.

Interest expense increased from $59,400 in the second six months of fiscal 2005 to $106,000 in the second six months of fiscal 2006. The increase was due to a more extensive use of factoring, service fees related to the cancellation of the Key Financial factoring agreement and the instatement of the new agreement with Presidential Financial Capital Partners.

The Company's estimated effective tax rate for fiscal 2006 is 0%. This estimated effective tax rate is lower than the statutory rate due to the existence of net operating loss carry forwards.

Liquidity and Capital Resources

The Company relies upon internally generated funds and accounts receivable factoring to finance its operations. During the six months ended November 30, 2005, the Company had an operating loss of $161,800. For the fiscal years ended May 31, 2005 and 2004, the Company had net income of approximately $1,308,700, which included a gain on settlement of debt of $1,504,800 and net loss of approximately $527,300, respectively. In order to generate the working capital required for operations, the Company must continue to generate orders, increase its gross margins, and effectively manage operating expenses during the remainder of fiscal 2006.

The Company must continue to market electronic enclosure products to government and commercial markets and enter into contracts that the Company can complete with favorable profit margins, ship the orders in a timely manner, and control operating costs in order to recover from the Company's liquidity problems and seek to operate profitably for the remainder of fiscal 2006.

The Company had $618,400 payable to trade creditors at November 30, 2005, as compared to $669,500 at May 31, 2005. The reduction in payables to trade creditors is being orchestrated to maintain the Company's good standing with vendors.

The Company has received significant new orders during the second quarter of fiscal 2006, and the shippable backlog at November 30, 2005 is $3.3 million as compared to $4.3 million at November 30, 2004. The Company must produce and ship this backlog of orders on schedule and on budget to generate positive cash flow and operate profitably in fiscal 2006. The Company must also maintain or increase the current level of backlog to provide positive cash flow over the next twelve-month period. However, there is no assurance the Company will be successful in its efforts to obtain an adequate level of new contracts to maintain positive cash flow or profitable operations.

As of November 30, 2005, the Company had cash and marketable securities totaling $97,200. During the quarter ended November 30, 2005, the Company had limited cash flow, and had difficulty meeting operating cash flow requirements. The Company was only able to meet cash requirements through the aggressive factoring of accounts receivable. This cash shortage was caused by the Company utilizing funds to make necessary changes in operations, such as decreasing accounts payable with key vendors to increase the availability of tactically imperative inventory and increasing the capabilities of the work force through cross training. The Company has taken, and is continuing to take, steps to address production planning through changes and additions to plant supervision, regularly updating scheduling and planning procedures, and adding new production machinery. The Company is trying to stabilize the level of shipments at a profitable level through these changes.

Management believes that the Company can meet its operating cash requirements, excluding the repayment of the debentures referred to below, through the current fiscal year with cash on hand and borrowings from the factoring of accounts receivable if the Company can maintain or increase the current level of backlog, and ship the scheduled backlog on time and within budget. However, there is no assurance the Company will be successful in pursuing its plans or in obtaining additional financing to meet those cash requirements. The Company must maintain or increase its current level of sales, consistently make timely shipments and produce its products at adequate profit margins, or the Company will continue to face liquidity problems and may be left without sufficient cash to meet its ongoing requirements.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. The Company has sustained operating losses in two of the last three fiscal years, and the Company has significant short-term cash commitments, the funding of which are limited to cash flow from operations and the factoring of certain accounts receivable, if available. The Company is also attempting to restructure or repurchase at a discount the remaining convertible debentures (discussed below) which matured on August 14, 2004. The losses and commitments raise significant doubt about the Company's ability to continue as a going concern. The financial statements do not contain any adjustments that might result from the outcome of these uncertainties. The Company's former auditors have given a going concern opinion for the last three years.

During the three months ended November 30, 2005, the Company at its own discretion chose to cancel its factoring agreement with Key Capital Partners. This cancellation resulted in a one-time cancellation fee of $11,000.

During the quarter ended November 30, 2005, the Company entered into a factoring agreement with Presidential Financial Capital Partners ("PFCP") that provides for advances of up to 86% of specified accounts receivable and a revolving credit facility equal to 40% of raw materials inventory or $150,000, which ever is less. The Company has drawn on the PFCP facility during fiscal 2006 as necessary to help alleviate liquidity problems, although, as discussed above, the Company will also need to control expenses, maintain the sales backlog at appropriate levels, and keep shipment levels in line with booked orders in order to meet these requirements. The Company factored accounts receivable under the PFCP facility during the quarter ended November 30, 2005. There were outstanding advances due to PFCP at November 30, 2005 of $566,900, which includes the $150,000 revolving credit facility. PFCP may cancel the agreement at any time with 30 days prior notice to the Company.

At November 30, 2005, convertible debentures were outstanding in an aggregate principal amount of approximately $7.32 million. The debentures matured on August 14, 2004, and were stated to be convertible into common stock at a conversion price of $0.50 per share, and to bear interest at 1% per annum, payable annually. The Company continues to accrue interest on these debentures; the accrued expenses and other payables at November 30, 2005 include approximately $270,200 in accrued interest on debentures. Shares issuable upon conversion were also subject to certain rights to registration under the Securities Act of 1933, as amended.

On March 12, 2003, Manassas Partners LLC, a Delaware limited liability company of which Larry Heimendinger, Chairman of the Board of Directors of the Company, is the managing member, purchased from third parties, at a significant discount, a portion of the Company's outstanding convertible debentures in an aggregate principal amount of $5,800,000. On July 18, 2005, an additional $290,000 of the Company's principal outstanding convertible debentures was purchased by Manassas Partners LLC, from third parties, at a significant discount.

In October 2004, the Company purchased $1.36 million aggregate principal amount of debentures from certain debenture holders for a total price (including accrued interest) equal to 3% of the principal amount. The Company made a final payment to the debenture holders in January 2005. In a separate transaction, in January 2005, the Company purchased an additional $160,000 aggregate principal amount of debentures from certain debenture holders for a total price (including accrued interest) equal to 3% of the principal amount. As a result of these transactions, the Company recognized a gain on the settlement of debt of $1,346,400 during the second quarter of fiscal 2005 and $158,400 during the third quarter of fiscal 2005.

The Company's cash flow, capital resources, and overall financial condition will not be sufficient to repay or refinance in full the approximately $7.32 million principal amount of outstanding debentures which matured on August 14, 2004. At present, the Company is in discussion with certain other debenture holders, but has decided on no specific plans with respect to the repayment or refinancing of the debentures. The Company is continuing to review the situation and considering its potential alternatives. There can be no assurance, however, that the Company will be able to come to agreement with the other debenture holders with respect to repayment or refinancing of the debentures. No payment has otherwise been made in respect of interest on the outstanding debentures.

Analysis of Cash Flows

Operating activities used $673,200 in cash during the six months ended November 30, 2005. This reflects net loss of $ 267,800 and $379,600 in cash utilized by working capital items, plus a utilization of $25,800 in net non-cash items. The cash used from changes in working capital items includes inventories and receivables of $197,600 and $348,700 respectively, and accrued expenses of $134,200.

Investing activities used $3,700 during the six months ended November 30, 2005, which consists primarily of the acquisition of computer equipment. Fully depreciated fixed assets were disposed of in the amount of $57,400 during the second quarter of fiscal 2006. This disposition had no affect on cash flows.

Financing activities provided $388,600 during the six months ended November 30, 2005. These activities consisted of $417,500 in advances from the factoring of accounts receivable and inventory and $28,900 of cash used for payments under capital leases.

Inflation

Management believes that inflation did not have a material effect on the operations, financial position or cash flows of the Company during the six months ended November 30, 2005.

Critical Accounting Policies

The Company’s significant accounting policies are more fully described in Note 2 to the financial statements in our 2005 Annual Report on Form 10-K, as amended. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions in certain circumstances that affect amounts reported in the accompanying financial statements and related notes. In preparing these financial statements, management has made its best estimates and judgments of certain amounts included in the financial statements, giving due consideration to materiality. The Company does not believe there is a great likelihood that materially different amounts would be reported related to the accounting policies described below; however, application of these accounting policies involves the exercise of judgment and the use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates.

Work in process inventory represents actual production costs, including manufacturing overhead incurred to date, reduced by amounts identified with revenue recognized on units delivered as well as reserves for amounts in excess of estimated net realizable value. The costs attributable to units delivered are based on the estimated average costs of all units, expected to be produced under multi-unit orders. Estimated costs to complete are based on historical experience and knowledge of building similar products. On an on-going basis, the Company evaluates the estimates of total costs to complete a multi-unit order. Work in process is reduced by charging any amounts in excess of estimated net realizable value to cost of sales as soon as they become known. Interim inventories are determined by application of estimated gross profit margins to sales.

The Company provides an allowance for uncollectible receivables based on experience with customers, and individual review of any past due accounts. Although it is reasonably possible that management’s estimate could change in the near future, management is not aware of any events that would result in a change to its estimate that would be material to the Company’s financial position or its results of operations. At November 30, 2005, the Company had an allowance for doubtful accounts of $20,000.

Item 3 - Quantitative and Qualitative Disclosures About Market Risk

Market Risk - The Company is exposed to market risk from changes in the defense budget, and other government spending changes, which are completely beyond the control of the Company.

Interest Rate Risks - The Company is exposed to risk from changes in interest rates as a result of its borrowing activities.

Item 4 -Controls and Procedures

The Company maintains disclosure controls and 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 Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to the Company’s management, including the Company’s Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

The Company conducted an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures that were in place at the end of the Company's second quarter of fiscal 2006. This evaluation was carried out under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer. Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures were not effective as of the end of the Company's second quarter of fiscal 2006 and that material weaknesses exist in the internal control structure of the Company, due in particular to the lack of appropriate resources dedicated to external financial reporting. Management of the Company is and has taken steps to address the weaknesses. Management is adding additional staff to the external reporting function and reengineering the reporting process to increase its efficiency and accuracy.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

Certain legal proceedings, in which we are involved, are discussed in Part I, Item 3 of our Annual Report on Form 10-K for the fiscal year ended May 31, 2005. As of the date hereof, the threatened legal action relating to a former employee alleging wrongful dismissal, was settled for an amount based on the employee's salary at the time of termination.

Item 3 - Defaults Upon Senior Securities

Information is incorporated by reference to “Item 2, Management’s Discussion and Analysis of Financial Condition and Results of Operations” under the heading “Liquidity and Capital Resources.”

Item 6 - Exhibits

31.1 Certification of the Chief Executive Officer of the Company pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2 Certification of the Chief Financial Officer of the Company pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1 Certification of the Chief Executive Officer of the Company pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2 Certification of the Chief Financial Officer of the Company pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

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

GENERAL KINETICS INCORPORATED

Date: January 17, 2006

By: /s/ Larry M. Heimendinger

Name: Larry M. Heimendinger, Chairman of the Board
Title: (Principal Executive Officer)

Date: January 17, 2006

By: /s/ Franco DeBlasio

Name: Franco DeBlasio, Chief Financial Officer
Title: (Principal Accounting Officer and Principal Financial Officer)