UNITED ENERGY CORP /NV/
Form 10KSB
June 29, 2006

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

FORM 10-KSB

(Mark one)

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

For the fiscal year ended March 31, 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: 000-30841

UNITED ENERGY CORP.
(Name of small business issuer in its charter)

Nevada	**22-3342379**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
600 Meadowlands Parkway, #20 Secaucus, New Jersey	**07094**
(Address of principal executive offices)	(Zip Code)

(201)-842-0288
(Issuer s telephone number, including area code)

Securities registered Under Section 12(b) of the Act

Title of each class	Name of each exchange on which registered
None	**None**

Securities registered Under Section 12(g) of the Act:

Title of each class	Name of each exchange on which registered

Common Stock, par value $.01 per share	Over-the-Counter (OTC) Bulletin Board

Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. Yes o No x

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 the filing requirements for the past 90 days. Yes x No o

Check if there is no disclosure of delinquent filers in response to item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of 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. o

Indicate by check mark whether the registrant is a shell company (as defined in rule 12b-2 of the Exchange Act. Yes o No x

The issuer s total consolidated revenues for the fiscal year ended March 31, 2006 were $492,235.

The aggregate market value of the common equity held by non-affiliates of the registrant was $36,000,414 as of June 23, 2006.

The number of shares outstanding of the registrant s common equity as of June 23, 2006 was 31,030,115 shares.

UNITED ENERGY CORP.

2006 FORM 10-KSB ANNUAL REPORT

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PART I

ITEM 1. DESCRIPTION OF BUSINESS

Overview

We develop and distribute environmentally friendly specialty chemical products with applications in several industries and markets. Our current line of products includes:

- KH-30 paraffin dispersant for the oil industry and related products;
- Uniproof specialty-coated proofing paper for the printing industry; and
- following additional testing, Slick Barrier underwater protective coatings for use in marine applications.

Through our wholly owned subsidiary, Green Globe Industries, Inc., we provide the U.S. military with a variety of solvents, paint strippers and cleaners under our trade name Qualchem. Green Globe is a qualified supplier for the U.S. military and has sales contracts currently in place with no minimum purchase requirements, which are renewable at the option of the U.S. Military.

We have developed and patented a system referred to as our S2 system, to work with our environmentally friendly paraffin dispersants products. This patented technology produces high volumes of steam and heat at variable pressures and temperatures to completely dissolve most deposits of paraffin and asphaltene within oil wells, pipelines or storage tanks. The S2 system apparatus is portable, compact and easy to use. We are further developing the process to enhance and support sales of KH-30 and its related products for the oil industry and for other potential applications.

A key component of our business strategy is to pursue collaborative joint working and marketing arrangements with established international oil and oil service companies. We intend to enter into these relationships to more rapidly and economically introduce our KH-30 product line to the worldwide marketplace for refinery, tank and pipeline cleaning services. We have recently entered into a non-exclusive distribution agreement with Champion Technologies Inc. and a non-exclusive Master Purchase Agreement with Petrobras America Inc. for the sale and distribution of our K-Line of patented specialty chemical solutions. The agreements do not provide for any minimum amounts to be purchased. We are also currently negotiating potential working arrangements with several other companies, however, there can be no assurance that any of these arrangements entered into or, if entered into, (as well as the agreements with Champion Technologies and Petrobras America Inc.) will be successful.

We provide specialty chemical and graphic arts products to our customers and generated revenues of $492,235 for the fiscal year ended March 31, 2006 and $1,850,954 for the fiscal year ended March 31, 2005.

Organizational History

We were originally incorporated in Nevada in 1971 as Aztec Silver Mining Co. We engaged in the manufacturing and distribution of printing equipment from 1995 through 1998. During that period, we began to develop specialty chemical products for use in the printing industry. In March 1998, we discontinued our printing equipment operations and changed our business focus to the development of specialty chemical products.

Business Operations and Principal Products

K-Product Line of Chemicals

KH-30 is a mixture of modified oils, dispersants and oil-based surfactants designed to control paraffin and asphaltene deposits in oil wells. When applied in accordance with our recommended procedures, KH-30 has resulted in substantial production increases in paraffin-affected oil and gas wells by allowing for a faster penetration of paraffin and asphaltene deposits. KH-30 disperses and suspends paraffin and asphaltene in a free-flowing state and prevents solids from sticking to each other or to oil well equipment. KH-30 is patented in the United States, Russia, Venezuela, Argentina, Canada, China, the European Union, Hong Kong, Malaysia and Mexico. We have ten additional country patent applications pending in most of the major oil-producing countries around the world.

Although we believe that the application of our K-Line of products on a continuous basis will result in higher production and lower lease operating costs in oil wells, the introduction of our K-Line of products into the oil and gas producing industry has been difficult. Many entrenched players such as the hot oilers and the major oil service companies who benefit from high mark-ups on their proprietary products have no incentive to promote the use of our K-Line of products. Moreover, oil production engineers are reluctant to risk damage to a well from a product that does not have the endorsement and backing of a major enterprise. Consequently, the pace of introduction of our K-line of products has been much slower than we initially anticipated. We believe that this situation has begun to change as a result of our marketing efforts with several oil service companies and well owners beginning to use our products after successful trials.

KX-91 is used for cleanup and stimulation of well bores. It works on all gravities of crudes. It penetrates and disperses faster than KH-30 and has a freeze point of 40F. KX-91 is good for tanks with buildup on the bottom and can be used on pipelines with paraffin and asphaltene blockages.

KDR-75 is effective in reducing friction pressure of petroleum crude and related oil products due to turbulent flow through pipelines and helps restore laminar flow. As a result, an increase in flow rate and productivity with reduced energy consumption can be achieved.

KX-100 is a product where contact time is limited for removal of a plug. It is fast acting and an effective dispersant that can be used in temperatures as low as 25F. It can be used in nearly any application.

KX-105DS-A Degreaser is a strong multi-functional, chemical cleaning compound designed to dissolve and remove tough heavy organic and sludge deposits. It possesses strong wetting, penetrating, dispersing and solvating properties. Hence, safe for use in oil field cleaning applications.

KX-104PDC is designed to reduce pour point, gel point, or cloud point of crude oil and improve its cold flow property and pumpability in oil field processing applications.

KX-404 EB is specifically formulated to destabilize both, oil-in-water and water-in-oil type emulsions when used in low treatment dosages of 50-100 PPM with minimal contact time. It triggers kinetically and thermodynamically unstable, weaker, transient emulsion phase into a sharp clean break down of oil and water phase. The application of steam heat up to 150-200F will activate and speed up demulsification.

Additional Product Line of Chemicals

Gunzilla BC-10 is a patent pending formula which was developed for the military as a safer and more effective bore and chamber cleaner. It can be used on everything from small handguns to 16 guns. Gunzilla BC-10 is currently being marketed and distributed by TopDuck Products LLC.

FR-15 is an environmentally friendly soil remediation agent.

AS-12 is an acidic cleaner in liquid form, which has been formulated to aid in the removal of Iron Sulfide and mild depositions of Calcium Carbonate from down-hole equipment surfaces and any other locations where a low pH may be advisable. Due to its very low pH, it is recommended that general safety precautions be observed while handling the concentrated material, wearing suitable facial and skin precautions.

CI-98 is formulated around an oil-soluble, water-dispersible filming amine designed for use in sour gas and producing oil wells. It is a liquid compound, which has been formulated to give a very tenacious film with an extended persistency without undesirable gunking on the down-hole tubulars.

SCI-97 Quaternary Surfacant is designed for use in down-hole cleanups in producing oil wells. It is a quaternary ammonium chloride compound which has been successfully used to clean the down-hole surfaces in producing wells, as well as in salt water disposal and injections systems, while at the same time water-wetting the solids to assist in removing these from the produced crude oil.

SI-18 Scale Inhibitor is a broad based spectrum, high-calcium tolerant, water soluble scale inhibitor which has been formulated to inhibit the formation and deposition of Calcium Carbonate scale in oil field brines. SI-15 will complex well with the calcium cations, impeding crystal growth and subsequent scale formation and deposition.

HI-17 is an aqueous solution of an alkyl amine along with other proprietary ingredients, which is used to prevent precipitation of sodium chloride crystals from high chloride brines. It may be applied over the wide range of temperatures and pressures, which are typically found in producing oil and gas wells with little to no impact on performance.

Uniproof Proofing Paper

We have developed a photo-sensitive coating that is applied to paper to produce what is known in the printing industry as proofing paper or blue line paper. We developed this formulation over several years of testing. The formulation is technically in the public domain as being within the scope of an expired patent of duPont. However, to the best of our knowledge, other companies have not duplicated the exact formulation utilized by us, and we protect it as a trade secret.

We introduced our proofing paper in June 1999. Sales of Uniproof proofing paper totaled $106,019 for the fiscal year ended March 31, 2006 and $546,096 for the fiscal year ended March 31, 2005. Revenues are expected to continue to decline due to the industry switching to a digital technology.

Slick Barrier

Slick Barrier is an underwater protective coating, which prevents the adherence of barnacles to boat hulls. The product is environmentally friendly and biodegradable, which we believe to be particularly appealing in fresh water marine applications.

Aqueous Coating

We have developed a patent pending aqueous coating with excellent oil, grease and water repellency for hot/cold food packaging such as cups, plates, cartons, wrappers and corrugated boxes which is biodegradable, decomposable, and recyclable.

Additional Technologies

We have a patent pending apparatus for introducing a vapor-containing stream into underground geological formations, pumps, conduits or tanks which represents an advance over previous techniques. The technique allows vapor-containing steam to bypass the well and be released to the atmosphere.

GreenGlobe Industries

In November 1998, we acquired all of the outstanding shares of Green Globe in exchange for 30,000 shares of our common stock. Green Globe is operated as a separate subsidiary and sells its products under the trade name Qualchem. We provide the U.S. military with a variety of solvents, paint strippers and cleaners under our trade name Qualchem. Green Globe is a qualified supplier for the U.S. military and has sales contracts currently in place with no minimum purchase requirements, which are renewable at the option of the U.S. Military.

Manufacturing and Sales

All of the raw materials necessary for the manufacture of our products are generally available from multiple sources. Although we have negotiated favorable arrangements with some of our current suppliers, (which include Pride Solvents and Chemical Co. of NJ Inc., Hy-Test Packaging Corp, Air Products and Chemicals and Arista Industries Inc), we would have to repeat the process if one or more of our current suppliers were no longer to be able to supply these raw materials to us. We do not own any special manufacturing facilities. Our chemical products are generally manufactured by contract blenders at a number of different locations. This method of manufacturing has reduced the need for us to invest in facilities and to hire the employees to staff them. Chemical blenders are relatively easy to replace and are bound by confidentiality agreements, where appropriate, which obligate them not to disclose or use our proprietary information.

We are not responsible for any environmental expenditure with respect to the manufacturing of our products. First, the chemical products that we use are generally environmentally friendly products in that they are low in toxicity and rank high in biodegradability. Further, any environmental issues involved in manufacturing are the responsibility of the blending facilities, provided they receive adequate and accurate information from us as to the components of the chemicals involved, however, there can be no assurance that we will not be liable as we are subject to various foreign, federal, state and local law and regulations relating to the protection of the environment.

Currently, the photosensitive coating for our Uniproof proofing paper is applied by an independent coater who is bound by a confidentiality agreement that obligates it not to disclose or use our confidential information. We believe this facility has the capacity to meet our production needs for the foreseeable future and also meets all environmental manufacturing regulations now or expected to be enacted. We believe that the services of this facility can be duplicated by others. We believe the need for a contract with the coater is obviated by the coater s clear economic benefit from continuing to provide services to us. We are more concerned about a precipitous event, such as damage to the coater s facility, which could result in an interruption of Uniproof production. We believe that alternate coating sources do exist and that the coater could be replaced, although with at least some interruption in production flow.

We currently sell our Uniproof proofing paper to one customer, The Alameda Company of Anaheim, California, which accounted for approximately 99% of our graphic arts sales and 21.5% of our total customer sales for the fiscal year ended March 31, 2006. In fiscal 2005, Alameda accounted for approximately 99% of our graphic arts sales and 29.5% of our total customer sales. Revenue from sales of our proofing paper is expected to continue to decline due to the paper technology switching to a digital technology. A decision by Alameda to discontinue its relationship with us could result in a significant loss of revenue to us.

In the fiscal year ended March 31, 2006, Howard Energy and Champion Technologies purchased our KH-30 and KX-100 oil cleaning products, which accounted for approximately 23.5% of our total customer sales. In the fiscal year ended March 31, 2005, PDVSA Services Inc. purchased our KH-30 and KX-91 oil well cleaning products, which accounted for approximately 39.4% of our total customer sales.

Except for these current and former customers, no other single entity has accounted for more than 10% of our sales during any of the fiscal years ended March 31, 2006 and 2005.

All of our products are sold in U.S. dollars and, therefore, we have had no foreign currency fluctuation risk.

Our current operations do not require a substantial investment in inventory other than minimum commitments to our distributors. However, we anticipate that any growth in our business will require us to maintain higher levels of inventory.

As of March 31, 2006, the Company s backlog included $123,722 of specialty chemical sales. Backlog represents products that the company s customers have committed to purchase. The Company s backlog is subject to fluctuations and is not necessarily indicative of future sales.

Marketing and Distribution

We have engaged the services of independent contractors to market our K-Product Line of chemicals. These contractors work under various non-exclusive commission and distribution agreements and have substantial contacts among oil well owners and major oil companies in the United States, Mexico, South America, Africa, Europe and the Middle East. These contractors earn a commission based upon the sales value of the products that they sell. These independent contractors use our marketing materials, brochures and website to interest clients and to describe the attributes of our products.

Although we have not achieved the volume of sales we had anticipated for the oil dispersant products, there have been significant barriers to entry in this market. Most of these potential customers require substantial testing of our product to prove its efficacy at cleaning wells, tanks and flow lines. In many cases, additional laboratory testing is required to prove that our chemical products are compatible with refinery systems and will not interfere with certain chemical processes and safety requirements of the potential clients. This process of testing has taken a great deal longer than was originally anticipated. We believe that we have made significant inroads and currently expect a higher volume of sales in the next fiscal year ending March 31, 2007, although there can be no assurance that sales will increase in fiscal 2007.

Research and Development

Our K-Product Line of chemical products for the oil industry and Uniproof proofing paper are developed and ready for market. Slick Barrier is in testing. All of these products are the result of research and development expenditures paid in the amounts of $193,032 and $212,613 for the fiscal years ended March 31, 2006 and 2005 respectively. We have had available the services of one research chemist and one analytical chemist, as well as one petroleum engineer, to lead in the development of our products. A significant amount of market adaptation has taken place in the field involving the development of application procedures for products. We do not anticipate having to make significant research and development expenditures on existing products in the future. However, we do expect to continue to develop new products to complement our existing product lines.

Competition

We compete directly or indirectly with other producers of specialty chemical products with similar uses, most of which are more established companies and have greater resources than we have. Generally, we attempt to compete by offering what we hope to be lower prices and better service. However, our KH-30, KX-91 and KH-30S products for the oil industry are often more expensive, and with these products we attempt to compete by emphasizing product effectiveness and environmental safety.

Proprietary Technologies

With respect to our formulations, which are proprietary, we have patented our KH-30 oil well cleaner in the United States, Russia, Venezuela, Argentina, Canada, China, the European Union, Hong Kong, Malaysia and Mexico. We have ten additional country patent applications pending in most of the major oil-producing countries around the world.

We believe our patent is strong and will help our competitive position. However, we are aware that others may try to imitate our product or invalidate our patents. We have in the past vigorously enforced our trade secrets such as the one relating to our Uniproof proofing paper, and intend to continue to do so in the future. However, we recognize that intellectual property rights provide less than complete protection. We believe that no other company is currently producing a product similar to KH-30.

In addition to applying for patent protection on our KH-30 product, we have also registered KH-30 as a trademark. Trademark protection has also been obtained for the Uniproof name for our proofing paper. We anticipate applying for both patent and trademark protection for our other products in those jurisdictions where we deem such protection to be beneficial.

Employees

As of March 31, 2006, we employed eleven people on a full-time basis and had available the services of six other individuals under consulting or product/production cooperation arrangements. The latter arrangement is meant to include a situation where a chemist, engineer or significant marketing person is engaged by an organization under contract with us to manufacture or market one or more of our products.

None of our employees are represented by a union. We consider our relations with our employees to be good.

Available Information

We file annual, quarterly and current reports, information statements and other information with the Securities and Exchange Commission (the SEC). The public may read and copy any materials we file with the SEC at the SEC s Public Reference Room at Station Place, 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The address of that site is http://www.sec.gov.

ITEM 2. DESCRIPTION OF PROPERTY

We lease 9,600 square feet of office space at 600 Meadowlands Parkway, #20, Secaucus, New Jersey 07094. Under the terms of the lease, which runs through June 2007, the monthly rent was $8,635 through June 2004, which then increased to $9,600 for the remainder of the lease. In addition, we leased office space of approximately 1,350 square feet in Midland, Texas as a regional sales office at a rate of $759 per month. This lease ran through September 2005 and has not been renewed.

We use independent non-affiliated contract chemical blending and manufacturing facilities in various locations around the United States for the manufacture of our products. We contract the production of our products to independent manufacturers and blenders and our products are therefore produced at the manufacturing facilities of those entities. We do not own any manufacturing facilities.

ITEM 3. LEGAL PROCEEDINGS

In July 2002, an action was commenced against us in the Court of Common Pleas of South Carolina, Pickens County, brought by Quantum International Technology, LLC and Richard J. Barrett. Plaintiffs allege that they were retained as a sales representative of ours and in that capacity made sales of our products to the United States government and to commercial entities. Plaintiffs further allege that we failed to pay to plaintiffs agreed commissions at the rate of 20% of gross sales of our products made by plaintiffs. The complaint seeks an accounting, compensatory damages in the amount of all unpaid commissions plus interest thereon, punitive damages in an amount treble the compensatory damages, plus legal fees and costs. Plaintiffs maintain that they are entitled to receive an aggregate of approximately $350,000 in compensatory and punitive damages, interest and costs. In June 2003, the action was transferred from the court in Pickens County to a Master in Equity sitting in Greenville, South Carolina and was removed from the trial docket. The action, if tried, will be tried without a jury. No trial date has yet been scheduled. We believe we have meritorious defenses to the claims asserted in the action and intend to vigorously defend the case. The outcome of this matter cannot be determined at this time.

No other legal proceedings are currently pending or threatened against us.

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

No matters were submitted to a vote of security holders during the fourth quarter of our fiscal year ended March 31, 2006.

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

As of June 23, 2006, there were approximately 467 record holders of our common stock and there were 31,030,115 shares of our common stock outstanding. We have not previously declared or paid any dividends on our common stock and do not anticipate declaring any dividends in the foreseeable future.

The following table shows the high and low bid prices of our common stock as quoted on the OTC Bulletin Board by quarter during each of our last two fiscal years ended March 31, 2006 and 2005 and for each quarter after March 31, 2006. These quotes reflect inter-dealer prices, without retail markup, markdown or commissions and may not represent actual transactions. The information below was obtained from those organizations, for the respective periods.

Fiscal Year ended March 31	Quarter	High	Low
2005	First Quarter (April-June 2004)	$ 1.08	$ .52
	Second Quarter (July-September 2004)	1.43	.86
	Third Quarter (October-December 2004)	1.25	.50
	Fourth Quarter (January-March 2005)	1.40	.46
2006	First Quarter (April-June 2005)	$ 1.81	$ 1.06
	Second Quarter (July-September 2005)	2.85	1.33
	Third Quarter (October-December 2005)	2.70	1.47
	Fourth Quarter (January-March 2006)	2.20	1.41
2007	First Quarter (through June 23)	$ 2.08	$ 1.32

The high and low bid prices for shares of our common stock on June 23, 2006 were $1.54 and $1.40 per share, respectively, based upon bids that represent prices quoted by broker-dealers on the OTC Bulletin Board. These quotations reflect inter-dealer prices, without retail mark-up, mark-down or commissions, and may not represent actual transactions.

Dividend Policy

While there are no restrictions on the payment of dividends, we have not declared or paid any cash or other dividends on shares of our common stock in the last two years, and we presently have no intention of paying any cash dividends in the foreseeable future. Our current policy is to retain earnings, if any, to finance the expansion of our business. The future payment of dividends will depend on the results of operations, financial condition, capital expenditure plans and other factors that we deem relevant and will be at the sole discretion of our board of directors.

Equity Compensation Plan Information

The following table provides information regarding the status of our existing equity compensation plans at March 31, 2006.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding option, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in the second column)
	(a)	(b)	(c)
Equity compensation plans approved by security holders	3,185,000	$ 1.11	265,000
Equity compensation plans not approved by security holders	5,125,000	$ 1.68	
Total	8,310,000		265,000

Recent Sales of Unregistered Securities

On January 26, 2006, we entered into the First Amendment to Securities Purchase Agreement dated March 18, 2005. Pursuant to the amendment, the investors agreed to purchase the remaining Series A Units or 1,100,000 shares of our common stock and Series A Warrants to purchase 550,000 shares of our common stock for $580,000. The common stock and warrants underlying such Series A Units issued by us were not registered under the Securities Act of 1933 in reliance upon the exemption from registration provided by Section 4(2) of that Act and Regulation D promulgated under that Act.

On March 9, 2006, we entered into the Second Amendment to Securities Purchase Agreement with the investors. Pursuant to the second amendment, one of the investors agreed to purchase three-tenths of one Series B unit, consisting of 3 shares of preferred stock and warrants to purchase 12,000 shares of our common stock (the Series B Warrant), for an aggregate purchase price of $24,000. In addition, the investors agreed to waive all existing defaults under the purchase agreement, including our failure to timely file a Certificate of Designations for the preferred stock and to timely issue common stock certificates and warrants. The preferred stock and warrants were not registered under the Securities Act of 1933 in reliance upon the exemption from registration provided by Section 4(2) of that Act and Regulation D promulgated under that Act.

We and the investors also agreed to terminate all further obligations of the investors to purchase and our obligation to sell any remaining Series B units. The remaining Series B units would have consisted of 417 shares of preferred stock convertible into an aggregate of 3,336,000 shares of common stock at a conversion price of $1.00 and of warrants to purchase 1,668,000 shares of common stock at an exercise price of $1.00 per share. Instead thereof, we agreed to issue to one of the investors warrants to purchase 5,004,000 shares of our common stock at an exercise price of $1.00 (the Series C Warrant). These warrants have been valued at $6,810,444 and shown as Non-cash equity financing costs in the Consolidated Statements of Operations. The Series C Warrant, as well as the preferred stock and the Series B Warrant, are subject to anti-dilution provisions in the event that we issue shares of common stock at a price less than the conversion price or the exercise price and contain provisions limiting the holders right to convert or exercise if doing so would cause such holder and its affiliates to beneficially own more than 9.99% of the outstanding common stock. The Series C Warrants were not registered under the Securities Act of 1933 in reliance upon the exemption from registration provided by Section 4(2) of that Act and Regulation D promulgated under that Act.

March 2006 Private Placement

On March 24, 2006, we entered into Securities Purchase Agreement with the purchasers named therein (the Purchasers) and a First Amendment to Securities Purchase Agreement and Registration Rights Agreement pursuant to which we raised $5,100,000 in gross cash proceeds from the sale to the Purchasers of 4,250,000 shares of common stock at a price of $1.20 per share. The common stock was not registered under the Securities Act of 1933 in reliance upon the exemption from registration provided by Section 4(2) of that Act and Regulation D promulgated under that Act.

ITEM 6. MANAGEMENT S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

You should read the following description of our financial condition and results of operations in conjunction with the financial statements and accompanying notes included in this Annual Report beginning on page F-1.

Overview

We develop and distribute environmentally friendly specialty chemical products with applications in several industries and markets. Our current line of products includes:

- KH-30 paraffin dispersant for the oil industry and related products;
- Uniproof specialty-coated proofing paper for the printing industry; and
- following additional testing, Slick Barrier underwater protective coatings for use in marine applications.

Through our wholly owned subsidiary, Green Globe Industries, Inc., we provide the U.S. military with a variety of solvents, paint strippers and cleaners under our trade name Qualchem. Green Globe is a qualified supplier for the U.S. military and has sales contracts currently in place with no minimum purchase requirements which are renewable at the option of the U.S. Military.

We have developed and patented a system referred to as our S2 system, to work with our environmentally friendly paraffin dispersants products. This patented technology produces high volumes of steam and heat at variable pressures and temperatures to completely dissolve most deposits of paraffin and asphaltene within oil wells, pipelines or storage tanks. The S2 system apparatus is portable, compact and easy to use. We are further developing the process to enhance and support sales of KH-30 and its related products for the oil industry and for other potential applications.

A key component of our business strategy is to pursue collaborative joint working and marketing arrangements with established international oil and oil service companies. We intend to enter into these relationships to more rapidly and economically introduce our KH-30 product line to the worldwide marketplace for refinery, tank and pipeline cleaning services. We have recently entered into a non-exclusive distribution agreement with Champion Technologies Inc. and a non-exclusive Master Purchase Agreement with Petrobras America Inc. for the sale and distribution of our K-Line of patented specialty chemical solutions. The agreements do not provide for any minimum amounts to be purchased. We are also currently negotiating potential working arrangements with several other companies however, there can be no assurance that any of these arrangements entered into or, if entered into, (as well as the agreements with Champion Technologies and Petrobras America Inc.) will be successful.

We provide specialty chemical and graphic arts products to our customers and generated revenues of $492,235 for the fiscal year ended March 31, 2006 and $1,850,954 for the fiscal year ended March 31, 2005.

Recent Developments

On March 9, 2006, pursuant to a Second Amendment to Securities Purchase Agreement with certain investors one of the investors agreed to purchase three-tenths of one Series B unit, consisting of 3 shares of Preferred Stock and warrants to purchase 12,000 shares of our common stock, for an aggregate purchase price of $24,000. We and the investors also agreed to terminate all further obligations of the investors to purchase and our obligation to sell any remaining Series B units. The remaining Series B units would have consisted of 417 shares of Series A Convertible Preferred Stock convertible into an aggregate of 3,336,000 shares of common stock at a conversion price of $1.00 and of warrants to purchase 1,668,000 shares of common stock at an exercise price of $1.00 per share. Instead thereof, we agreed to issue to one of the investors warrants to purchase 5,004,000 shares of our common stock at an exercise price of $1.00.

On March 24, 2006, we raised $5,100,000 in gross cash proceeds from the sale to the purchasers in a private placement of 4,250,000 shares of our common stock at a price of $1.20 per share.

Critical Accounting Policies and Estimates

The preparation of consolidated financial statements in accordance with accounting principles generally accepted in the United States of America requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities.

On an ongoing basis, we evaluate our estimates, including those related to product returns, bad debts, inventories, valuation of options and warrants, intangible assets, long-lived assets and contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Revenue Recognition

Our primary source of revenue is from sales of our products. We recognize revenue upon shipment and transfer of title.

Allowance for Doubtful Accounts

We monitor our accounts and note receivable balances on a monthly basis to ensure they are collectible. On a quarterly basis, we use our historical experience to determine our accounts receivable reserve. Our allowance for doubtful accounts is an estimate based on specifically identified accounts, as well as general reserves. We evaluate specific accounts where we have information that the customer may have an inability to meet its financial obligations. In these cases, management uses its judgment, based upon the best available facts and circumstances, and records a specific reserve for that customer against amounts due to reduce the receivable to the amount that is expected to be collected. These specific reserves are re-evaluated and adjusted as additional information is received that impacts the amount reserved. We also establish a general reserve for all customers based upon a range of percentages applied to aging categories. These percentages are based on historical collection and write-off experience. If circumstances change, our estimate of the recoverability of amounts due to us could be reduced or increased by a significant amount. A change in estimated recoverability would be accounted for in the period in which the facts that give rise to the change become known.

Results of Operations

Comparison of Fiscal Year Ended March 31, 2006 to Fiscal Year Ended March 31, 2005

Sales. Sales decreased to $492,235 for the year ended March 31, 2006 from $1,850,954 for the year ended March 31, 2005. The $1,358,719 or 73%, decrease in sales was due to lower levels of Specialty Chemicals and Uniproof proofing paper. Sales for our specialty chemical products including KH-30 and KX-91, and our Green Globe / Qualchem product line decreased by 70%. The decrease was primarily related to a 76% decrease in sales of our KH-30 family of oil field dispersant products reflecting a lower level of orders. This was partially offset by a 105% increase in the level of U.S. Military sales during the year. Our three largest customers accounted for 45% of revenues for the year ended March 31, 2006 compared with 72% for the comparable period in 2005. Uniproof proofing paper sales decreased by 81% due to lower level of orders from our primary customer. We expect sales of proofing paper to continue to decrease in the future due to the paper industry switching to a digital technology.

Cost of Goods Sold. Cost of goods sold decreased to $301,642 or 61% of sales, for the year ended March 31, 2006 from $759,064, or 41% of sales, for the year ended March 31, 2005. The decrease in cost of goods sold was due to the decreased sales of KH-30 products compared to the prior year and a decrease in the volume of Uniproof proofing paper sales compared to the prior fiscal year. The increase in cost of goods sold as a percentage of sales is due to an increase in the level of U.S. Military sales during the year at a much lower gross profit percentage.

Gross Profit. Gross profit decreased to $190,593 or 39% of sales, for the year ended March 31, 2006 from $1,091,890, or 59% of sales, for the year ended March 31, 2005. Gross profit for our specialty chemical products including KH-30 and KX-91, decreased to $126,595 or 42% of specialty chemical sales, for the year ended March 31, 2006 from $846,846 or 69% of specialty chemical sales, for the year ended March 31, 2005. The decrease in gross profit was due to a decrease in sales of our KH-30 family of oil field dispersant products reflecting a lower level of orders. Gross profit for Uniproof proofing paper sales decreased to $44,961 or 42% of sales, for the year ended March 31, 2006 from $238,146, or 43% of sales, for the year ended March 31, 2005. The decrease was due to a lower level of orders from our primary customer, because the use of proofing paper is slowly being phased out due to the paper industry switching to a digital technology.

Selling, General and Administrative Expenses. General and administrative expenses increased to $3,584,653 or 728% of sales, for the year ended March 31, 2006 from $2,581,033, or 139% of sales, for the year ended March 31, 2005. The increase in selling, general and administrative expenses are primarily related to an increase in salaries due to the exercise of options, the recording of stock-based compensation costs, benefits and bad debts partially offset by a decrease in travel and entertainment expenses.

Non-cash equity financing costs. On March 9, 2006, the Company entered into the Second Amendment to Securities Purchase Agreement with the investors. In an exchange to terminate all further obligations of the investors to purchase and our obligation to sell any remaining Series B Units, the Company issued warrants to purchase 5,004,000 shares of our common stock at an exercise price of $1.00 valued at $6,810,444.

Impairment loss. During the year ended March 31, 2006, we tested our goodwill by estimating its fair value using a discounted cash flow analysis. As a result of the impairment tests, the Company did not record a goodwill impairment charge during the fiscal year ended March 31, 2006, related to the Green Globe segment. During the year ended March 31, 2005, we recorded a $2,010 impairment charge related to the Green Globe segment.

Depreciation, Amortization and Depletion. Depreciation, amortization and depletion decreased to $70,061 for the year ended March 31, 2006 from $84,401 for the year ended March 31, 2005 reflecting the Company s use of an accelerated method of depreciation, offset by a slight increase in fixed assets.

Interest Expense. Interest expense increased to $577,589 for the year ended March 31, 2006 compared with $287,118 for the year ended March 31, 2005. The increase was due to the additional warrants issued to the holder of the convertible term note issued February 2005 and satisfied in August 2005.

Net Loss. For the year ended March 31, 2006, we incurred a net loss of $10,836,644, or $0.43 per share, as compared to a net loss of $1,854,876 for the year ended March 31, 2005, or $0.08 per share. The average number of shares of common stock used in calculating earnings per share increased to 25,330,737 from 22,377,184 shares.

Liquidity and Capital Resources

Since 1995, operations have been financed primarily through loans, equity contributions from directors and executive officers and from third parties supplemented by funds generated by our business. As of March 31, 2006, we had $5,194,748 in cash and cash equivalents.

Net Cash Used in Operating Activities. During the fiscal year ended March 31, 2006, net cash used in operating activities was $1,520,032 compared with $1,887,981 for the fiscal year ended March 31, 2005.

Net Cash Used in Investing Activities. During the fiscal year ended March 31, 2006, net cash used in investing activities increased to $108,407 compared with $24,701 for the year ended March 31, 2005. The increase was primarily a result of an increased level of expenditures for the purchase of fixed assets to support operations and capitalized legal fees required to file patent applications for our KH-30, KX-91 and S2 system.

Net Cash Provided by Financing Activities. During the fiscal year ended March 31, 2006, net cash generated from financing activities increased to $6,457,577 resulting from $6,060,000 of proceeds from the issuance of common stock, proceeds from related parties of $200,000, proceeds from the issuance of preferred stock of $24,000, proceeds from the exercise of stock options of $345,000, the receipt of stock subscription receivable of $13,333, which was partially offset by the payment of related party payable of $133,600 and the payment of private placement costs of $51,156. This compares to cash provided by financing activities of $760,267 for the year ended March 31, 2005 resulting from the proceeds from our private placements on March 18, 2005 in the amount of $626,667 and proceeds from related party payable of $133,600.

On March 18, 2005, we entered into a securities purchase agreement with two private investors with the respect to the sale of shares of our common stock and warrants. The agreement provides for two types of units, designated as Series A and Series B.

The Series A Units each consist of 100,000 shares of our common stock and a Series A Warrant to purchase 50,000 shares of our common stock at $1.00 per share, subject to adjustment. The Series A Warrants expire five (5) years from the date they are issued. The purchase price for each Series A Unit is $80,000. The securities purchase agreement provides for the sale of up to twenty (20) Series A Units.

On March 18, 2005, the contract date, the company issued 8 Series A Units or 800,000 shares of its common stock for a purchase price of $640,000. In connection with the issuance of such Series A Units, 37,500 shares of Common Stock were issued to investor s counsel as reimbursement for their expenses.

The Series B Units each consist of ten (10) shares of a new class of preferred stock that will be converted into 80,000 shares of our common stock in the aggregate, subject to adjustment, and Series B Warrant to purchase 40,000 shares of our stock at $1.50 per share. The Series B Warrants expire five (5) years from the date they are issued. The purchase price for each Series B Unit is $80,000. The securities purchase agreement provides for the sale of up to forty-two (42) Series B Units.

On August 25, 2005, we entered into an Amendment and Waiver Agreement with the investors providing, among other things, that the investors would waive certain defaults under the securities purchase agreement in exchange for a reduction in the price of the shares issuable upon exercise of the Series B Warrants from $1.50 to $1.00 per share.

During the year ended March 31, 2006, the Company issued the remaining 12 Series A Units or 1,200,000 shares of its common stock for a purchase price of $960,000 as per the securities agreement dated March 18, 2005.

On January 26, 2006, the Company entered into the First Amendment to the securities purchase agreement dated March 18, 2005. The agreement was scheduled to expire on its first anniversary, March 18, 2006. The amendment changes that date to the earlier of March 18, 2008 or thirty (30) days after notice of termination from the holder of a majority of the shares issued under the agreement. For the period beginning on the date of the amendment through June 30, 2007, the consent of the majority holder is required for the Company to do any of the following:

(i) contract for equity financing or debt financing with an equity component or issue any equity securities or securities convertible to equity;

(ii) incur indebtedness in excess of $250,000 other than trade debt in the ordinary course of business;

(iii) merge or consolidate or sell, transfer or license our assets outside of the ordinary course of business;

(iv) enter into an operating or capital lease in a transaction or series of transactions with annual payments in excess of $250,000;

(v) make capital expenditures in excess of $125,000 per fiscal year;

(vi) grant exclusive distribution rights with respect to any of our products; or

(vii) permit any of our officers to sign or endorse any check, note, draft or other form of indebtedness in excess of $5,000 without the prior written authority of our Chairman.

We also agreed that from the date of the amendment through March 18, 2009 we will not negotiate or contract for a future offering without first providing to the investors a ten-day right of first refusal to participate in the future offering. To the extent the investors choose not to participate, we will then have 60 days to complete the future offering without re-offering the investors the right to participate.

During the period from the date of the amendment through March 18, 2008, the majority holder has the right to designate someone to receive notices of our Board of Directors meetings and attend as an observer.

For so long as the investors hold 1,500,000 shares of common stock equivalents (meaning shares of common stock and other securities convertible to or exercisable for common stock), the majority holder shall have the right to designate a majority of the members of our Board of Directors in the event of any of the following, referred to as triggering events:

(i) if we fail to have gross revenue of at least $5,000,000 for the six months ending September 30, 2006;

(ii) if we breach any of our representations, warranties, agreements, covenants, terms or obligations under the securities purchase agreement or ancillary agreements; or

(iii) if the investors purchase an aggregate of twenty one or more Series B Units

On March 9, 2006, we entered into the Second Amendment to Securities Purchase Agreement dated March 18, 2005. Pursuant to the second amendment, one of the investors agreed to purchase three-tenths of one Series B Unit, consisting of 3 shares of preferred stock and Series B Warrants to purchase 12,000 shares of our common stock, for an aggregate purchase price of $24,000. In addition, the investors agreed to waive all existing defaults under the purchase agreement, including our failure to timely file a Certificate of Designations for the Preferred Stock and to timely issue common stock certificates and warrants.

We and the investors also agreed to terminate all further obligations of the investors to purchase and our obligation to sell any remaining Series B Units. The remaining Series B Units would have consisted of 417 shares of preferred stock convertible into an aggregate of 3,336,000 shares of common stock at a conversion price of $1.00 and of warrants to purchase 1,668,000 shares of common stock at an exercise price of $1.00 per share. Instead thereof, we agreed to issue to one of the investors Series C Warrants to purchase 5,004,000 shares of our common stock at an exercise price of $1.00. The Series C Warrant, as well as the preferred stock and the Series B Warrant, are subject to anti-dilution provisions in the event that we issue shares of common stock at a price less than the conversion price or the exercise price and contain provisions limiting the holders right to convert or exercise if doing so would cause such holder and its affiliates to beneficially own more than 9.99% of the outstanding common stock.

For so long as the investors hold 1,500,000 shares of common stock equivalents (meaning shares of common stock and other securities convertible to or exercisable for common stock), the majority holder shall have the right to designate a majority of the members of our Board of Directors in the event of any of the following, referred to as triggering events:

(i) if we fail to have gross revenue of at least $5,000,000 for the six months ending September 30, 2006; or

(ii) if we breach any of our representations, warranties, agreements, covenants, terms or obligations under the securities purchase agreement or ancillary agreements.

On March 24, 2006, we entered into Securities Purchase Agreements with the purchasers named therein and a First Amendment to Securities Purchase Agreement and Registration Rights Agreement pursuant to which the we raised $5,100,000 in gross cash proceeds from the sale to the purchasers in a private placement of 4,250,000 shares of our common stock at a price of $1.20 per share.

The Company currently anticipates that its available cash in hand and cash resources from expected revenues will be sufficient to meet its anticipated working capital and capital expenditure requirements for at least the next twelve months.

Our continued existence is dependent upon several factors, including increased sales volumes, collection of existing receivables and the ability to achieve profitability from the sale of our product lines. In order to increase our cash flow, we are continuing our efforts to stimulate sales and cut back expenses not directly supporting our sales and marketing efforts.

Concentration of Credit Risk

We currently sell our Uniproof proofing paper to one customer, The Alameda Company of Anaheim, California, which accounted for approximately 99% of our graphic arts sales and 21.5% of our total customer sales for the fiscal year ended March 31, 2006. In fiscal 2005, Alameda accounted for approximately 99% of our graphic arts sales and 29.5% of our total customer sales. Revenue from sales of our proofing paper is expected to continue to decline due to the paper technology switching to a digital technology. A decision by Alameda to discontinue its relationship with us could result in a significant loss of revenue to us.

Contractual Obligations

Below is a table which presents our contractual obligations commitments at March 31, 2006:

Contractual Obligation	Total	Less than 1 Year	1-3 Years	3-5 Years	After 5 Years
Short-term debt Obligations(1)	$ 444,141	$ 444,141	$	$	$
Operating leases	548,341	129,592	261,715	157,034	
Total contractual cash obligations	$ 992,482	$ 573,733	$ 261,715	$ 157,034	$

(1) Short-term debt obligations include an amount due to Robert Seaman, a shareholder and former director of the Company. The amount due as of March 31, 2006 and 2005 is $244,141. This amount is unsecured, non-interest bearing and due upon demand. The Chairman of the Board and Secretary, Ron Wilen and the President and Chief Executive Officer, Brian King, each loaned the Company $100,000. The loans were both unsecured, non-interest bearing and due upon demand. Each of these loans were repaid in full in April, 2006.

Reporting by Segments

We are primarily a specialty chemicals company because of our determination in fiscal 1998 to close our printing equipment division and focus on our KH-30 oil well cleaner and related products. However, a significant portion of our revenues has been related to the printing and the graphic arts industry. We believe that in the future our chemical sales will increase and that our reliance on the graphic arts segment of the company will decrease. During the past two fiscal years, we have derived additional revenues by acting as a graphic arts products distributor.

We do devote almost all of our time and effort into selling, promoting and developing our chemical products and we are continuing to increase our marketing efforts to develop new products as extensions of our original KH-30 product. We do believe that in the future our sales will increase. We also believe that our reliance on the graphic arts segment of the company will decrease.

The following table shows the proportion of total revenues by segment in each of the last two fiscal years:

Fiscal Year	Graphic Arts	Specialty Chemicals
2005	$ 549,462	$ 1,301,492
2006	$ 106,861	$ 385,374

Off-Balance Sheet Arrangements

We do not currently have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to our stockholders.

Inflation

We do not believe that inflation in the cost of our raw materials has had in the past or will have in the future any significant negative impact on our operations. However, no assurance can be given that we will be able to offset such inflationary cost increases in the future.

Recently Issued Accounting Standards

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (Revised 2004), Share-Based Payment (SFAS No. 123(R)). This revised accounting standard eliminates the ability to account for share-based compensation transactions using the intrinsic value method in accordance with APB Opinion No. 25 and requires instead that such transactions be accounted for using a fair-value-based method. SFAS No. 123(R) requires public entities to record noncash compensation expense related to payment for employee services by an equity award, such as stock options, in their financial statements over the requisite service period. SFAS No. 123(R) is effective as of the beginning of the first interim or annual period that begins after December 15, 2005 for small business issuers. On January 1, 2006, we adopted SFAS No. 123(R). We have historically through the nine months ended December 31, 2005, provided pro forma disclosures pursuant to SFAS No. 123 and SFAS No. 148 as if the fair value method of accounting for stock options had been applied, assuming use of the Black-Scholes option-pricing model. With the adoption of SFAS No. 123(R), we have recorded $428,798, as stock-based compensation cost, which has had a negative impact on our consolidated statement of operations.

Quantitative and Qualitative disclosures About Market Risk

The market risk inherent in our market risk sensitive instruments and positions are the potential losses arising from adverse changes in interest rate and foreign currency exchange rates.

Foreign Currency Exchange Rates

Although our business is international in scope, to date our product sales have been all U.S. dollar-denominated. As we expand, we may be affected by exchange rate fluctuations in foreign currencies relative to the U.S. dollar. We do not currently use derivative financial instruments to hedge our exposure to changes in foreign currency exchange rates

SPECIAL NOTE ON FORWARD-LOOKING STATEMENTS

This Annual Report contains forward-looking statements. These forward-looking statements are based largely on our expectations and are subject to a number of risks and uncertainties, many of which are beyond our control. Actual results could differ materially from these forward-looking statements as a result of, among other factors, risks related to the large amount of our outstanding term loan; history of net losses and accumulated deficits; reliance on third parties to market, sell and distribute our products; future capital requirements; competition and technical advances; dependence on the oil services market for pipe and well cleaners; ability to protect our patents and proprietary rights; reliance on a small number of customers for a significant percentage of our revenues; and other risks. In light of these risks and uncertainties, there can be no assurance that the forward-looking information contained in this Annual Report will in fact occur.

RISK FACTORS

An investment in our common stock involves a high degree of risk. You should carefully consider the following material risks, before you decide to buy our common stock. If any of the following risks actually occur, our business, results of operations and financial condition would likely suffer. In these circumstances, the market price of our common stock could decline and you may lose all or part of your investment.

WE HAD A CURRENT ACCUMULATED DEFICIT OF APPROXIMATELY $23,234,612 AS OF MARCH 31, 2006 AND IF WE CONTINUE TO INCUR OPERATING LOSSES, WE MAY BE UNABLE TO SUPPORT OUR BUSINESS PLAN, WHICH WILL HAVE A DETRIMENTAL EFFECT ON OUR STOCK.

We have incurred losses in each of our last three fiscal years. As of March 31, 2006, we had an accumulated deficit of $23,234,612. If we continue to incur operating losses and fail to become a profitable company, we may be unable to support our business plan, namely to market our KH-30 oil and gas well cleaning products. We incurred net losses of $10,836,649 and $1,854,876 in the fiscal years ended March 31, 2006 and 2005, respectively. Our future profitability depends in large part on our ability to market and support our KH-30 oil and gas well cleaners. We cannot assure you that we will achieve or sustain significant sales or profitability in the future. This would have a detrimental effect on the long-term capital appreciation of our stock.

THERE ARE SIGNIFICANT OBSTACLES TO ENTERING THE O