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AQUACELL TECHNOLOGIES INC
Form 10QSB
November 15, 2004

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-QSB

(Mark one)

Quarterly report under Section 13 or 15(d) of
the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2004.

Transition report under Section 13 or 15(d) of the Exchange Act
For the transition period from _____ to _____

Commission File Number 1-16165

AQUACELL TECHNOLOGIES, INC.

(Exact Name of Small Business Issuers as Specified in its Charter)

Delaware

33-0750453

(State of Incorporation)

(IRS Employer Identification Number)

10410 Trademark Street
Rancho Cucamonga, CA 91730

(Address of Principal Executive Offices)

(909) 987-0456

(Issuer's Telephone Number, Including Area Code)

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY
PROCEEDING DURING THE PRECEDING FIVE YEARS

Check whether the registrant filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Exchange Act after the distribution of Securities under a plan confirmed by a court. Yes [] No []

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date:

Common Stock, \$.001 par value
15,764,137 shares outstanding as of November 12, 2004.

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Transitional Small Business Disclosure Format (check one): Yes [] No [X]

AQUACELL TECHNOLOGIES, INC.

FORM 10-QSB

FOR THE QUARTER ENDED SEPTEMBER 30, 2004

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

AQUACELL TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEET
September 30, 2004
(Unaudited)

ASSETS

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| | |
|--|--------------|
| Current assets: | |
| Cash..... | \$ 203,000 |
| Subscription receivable..... | 44,000 |
| Accounts receivable, net of allowance of \$42,000..... | 51,000 |
| Inventories..... | 79,000 |
| Prepaid expenses and other current assets..... | 46,000 |
| | ----- |
| Total current assets..... | 423,000 |
| | ----- |
| Property, equipment and billboard coolers, net..... | 877,000 |
| | ----- |
| Other assets: | |
| Goodwill..... | 824,000 |
| Patents, net..... | 75,000 |
| Security deposits..... | 16,000 |
| | ----- |
| Total other assets..... | 915,000 |
| | ----- |
| | \$ 2,215,000 |
| | ===== |
| LIABILITIES | |
| Current liabilities: | |
| Accounts payable..... | \$ 444,000 |
| Accrued expenses..... | 665,000 |
| Preferred stock dividend payable..... | 17,000 |
| Customer deposits..... | 20,000 |
| Installment note payable..... | 2,000 |
| Current portion of deferred payable..... | 13,000 |
| | ----- |
| Total current liabilities..... | 1,161,000 |
| Deferred payable, net of current portion..... | 460,000 |
| | ----- |
| Total liabilities..... | 1,621,000 |
| | ----- |
| Commitments and contingencies | |
| STOCKHOLDERS' EQUITY: | |
| Preferred stock - Class A, par value \$.001; | |
| 1,870,000 shares authorized; | |
| 675,000 shares issued and outstanding..... | 1,000 |
| Preferred stock, par value \$.001; | |
| 8,130,000 shares authorized; | |
| no shares issued..... | - |
| Common stock, par value \$.001; | |
| 40,000,000 shares authorized; | |
| 15,048,769 shares issued and outstanding..... | 15,000 |
| Additional paid-in capital..... | 20,918,000 |
| Accumulated deficit..... | (18,429,000) |
| | ----- |
| | 2,505,000 |
| Subscription receivable..... | (5,000) |
| Unamortized deferred compensation..... | (1,906,000) |
| | ----- |
| Total stockholders' equity..... | 594,000 |
| | ----- |
| | \$ 2,215,000 |
| | ===== |

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See notes to condensed consolidated financial statements.

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AQUACELL TECHNOLOGIES, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

| | Three Months Ended September 30, | |
|--|-------------------------------------|----------------|
| | 2004 | 2003 |
| Revenue: | | |
| Net sales..... | \$ 199,000 | \$ 201,000 |
| Costs and expenses: | | |
| Cost of sales..... | 124,000 | 129,000 |
| Salaries and wages..... | 288,000 | 299,000 |
| Legal, accounting and other professional expenses..... | 52,000 | 65,000 |
| Consulting fees and expenses- marketing research and development..... | 24,000 | - |
| Fair value adjustment of derivative..... | - | 207,000 |
| Stock based compensation..... | 242,000 | 375,000 |
| Other..... | 337,000 | 255,000 |
| | 1,067,000 | 1,330,000 |
| Loss from operations before other income (expense):..... | (868,000) | (1,129,000) |
| Other income (expense): | | |
| Interest income..... | - | 1,000 |
| Interest (expense)..... | - | - |
| | - | 1,000 |
| Net loss for the period..... | \$ (868,000) | \$ (1,128,000) |
| Weighted average share outstanding- basic and diluted..... | 14,576,000 | 9,349,000 |
| Loss attributable to common stockholders: | | |
| Net loss..... | \$ (868,000) | \$ (1,128,000) |
| Preferred stock dividends..... | 9,000 | 16,000 |
| Loss attributable to common stockholders... | \$ (877,000) | \$ (1,144,000) |
| Net loss per common share..... | \$ (0.06) | \$ (0.12) |

See notes to condensed consolidated financial statements.

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AQUACELL TECHNOLOGIES, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (Unaudited)

| | Three Months Ended September 30, | |
|---|-------------------------------------|----------------|
| | 2004 | 2003 |
| Cash flows from operating activities: | | |
| Net loss..... | \$ (868,000) | \$ (1,128,000) |
| Adjustment to reconcile net loss to net cash used in operating activities: | | |
| Stock based compensation..... | 242,000 | 375,000 |
| Fair value adjustment of derivative..... | - | 207,000 |
| Depreciation and amortization..... | 6,000 | 13,000 |
| Changes in: | | |
| Accounts receivable..... | - | 10,000 |
| Accrued interest receivable..... | - | 7,000 |
| Prepaid expenses and other current assets.... | 7,000 | (35,000) |
| Inventories..... | 15,000 | (150,000) |
| Accounts payable..... | (138,000) | (226,000) |
| Accrued expenses..... | (41,000) | 37,000 |
| Customer deposits..... | (41,000) | 6,000 |
| Net cash used in operating activities..... | (818,000) | (884,000) |
| Cash flows from investing activities: | | |
| Collections on notes receivable..... | - | 68,000 |
| Payments on note issued for purchase of property and equipment..... | (1,000) | (1,000) |
| Capital expenditures..... | (84,000) | (1,000) |
| Net cash provided by (used in) investing activities..... | (85,000) | 66,000 |
| Cash flows from financing activities: | | |
| Proceeds from private placements of common stock..... | - | 2,555,000 |
| Expenses of offerings..... | - | (259,000) |
| Preferred stock dividend paid..... | - | (12,000) |
| Exercise of stock options..... | - | 27,000 |
| Proceeds (repayments) of loans from related parties..... | - | (25,000) |
| Proceeds from subscriptions receivable..... | 40,000 | - |
| Proceeds from exercise of commons stock warrants..... | 209,000 | - |
| Expense of warrant exercise..... | (3,000) | - |
| Net cash provided by financing activities.. | 246,000 | 2,286,000 |
| Increase (decrease) in cash..... | (657,000) | 1,468,000 |
| Cash, beginning of period..... | 860,000 | 32,000 |
| Cash, end of period..... | \$ 203,000 | \$ 1,500,000 |

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Supplemental disclosure of cash flow information:

| | | | | |
|------------------------|----|---|----|---|
| Cash paid for interest | \$ | - | \$ | - |
|------------------------|----|---|----|---|

Supplemental schedule of non-cash investing and financing activities:

| | | | | |
|--|----|--------|----|-----------|
| Issuance of common stock warrants for services to the company..... | \$ | 91,000 | \$ | 2,564,000 |
| Subscription receivable for conversion of warrants..... | \$ | 49,000 | \$ | - |
| Dividends payable on preferred stock..... | \$ | 9,000 | \$ | 16,000 |

See notes to condensed consolidated financial statements.

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AQUACELL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2004 (Unaudited)

NOTE A - BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements include the accounts of AquaCell Technologies, Inc. and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with instructions to Form 10-QSB. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. The results of operations for the three months ended September 30, 2004 are not necessarily indicative of the results to be expected for the full year. For further information, refer to the Company's annual report filed on Form 10-KSB for the year ended June 30, 2004.

At September 30, 2004 the Company's ability to continue as a going concern, for the reasons outlined on the 10-KSB filed for the year ended June 30, 2004, still existed. During the quarter ended September 30, 2004 the Company successfully obtained external financing through exercise of warrants and plans to continue to raise capital through the sale or exercise of equity securities on a just in time basis.

NOTE B - INVENTORIES

Inventories consist of the following at September 30, 2004:

| | | | | |
|-----------------------|----|--------|--|-----------|
| Raw materials..... | \$ | 50,000 | | 23,000 |
| Work in progress..... | | 6,000 | | |
| Finished goods..... | | | | |
| | | | | ----- |
| | | | | \$ 79,000 |
| | | | | ===== |

NOTE C - PROPERTY, EQUIPMENT AND BILLBOARD COOLERS

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Property and equipment is summarized as follows at September 30, 2004:

| | |
|---|------------|
| Billboard coolers, including parts..... | \$ 853,000 |
| Furniture and fixtures..... | 36,000 |
| Equipment - office..... | 102,000 |
| Machinery and equipment..... | 127,000 |
| Rental units..... | 9,000 |
| Leasehold improvements..... | 10,000 |
| Truck..... | 11,000 |
| | ----- |
| | 1,148,000 |
| Less accumulated depreciation..... | 271,000 |
| | ----- |
| | \$ 877,000 |
| | ===== |

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AQUACELL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2004 (Unaudited)

NOTE D - DEFERRED PAYABLE

At September 30, 2004, the deferred payable represented the balance due to a private company for the return and cancellation of all exclusive distribution and marketing rights previously held under a distribution agreement. This amount is payable solely from 5% of the future revenues to be generated by our Global Water-Aquacell subsidiary.

NOTE E - EQUITY TRANSACTIONS

During August 2004 the Company amended a February 2004 consulting agreement to provide for additional compensation of 100,000 common shares. These shares were valued at \$66,000 based upon closing market price at the date of issuance. Such amount will be amortized to expense over the remaining term of the agreement. Amortization amounted to \$4,000 for the quarter ended September 30, 2004.

During August 2004 the Company issued 50,000 common stock purchase warrants at a price of \$.66 per share in connection with performance under an existing consulting agreement. These warrants were valued at \$25,000 utilizing the Black Scholes valuation method. Such amount will be amortized over a period of 31 months. Amortization amounted to \$2,000 for the quarter ended September 30, 2004.

During September 2004 the Company issued an aggregate of 457,000 shares of common stock in connection with the repricing of 457,000 common stock purchase warrants issued in previously completed private placements. Warrants with exercise prices of \$2.00 and \$4.00 were repriced to \$.70 and \$.56. The Company realized gross proceeds of \$286,000 and expenses were \$32,000 in connection with the repricings. New common stock purchase warrants were issued for 247,000 shares of common stock exercisable at \$.90 per share and 210,000 shares of common stock exercisable at \$.95 per share and an additional 210,000 shares of common stock exercisable at \$4.00 per share.

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NOTE F - CONCENTRATION OF CREDIT RISK

The Company's financial instruments that are exposed to concentration of credit risk consists of cash. Such amounts are in excess of FDIC insurance limits.

NOTE G - SUBSEQUENT EVENTS

During October and November 2004 the Company issued an aggregate of 693,000 shares in connection with the repricing of outstanding warrants. The Company realized gross proceeds of \$434,000 in connection with the repricing.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

When used in this Form 10-QSB and in future filings by the Company with the Commission, statements identified by the words "believe", "positioned", "estimate", "project", "target", "continue", "will", "intend", "expect", "future", "anticipates", and similar expressions express management's present belief, expectations or intentions regarding the Company's future performance within the meaning of the Private Securities Litigation Reform Act of 1995. Readers are cautioned not to place undue reliance on any such forward-looking statements, each of which speaks only as of the date made. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. The Company has no obligations to publicly release the result of any revisions which may be made to any forward-looking statements to reflect anticipated or unanticipated events or circumstances occurring after the date of such statements.

Overview

The following discussions and analysis should be read in conjunction with the Company's condensed consolidated financial statements and the notes presented following the condensed consolidated financial statements. The discussion of results, causes and trends should not be constructed to imply any conclusion that such results or trends will necessarily continue in the future.

During the quarter ended September 30, 2004, we diligently worked to finalize agreements for our newly launched "Message On The Bottle" advertising program through our Aquacell Media subsidiary. Aquacell Media installs our patented Aquacell 1000 Bottled Water Cooler Systems free of charge into various locations while retaining ownership of the coolers. Revenue is generated through the sale of advertising on the band of the cooler's permanently attached five-gallon bottle, as well as on the cup holder.

Subsequent to the end of the quarter, we signed our first Water Cooler Placement Agreement with Rite Aid Corporation, the third largest drug chain in America with more than 3000 stores. Rite Aid conducted an extensive test over several months on the performance of our coolers in their corporate office as well as in several stores.

Under an initial term of five years, Rite Aid has agreed that the Aquacell 1000 coolers will be installed on a national basis at no cost to Rite Aid, and

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that AquaCell may sell the advertising space on the bottle band. The initial rollout, expected to be completed by the end of December 2004, will entail replacing water fountains in approximately half of the stores. Aquacell has been manufacturing coolers in anticipation of this agreement and is in position to use current inventory to supply the water coolers for these initial locations.

We are in negotiations with other retailers including other national chain drug stores and supermarkets, as well as other national chain retail stores for installations in these locations, as well. Test units have been installed in many of these locations and we anticipate the signing of agreements with additional retailers in the near future.

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Also subsequent to the end of the quarter, we secured our first advertiser, Unilever, one of the world's largest consumer products companies. This inaugural program is for the Dove(R) product line, the timing of which coincides with the roll out of installations in Rite Aid stores. The program also includes advertising in other chain drug stores.

The "Message On The Bottle" advertising provides a unique point-of-sale opportunity for manufacturers to reach the consumer. Advertising on the bottle gets face-to-face impact reaching the consumers while they are in the store. We are negotiating with other major manufacturers and providers of health care related products and/or their agencies, for the advertisement of their products.

AquaCell has engaged several new marketing partners, including Beau Dietl & Associates. Through this association, we retained the services of J. DeKama Associates, through which we have signed consulting agreements with former Unilever executives who have tapped into the services of Advantage Sales and Marketing. This network has been instrumental in assisting us in developing a wide variety of companies for both advertising and for placement of Aquacell 1000 coolers into retail locations. By utilizing these and other individuals who are responsible for payment of their own expenses, and who will receive cash compensation only upon the generation of revenues, we do not anticipate incurring any significant direct sales and marketing expenses in the rollout of this program.

During the quarter ended September 30, 2004 we incurred non-cash charges for stock based compensation for warrants issued to consultants, which we believe is a benefit to the Company and its shareholders for the growth of the Company.

We are embarking on additional opportunities, including expansion of our "Message On The Bottle" advertising program into more diverse areas, which we believe will provide long-term benefits to the Company.

Results of Operations

During the three months ended September 30, 2004 on a consolidated basis, revenues were \$199,000 as compared to \$201,000 for the similar period of the preceding year.

On a consolidated basis cost of sales was 62% for the quarter ended September 30, 2004 as compared to 64% for the same quarter of the prior year.

Net loss on a consolidated basis, attributable to common stockholders, for the three months ended September 30, 2004 was \$877,000 or \$0.06 per share, as

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compared to \$1,144,000 or \$.12 per share for the same period of the prior year. The decrease in the loss is primarily attributable to the decrease in fair value adjustment of derivative in the amount of \$207,000.

Salaries and wages decreased by \$11,000 for the quarter ended September 30, 2004 over the prior year. Legal, accounting and other professional expensed decreased by approximately \$13,000 for the quarter ended September 30, 2004. Stock based compensation decreased by \$133,000 to \$242,000 for the quarter ended September 30, 2004. Other selling, general and administrative expenses, consisting primarily of rent - \$49,000, telephone and utilities- \$17,000, travel- \$21,000, business promotion- \$22,000, insurance- \$37,000, and vehicle expenses-\$25,000 increased by approximately \$82,000 to \$337,000 for the quarter ended September 30, 2004.

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Liquidity and Capital Resources

During the three months ended September 30, 2004 we raised, through the repricing of warrants to purchase common shares, net equity of approximately \$209,000.

Cash used by operations during the three months ended September 30, 2004 amounted to \$818,000. Net loss of \$868,000 was reduced by non-cash stock based compensation in the amount of \$242,000, and depreciation and amortization of \$6,000. Cash used by operations was further increased by decreases in accounts payable of \$138,000, accrued expenses of \$41,000, and customer deposits in the amount of \$41,000. Net loss was further decreased by net changes in inventories and prepaid expenses aggregating \$22,000.

Cash used by investing activities during the three months ended September 30, 2004 represented capital expenditures in the amount of \$84,000 increased by payments on a note issued for the purchase of equipment in the amount of \$1,000.

Cash provided by financing activities was approximately \$246,000. Proceeds from sales of common stock purchase warrants amounted to \$209,000 and expenses of warrant exercises amounted to \$3,000. Proceeds from subscriptions receivable were \$40,000.

We have granted warrants, subsequent to our initial public offering in connection with private placements, consulting, marketing and financing agreements that remain outstanding at the date of this filing and may generate additional capital of up to approximately \$13,800,000 if exercised. There is no assurance however, that any of the warrants will be exercised.

Management believes that its present cash position combined with subsequent equity raises and conversion of warrants, and cash flows expected to be generated from future operations will be sufficient to meet presently anticipated needs for working capital and capital expenditures through at least the next 12 months; however, there can be no assurance in that regard. The Company presently has no material commitments for future capital expenditures.

ITEM 3. CONTROLS AND PROCEDURES

Within the 90 days prior to the date of this Report the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's chief executive officer and chief financial officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Rule 13a-14 adopted under the

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Securities Exchange Act of 1934. Based upon that evaluation, the chief executive officer and chief financial officer concluded that the Company's disclosure controls and procedures are effective. There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

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PART II. OTHER INFORMATION

ITEM 2(C). SALES OF UNREGISTERED SECURITIES

During September 2004 the Registrant repriced and sold 222,300 Common Stock Purchase Warrants to 4 accredited investors pursuant to the exemption provided by Regulation D, Rule 505, and Section 4(2) of the Securities Act of 1933, as amended. New Common Stock Purchase Warrants were issued to the investors at prices ranging from \$.90 to \$4.00.

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

None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits.

31.1 CEO's Certification Pursuant to Rule 13a-14(a)/ 15d-14(a)

31.2 CFO's Certification Pursuant to Rule 13a-14(a)/ 15d-14(a)

32 Certification Pursuant to 18 U.S.C. Section 1350

(b) Reports on Form 8-K.

None

SIGNATURE

In accordance with the requirements of the Exchange Act, the Registrant caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

AquaCell Technologies, Inc.

Registrant

Date: November 15, 2004

/s/ Gary S. Wolff

Name: Gary S. Wolff
Title: Chief Financial Officer

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