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FLEXPOINT SENSOR SYSTEMS INC
Form 10QSB
August 16, 2004

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

FORM 10-QSB

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

For quarterly period ended June 30, 2004

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

Commission file number: No. 0-24368

FLEXPOINT SENSOR SYSTEMS, INC.
(Name of small business issuer in its charter)

Delaware 87-0620425
(State of incorporation) (I.R.S. Employer Identification No.)

106 West Business Park Drive, Draper, Utah 84020
(Address of principal executive offices) (Zip code)

Issuer's telephone number: 801-568-5111

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 No

Check if the issuer has filed all documents and reports required to be filed by Section 12, 13, 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by a court. Yes No

As of August 4, 2004, Flexpoint Sensor Systems, Inc. had a total of 18,798,202 shares of common stock issued and outstanding.

Transitional small business disclosure format: Yes No

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

As a result of our reorganization under a court approved Chapter 11 bankruptcy plan, we are now a development stage company with a date of inception of February 24, 2004. We used fresh-start reporting (See Note 3 of the Notes to Unaudited Consolidated Financial Statements, below) and all assets of Flexpoint Sensor Systems, Inc. were restated to reflect their reorganization value, which approximated the fair value at the date of reorganization. Management estimated the reorganization value to be \$5,634,000 based upon the negotiated price at which certain creditors were willing to convert their claims into common shares.

The financial information set forth below with respect to our consolidated financial position as of June 30, 2004 and the consolidated statements of operations and cash flows for the interim period from February 24, 2004 through June 30, 2004 are unaudited. This financial information, in the opinion of management, includes all adjustments consisting of normal recurring entries necessary for the fair presentation of such data. The results of operations for the periods herein ended June 30, 2004 are not necessarily indicative of results to be expected for any subsequent period.

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FLEXPOINT SENSOR SYSTEMS, INC. AND SUBSIDIARIES
 (A Company in the Development Stage)
 UNAUDITED CONSOLIDATED BALANCE SHEET
 JUNE 30, 2004

 ASSETS

Current Assets	
Cash	\$ 68,155
Accounts receivable	33,500
Prepaid expenses	3,292

 Total Current Assets 104,947

Property and equipment, net of accumulated depreciation of \$982 1,702,882

Patents and proprietary technology, net of accumulated
 amortization of \$18,004 6,750,248

Total Assets \$ 8,558,077
 =====

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities

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Accounts payable	\$ 212,864
Accrued liabilities	74,233
Deferred revenue	331,250
Notes payable - related party	3,000

Total Current Liabilities	621,347

Stockholders' Equity	
Common stock - \$0.001 par value; 100,000,000 shares authorized; 18,798,718 shares issued and outstanding	
	18,798
Additional paid-in capital	8,439,986
Warrants outstanding	595,100
Deficit accumulated during the development stage	(1,117,154)

Total Stockholders' Equity	7,936,730

Total Liabilities and Stockholders' Equity	\$ 8,558,077
=====	

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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FLEXPOINT SENSOR SYSTEMS, INC. AND SUBSIDIARIES
(A Company in the Development Stage)
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Three Months Ended June 30, 2004	For the Period From February 24, 2004 (date of inception) through June 30, 2004

Sales	\$ 39,750	\$ 55,500
Cost of goods sold	(18,871)	(18,871)

Gross Profit	20,879	36,629
General and administrative expense	(538,483)	(1,052,525)
Interest expense	(1,377)	(101,258)

Net Loss	\$ (518,981)	\$ (1,117,154)
=====		
Basic and Diluted Loss Per Share	\$ (0.03)	\$ (0.06)
=====		
Basic and Diluted - Weighted-Average Shares Outstanding	18,047,035	18,006,531
=====		

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The accompanying notes are an integral part of these unaudited consolidated financial statements.

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FLEXPOINT SENSOR SYSTEMS, INC. AND SUBSIDIARIES
(A Company in the Development Stage)
UNAUDITED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
FOR THE PERIOD FEBRUARY 24, 2004 (DATE OF INCEPTION OF THE DEVELOPMENT STAGE) THROUGH JUNE 30, 2004

	Common Stock		Additional	Warrants	Deficit	Total
	Shares	Amount	Paid-in Capital	Outstanding	Accumulated During the Development Stage	Stockholders' Equity
Balance - February 24, 2004 (Date of Inception of the Development Stage)	-	\$ -	\$ -	\$ -	\$ -	\$ -
Issuance for patents, cash, net of assumption of liabilities, February 24, 2004, \$0.52 per share	14,098,718	14,098	4,952,166	-	-	4,966,264
Issuance for consulting services, March 3, 2004, \$1.15 per share	100,000	100	114,580	-	-	114,680
Stock based compensation from 650,000 warrants issued on March 3, 2004 for consulting services	-	-	-	595,100	-	595,100
Issuance for acquisition of equipment and proprietary technology from Flexpoint Holdings, LLC, a company controlled by a shareholder, March 31, 2004, \$1.15 per share	1,600,000	1,600	1,833,400	-	-	1,835,000
Conversion of note payable, March 31, 2004, \$0.50 per share	2,800,000	2,800	1,397,200	-	-	1,400,000

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Beneficial conversion option on note payable	-	-	42,840	-	-	
Conversion of note payable, May 19, 2004, \$0.50 per share	200,000	200	99,800	-	-	1
Net loss	-	-	-	-	(1,117,154)	(1,117,154)

Balance - June 30, 2004	18,798,718	\$ 18,798	\$ 8,439,986	\$ 595,100	\$ (1,117,154)	\$ 7,985,347
=====						

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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FLEXPOINT SENSOR SYSTEMS, INC. AND SUBSIDIARIES
(A Company in the Development Stage)
UNAUDITED CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE PERIOD FEBRUARY 24, 2004 (DATE OF INCEPTION OF THE
DEVELOPMENT STAGE) THROUGH JUNE 30, 2004

Cash Flows from Operating Activities:	
Net loss	\$ (1,117,154)
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation	982
Amortization of intangible assets	1,008
Issuance of stock and warrants for services	709,780
Expenses paid by increase in convertible note payable	60,000
Interest expense from beneficial conversion option of convertible note payable	42,840
Interest expense from origination fees on convertible notes payable	56,666
Changes in operating assets and liabilities:	
Accounts receivable	(33,500)
Prepaid expense	(3,292)
Accounts payable	4,758
Accrued liabilities	72,741
Deferred revenue	(12,500)

Net Cash Used by Operating Activities	(217,671)

Cash Flows from Investing Activities:	
Payments for patents	(15,695)
Purchase of equipment	(5,864)
Payment for acquisition of equipment and proprietary technology from Flexpoint Holdings, LLC	(265,000)

Net Cash Used in Investing Activities	(286,559)

Cash Flows from Financing Activities:	
Principal payments on related party debt	(13,000)
Cash received in fresh start accounting	2,051

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Proceeds from borrowings under convertible note payable	583,334

Net Cash Provided By Financing Activities	572,385

Net Change in Cash	68,155
Cash at Beginning of Period	-

Cash at End of Period	\$ 68,155
=====	

Supplemental Schedule of Non Cash Investing and Financing Activities:

Issuance of 14,813,004 shares of common stock valued at \$4,966,264 and the assumption of \$671,348 of liabilities in exchange for patents of \$5,635,561 and \$2,051 cash in fresh start.

Short-term advances of \$102,000 were repaid from an increase in a convertible note payable.

Equipment and proprietary technology with a fair value of \$2,798,000 purchased from Flexpoint Holdings, LLC, a company controlled by a shareholder, in exchange for the issuance of 1,600,000 shares of common stock valued at \$1,835,000, a cash payment of \$265,000 and the payment of \$698,000 from an increase in a convertible note payable.

The principal balance of a \$1,500,000 convertible note payable was converted into 3,000,000 shares of common stock.

The accompanying notes are an integral part of these unaudited consolidated financial statements.

FLEXPPOINT SENSOR SYSTEMS, INC. AND SUBSIDIARIES
(A Company in the Development Stage)
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - NATURE OF BUSINESS

Nature of Operations - Flexpoint Sensor Systems, Inc. (the Company) is a development stage enterprise engaged principally in designing, engineering, and manufacturing sensor technology and equipment using flexible potentiometer technology. On February 24, 2004, the Company's plan of reorganization was confirmed by the U.S. Bankruptcy Court and the Company emerged from bankruptcy. As discussed further in Note 3, the emergence from bankruptcy was accounted for using fresh start accounting and the Company is considered a new entity for financial reporting purposes. The new entity is in the development stage as planned operations have not commenced. Development stage activities include acquiring equipment and technology, organization operations, obtaining financing and seeking manufacturing contracts.

Principles of Consolidation - The accompanying consolidated financial statements include the accounts of Flexpoint Sensor Systems, Inc. and its 90%-owned subsidiary, Sensitron, Inc., and Sensitron Inc.'s 90%-owned subsidiary, Flexpoint, Inc. Minority interests in subsidiaries are carried at no value based on their historical cost. Intercompany transactions and accounts have been eliminated in consolidation.

Use of Estimates - The preparation of financial statements in conformity with

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generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Actual results could differ from these estimates.

Interim Financial Statements - The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America. In the opinion of the Company's management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to fairly present the Company's consolidated financial position as of June 30, 2004, its consolidated results of operations and cash flows for the period from February 24, 2004 (date of inception of the development stage) through June 30, 2004. The results of operations for the period from February 24, through June 30, 2004, may not be indicative of the results that may be expected for the period ending December 31, 2004.

Business Condition - The accompanying unaudited consolidated financial statements have been prepared assuming that the Company will continue as a going concern. The Company is in the development stage and its efforts are primarily obtaining necessary capital to complete its production facility and re-start operations following its emergence from Chapter 11 bankruptcy proceedings. The Company incurred a loss of \$1,117,154 and used cash from operations of \$217,671 for the period from February 24, 2004 (date of inception of the development stage) through June 30, 2004. Through June 30, 2004, the Company has accumulated a deficit during the development stage of \$1,117,154. These conditions raise substantial doubt about the Company's ability to continue as a going concern. The unaudited consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

The Company's continuation as a going concern is dependent upon its ability to generate sufficient cash flow to meet its obligations on a timely basis, which may include the need to obtain additional financing, and ultimately to attain profitable operations. While the Company has received some customer deposits against future deliveries, the Company does not have sufficient cash flow to finance its operations on an on-going basis. To date, the Company has met its short-term cash needs through confirmation of its plan of reorganization and through proceeds from a convertible note payable as described in Note 2. Management plans to issue equity securities through a private placement offering. However, there can be no assurance that such sources of financing, if any, will be completed as planned or continue to be available, and if available, that they will be on terms favorable to the Company or in amounts sufficient to meet the Company's cash flow requirements.

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FLEXPOINT SENSOR SYSTEMS, INC. AND SUBSIDIARIES
(A Company in the Development Stage)
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Fair Values of Financial Instruments - The amounts reported as accounts payable, accrued liabilities and notes payable are considered to be reasonable approximations of their fair values. The fair value estimates were based on information available to management at the time of the preparation of the financial statements.

Accounts Receivable - The Company regularly reviews its accounts receivable and makes provisions for potentially uncollectible balances. At June 30, 2004, management believed the Company had incurred no material impairments in

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the carrying values of its accounts receivable.

Property and Equipment - Property and equipment are stated at cost. Additions and major improvements are capitalized while maintenance and repairs are charged to operations. Upon retirement, sale or disposition, the cost and accumulated depreciation of the items sold are eliminated from the accounts, and any resulting gain or loss is recognized in operations. Depreciation is computed using the straight-line method and is recognized over the estimated useful lives of the property and equipment, which are three to seven years. Depreciation expense was \$982 for the period from February 24, 2004 (date of inception of the development stage) through June 30, 2004.

Valuation of Long-lived Assets - The carrying values of the Company's long-lived assets will be reviewed for impairment whenever events or changes in circumstances indicate that they may not be recoverable. When projections indicate that the carrying value of the long-lived asset is not recoverable, the carrying value of the long-lived asset is reduced by the estimated excess of the carrying value over the projected discounted cash flows.

Intangible Assets - The Company currently has the rights to several patents. Patents are amortized from the date the Company is awarded the patent, over their estimated useful lives. Impairment is recognized if the carrying amount is not recoverable and the carrying amount exceeds the fair value of the intangible asset. Costs to obtain or develop patents are capitalized and amortized over a five-year period.

Revenue Recognition - Revenue from the sale of products is recorded at the time of shipment to the customers. Revenue from research and development engineering contracts is recognized as the services are provided and accepted by the customer. Revenue from contracts to license technology to others, is deferred until all conditions under the contracts are met and then recognized as licensing royalty revenue over the remaining term of the contracts.

As of June 30, 2004, Sensitron, the Company's subsidiary, had deferred revenue of \$331,250, consisting of \$250,000 of prepaid licensing royalties to be deferred and recognized as the related licensing royalty sales are reported to the Company by the customer over the remaining term of the agreement, and \$81,250 of deferred sales related to software license rights sold to the customer that is being amortized over the six-year term of the contract.

Stock Based Compensation - The Company accounts for its stock-based compensation issued to employees and directors under Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Under APB Opinion No. 25, compensation related to stock options, if any, is recorded if an option's exercise price on the grant date is less than the fair value of the Company's common stock on the grant date, and amortized over the vesting period. Compensation expense for stock awards or purchases, if any, is recognized if the award or purchase price on the measurement date is below the fair value of the Company's common stock, and is recognized on the date of award or purchase. Employee stock options have not been granted nor have any employee stock awards occurred; therefore, no employee stock-based compensation has been recognized in the accompanying financial statements nor would there have been any employee stock-based compensation using the fair value method to value grants or awards.

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The Company accounts for its stock-based compensation issued to non-employees using the fair value method in accordance with SFAS No. 123, Accounting for Stock Based Compensation. Under SFAS No. 123, stock-based compensation is determined as the fair value of the equity instruments issued. The measurement date for these issuances is the earlier of the date at which a commitment for performance by the recipient to earn the equity instruments is reached or the date at which the recipient's performance is complete. Stock-based compensation to non-employees totaled \$709,780.

At June 30, 2004, the Company has a stock-based employee compensation plan, which is described more fully in Note 7. As of June 30, 2004 no stock options had been granted or were outstanding.

Basic and Diluted Loss Per Share - Basic and diluted loss per share is computed by dividing net loss by the weighted-average number of common shares outstanding during the period. At June 30, 2004, there were outstanding stock equivalents to purchase 650,000 shares of common stock that were not included in the computation of basic and diluted net loss per share as their effect would have been anti-dilutive, thereby decreasing the net loss per common share.

NOTE 2 - CONFIRMATION OF PLAN OF REORGANIZATION

On February 24, 2004, the Bankruptcy Court confirmed the Company's plan of reorganization. The confirmed plan provided for the following:

Reverse Stock Split - The shares of common stock outstanding prior to the confirmation were reverse split on a 1-for-7 basis. All shares amounts are presented in the accompanying financial statements on a post-split basis.

Cancellation of Common Stock - The Company cancelled 714,286 shares of common stock issued to an officer during 2001, as provided for by the confirmed plan of reorganization.

Convertible Debentures Payable - Convertible debentures of \$3,681,280 were forgiven in exchange for the Company agreement not to contest the issuance of 7,142,087 shares of common stock that were issued to Aspen Capital based upon the exercise of warrants prior to the bankruptcy petition.

Convertible Promissory Note to Former Employee - The Company converted \$194,620 of claims that included accounts payable, accrued wages and a convertible promissory note to a former employee of \$20,000, into 377,682 shares of common stock at a conversion price of \$0.5153 per share.

Note Payable to Stockholder - The Company exchanged \$1,230,218 of notes payable to a stockholder for 2,387,382 shares of common stock at a conversion price of \$0.5153 per share.

Lease Obligation - A lease obligation of \$574,255 was exchanged for 1,114,410 shares of common stock at a conversion price of \$0.5153 per share.

Delphi Automotive Systems Supply Agreement - Flexpoint entered into a Purchase and Supply Agreement (the "Supply Agreement") with Delphi Automotive Systems ("Delphi") in June 1998. Under the terms of the Supply Agreement, the Company was to supply its proprietary sensor mats to Delphi for integration into a weight-based suppression system as a critical part of a smart air bag system. The Supply Agreement provided that such sensor mats were to be exclusively supplied to General Motors, through Delphi, by the Company through 2002. In May 2000, the Supply Agreement was amended, primarily providing for Delphi to make loan payments to the Company to be used directly for Delphi programs. As

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of December 31, 2000, the Company had received loan payments of \$1,700,000 from Delphi.

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FLEXPPOINT SENSOR SYSTEMS, INC. AND SUBSIDIARIES (A Company in the Development Stage) NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

In August 2000, Delphi notified the Company of its intent to terminate the Supply Agreement. The Company believes that Delphi was not entitled to terminate the agreement or had not followed the appropriate contractual provisions for termination of the Supply Agreement. As a result of the termination, the Company was required to significantly reduce its workforce and its operating costs. In addition, the Company sought protection under the United States federal bankruptcy laws.

The Company believes it was damaged and has offsets to the loan from Delphi. Accordingly, the note payable was reduced to zero.

Litigation under the Delphi Supply Agreement remains under the jurisdiction of the bankruptcy court and the outcome of the future legal proceedings between the Company and Delphi is uncertain. However, on February 24, 2004, the Company concluded that the likelihood that this contingency will require that the Company transfer assets to Delphi is remote, and therefore, the liability was accounted for as extinguished with the resulting gain included in gain on forgiveness of debt in the pre-confirmation consolidated statements of operations.

Convertible Note Payable - The plan of reorganization provided for the Company to draw upon a convertible note payable. During March 2004, the Company borrowed \$1,343,334, net of origination fees of \$56,666, from the note. The terms of the convertible note payable provide that interest accrues on outstanding balance at 10% per annum, and that all amounts become due within three years of the date of the agreement. Proceeds of \$698,000 were used for the acquisition of assets from Flexpoint Holdings, LLC, as described in Note 3, and proceeds of \$102,000 were used to repay a short-term advance from Flexpoint Holdings, LLC. The Company borrowed \$483,334 under the note and \$60,000 was borrowed from the direct payment to settle certain secured and priority claims determined in the reorganization plan and to pay operating expenses. The \$1,400,000 balance under the note payable was converted into common stock during March 2004 at the rate of \$0.50 per share resulting in the issuance of 2,800,000 shares of common stock. During May 2004, the Company borrowed the remaining \$100,000 on the convertible line of credit. The balance was immediately converted into 200,000 shares of common stock at a rate of \$0.50 per share.

NOTE 3 - FRESH START ACCOUNTING

In accordance with the fresh start requirements of SOP 90-7, Financial Reporting by Entities in Reorganization Under the Bankruptcy Code, the Company accounted for the reorganization using fresh-start reporting. Accordingly, all assets of Flexpoint Sensor Systems, Inc. have been restated to reflect their reorganization value, which approximates fair value at the date of reorganization. Management estimated a reorganization value of \$5,634,000 based upon the negotiated price at which certain creditors were willing to convert their claims into common stock. The following summarizes the effect of the plan of reorganization on the Company's consolidated balance sheet, as of February 24, 2004, the date of confirmation of the plan of reorganization:

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FLEXPOINT SENSOR SYSTEMS, INC. AND SUBSIDIARIES
(A Company in the Development Stage)
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

As of Date of Confirmation of Plan, February 24, 2004	Pre- Confirmation	Debt Discharge	Exchange of Stock	Fresh Start	Reorgani Balance Sheet
ASSETS					
Current Assets - Cash	\$ 2,051	\$ -	\$ -	\$ -	\$ 2,
Patents, net	1,561	-	-	5,634,000	5,635,
Total Assets	\$ 3,612	\$ -	\$ -	\$ 5,634,000	\$ 5,637,
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)					
Liabilities Not Subject to Compromise - Current					
Accounts payable	\$ 244,642	\$ (36,536)	\$ -	\$ -	\$ 208,
Accrued liabilities	1,492	-	-	-	1,
Deferred revenue	343,750	-	-	-	343,
Short-term advance payable	102,000	-	-	-	102,
Notes payable - related party	16,000	-	-	-	16,
Total Liabilities Not Subject to Compromise - Current	707,884	(36,536)	-	-	671,
Liabilities Subject to Compromise	7,777,379	(7,777,379)	-	-	
Stockholders' Equity (Deficit)					
Preferred stock	1,080,426	-	(1,080,426)	-	-
Common stock (old)	76,535	-	(76,535)	-	-
Common stock (new)	-	11,022	3,076	-	14,
Additional paid-in capital	22,078,206	5,669,351	1,153,885	(23,949,276)	4,952,
Deficit accumulated during the development stage	(31,716,818)	2,133,542	-	29,583,276	
Total Stockholders' Equity (Deficit)	(8,481,651)	7,813,915	-	5,634,000	4,966,
Total Liabilities and Stockholders' Equity (Deficit)	\$ 3,612	\$ -	\$ -	\$ 5,634,000	\$ 5,637,

NOTE 4 - PROPERTY AND EQUIPMENT

On March 31, 2004, Flexpoint Sensor Systems, Inc. entered an asset purchase agreement with Flexpoint Holdings, LLC, a company controlled by a shareholder,

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to acquire equipment and proprietary software technology with a total fair value of \$2,798,000 in exchange for \$963,000 and 1,600,000 shares of common stock valued at \$1,835,000, or \$1.15 per share. Flexpoint Holdings, LLC is a holding company with the primary purpose to acquire and hold assets which one of the Company's creditors caused to be seized during 2001 and sold at public auction during 2002.

The acquisition of the assets of Flexpoint Holdings, LLC has been accounted for using the purchase method of accounting; however, Flexpoint Holdings, LLC was not a business and had no operations. Accordingly, pro forma financial information is not provided. The purchase price was determined using estimated fair values of the assets acquired. The Company is in the process of determining the fair values of certain assets; accordingly, the purchase price is subject to refinement. At March 31, 2004, the fair value of the assets acquired were as follows:

The equipment consists of manufacturing equipment to produce the Company's product, and the technology consists of software algorithms that interpret data provided by the Company's flexible sensor technology. The technology has an estimated weighted-average useful life of 5 years.

Property and equipment	\$ 1,698,000
Proprietary technology	1,100,000
Net assets acquired	\$ 2,798,000

The equipment consists of manufacturing equipment to produce the Company's product, and the technology consists of software algorithms that interpret data provided by the Company's flexible sensor technology. The technology has an estimated weighted-average useful life of 5 years.

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FLEXPOINT SENSOR SYSTEMS, INC. AND SUBSIDIARIES
(A Company in the Development Stage)
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 - NOTE PAYABLE - RELATED PARTY

The Company had \$16,000 of unsecured notes payable to a shareholder with interest stated at 10% with repayment terms requiring payment of the principal and interest by December 31, 2004. The Company paid \$13,000 of payments on the notes during April and May 2004, leaving a remaining balance of \$3,000 as of June 30, 2004.

NOTE 6 - INCOME TAXES

There was no provision for, or benefit from, income tax during the period. The components of the net deferred tax asset as of June 30, 2004 are as follows:

Operating loss carry forwards	\$ 9,081,406
Deferred license and royalty income	123,556
Amortization of intangibles	2,014,969
Total Deferred Tax Assets	11,219,931
Valuation allowance	(11,219,931)
Net Deferred Tax Asset	\$ -

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As a result of the confirmation of the bankruptcy plan, \$7,813,915 in debt was discharged. For tax reporting purposes, net operating loss carry forwards were reduced to \$24,346,934 at June 30, 2004. Although net operating losses begin to expire in the year 2012 those carry forwards will be limited or unavailable, under the tax laws, due to a change of greater than 50% in ownership of the Company upon emergence from bankruptcy.

The following is a reconciliation of the amount of benefit that would result from applying the federal statutory rate to pretax loss with the provision for income taxes for the period from February 24, 2004 through June 30, 2004:

Tax at statutory rate (34%)	\$ (379,832)
Change in valuation allowance	416,698
State tax benefit, net of federal tax effect	(36,866)

Provision for Income Taxes	\$ -
=====	

NOTE 7 - STOCK OPTION PLAN

On April 1, 1995, the Board of Directors and shareholders adopted an Omnibus Stock Option Plan (the "Plan"). Under the terms of the Plan, as amended in October 1997, Flexpoint may grant options to employees, directors and consultants to purchase up to 719,643 shares of common stock. Incentive or non-qualified options may be granted under the Plan. Options granted under the Plan are exercisable over periods determined by the Board of Directors, not to exceed 10 years from the date of grant. Options generally vest from immediately to five years. Generally, the only condition for exercise of options granted under the Plan is that the employees remain employed through the date the options are exercised or vested. As of the date of the confirmation of the plan of reorganization, all previously outstanding stock options were cancelled. No stock options have been issued since the Company emerged from bankruptcy.

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FLEXPOINT SENSOR SYSTEMS, INC. AND SUBSIDIARIES
(A Company in the Development Stage)
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8 - LEASE COMMITMENT

Effective March 31, 2004, the Company agreed to sub-lease offices and a manufacturing facility in which the Company's acquired equipment is located. The sublease expires in October 2004 with monthly lease payments of \$5,500. Total future minimum lease payments as of June 30, 2004 are \$22,000.

NOTE 9 - CONSULTING AGREEMENT

On March 3, 2004, the Company entered into a twelve-month consulting agreement with Summit Resource Group ("Summit") whereby Summit has agreed to provide consulting services for the Company related to investor relations, including dealing with direct investor relations and broker/dealer relations and the investing public. The agreement may be terminated after the first 90 days by a 45-day written notice from either party. In consideration for consulting services, the Company issued Summit 100,000 common shares and warrants to purchase 650,000 common shares. The warrants are exercisable for five years

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from the dated awarded as follows: i) warrants to purchase 150,000 shares are exercisable at \$0.70 per share from the date awarded, ii) warrants for 150,000 shares are exercisable at \$0.70 per share beginning on May 1, 2004 and iii) warrants to purchase 350,000 shares are exercisable at \$0.80 per share beginning September 1, 2004, unless the agreement is terminated, whereupon they are exercisable pro rata through the date of termination as a percentage of the days outstanding from March 3, 2004 through September 1, 2004. The Company granted Summit registration rights with respect to the 650,000 common shares underlying the warrants, and the Company has the obligation for all related registration costs.

The Company valued the issuance of 100,000 common shares to Summit at \$114,680, or approximately \$1.15 per share, based on the estimated market value of the stock issued on the date of the agreement, with the related expense charged to operations. The Company valued the warrants granted to Summit at \$731,328, estimated on the date granted using the Black-Scholes option pricing model with the following weighted-average assumptions: risk-free interest rate of 3.06%, expected dividend yield of 0.0%, expected life of 5 years and expected volatility of 200%. Consulting expense is recognized over the period the warrants vest, which resulted in recognizing \$595,100 of compensation to Summit during the period from February 24, 2004 through June 30, 2004.

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In this report references to "Flexpoint Sensor," "we," "us," and "our" refer to Flexpoint Sensor Systems, Inc. and its subsidiaries.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

The Securities and Exchange Commission ("SEC") encourages companies to disclose forward-looking information so that investors can better understand future prospects and make informed investment decisions. This report contains these types of statements. Words such as "may," "will," "expect," "believe," "anticipate," "estimate," "project," or "continue" or comparable terminology used in connection with any discussion of future operating results or financial performance identify forward-looking statements. You are cautioned not to place undue reliance on the forward-looking statements, which speak only as of the date of this report. All forward-looking statements reflect our present expectation of future events and are subject to a number of important factors and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

Executive Overview

We are engaged principally in designing, engineering and manufacturing sensor technology and equipment using flexible potentiometer technology, which we refer to as Bend Sensor technology. On February 24, 2004 our Chapter 11 bankruptcy reorganization plan was confirmed by the bankruptcy court and effected on March 5, 2004. As a result, Flexpoint Sensor is considered a new entity for financial reporting purposes. We are a development stage company focused on obtaining necessary capital to re-start operations following our reorganization.

While we recorded sales of \$39,750 for the three month period ended June 30, 2004 (the "2004 second quarter"); we recorded a net loss of \$518,981 for the 2004 second quarter and a net loss of \$1,117,154 from inception on February 24, 2004 through June 30, 2004. Our auditors have expressed doubt that we can continue as a going concern because we do not have sufficient cash flow to

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finance our operations on an on-going basis. We will require additional financing to fund our short-term cash needs and we will likely rely on debt financing and private placements of our common stock for additional funding.

During the second quarter of 2004 we have focused our efforts on renewing contacts with old customers and developing new applications for our Bend Sensor technology. We are currently working with several companies on new development projects. Management believes these projects will provide the quickest and best return on our investment with the least amount of risk involved. While these new development projects are related to industrial controls and medical applications, there has been a strong interest in our sensor technology from the auto industry. Management is excited that we are receiving contact from many companies that believe in our sensor technology as a viable product for their industry.

During the second quarter of 2004 we established an operating production line in our new manufacturing facility located in Draper, Utah. We are still rebuilding our staff and engineers and setting up a sales structure. Management believes that even though we are making positive strides forward with our business plan, it is likely that significant progress may not occur for the next six months to one year. Accordingly, we cannot guarantee that we will realize significant progress or that the progress will result in profitability.

Our primary challenge is to manage the timing of distribution and promotion of our products. Our plan is to rehabilitate our operations within the next two years to the point that we can offer mass production and incorporation of our products into new applications. However, this will be subject to our ability to market our products to customers who can exploit the potential of the patents we own. We will continue to reestablish old relationships and establish new ones.

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Liquidity and Capital Resources

For the next twelve months, management anticipates that we will rely on revenues, debt financing and private placements of our common stock to fund our on-going operations. In addition, as we enter into new technology agreements, we must ensure that those agreements provide adequate funding for any pre-production research and development and manufacturing costs. If we are successful in establishing agreements with adequate initial funding, management believes that our operations for the long term will be funded by revenues, licensing fees and royalties related to these agreements. However, we have formalized only a few additional agreements since confirmation of our bankruptcy reorganization plan and there can be no assurance that agreements will come to fruition in the future or that a desired technological application can be brought to market.

Net cash used in operating activities for the period from February 24, 2004 through June 30, 2004 was \$217,671. Net cash used in investing activities for that interim period was \$286,559, with \$265,000 of that amount related to the payment for acquisition of equipment from Flexpoint Holdings LLC in March 2004. We are fulfilling orders for Bend Sensor technology and anticipate that on-going negotiations with third parties may result in several new technology agreements. It is critical to our continued operations that we are successful in closing these agreements.

Financing. We have relied on a \$1.5 million convertible line of credit which was part of our bankruptcy reorganization plan. During March 2004, we drew

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approximately \$1,343,000, net of origination fees of approximately \$57,000, from this line of credit. Of the amount drawn from the line of credit, we used \$698,000 to acquire the assets of Flexpoint Holdings, LLC, and \$102,000 was used to repay a short-term advance from Flexpoint Holdings, LLC. We borrowed approximately \$483,000 for operations and \$60,000 was borrowed to settle certain secured and priority claims of the reorganization plan.

We initially placed 3,000,000 free trading shares in an escrow account for conversion of the credit line as part of our reorganization plan. In March 2004 the \$1,400,000 amount drawn from the line of credit was converted into common stock at a rate of \$0.50 per share. This conversion resulted in the issuance of 2,800,000 shares of common stock to Broad Investment Partners and its assignees. During May 2004 we borrowed the remaining \$100,000 on the convertible line of credit and the balance was immediately converted into 200,000 shares of common stock at a rate of \$0.50 per share.

Management anticipates that additional funding may be obtained through a private placement of our common stock; but we cannot assure you that we will complete a private placement. We expect to issue our stock pursuant to exemptions from registration provided by federal and state securities laws and currently do not intend to make a public offering of our stock. We also note that if we issue more shares of our common stock, then our shareholders may experience dilution in the value per share of their common stock.

Commitments and Contingencies

Our principal commitments consist of our total current liabilities, discussed in more detail below in "Results of Operations," and an operating lease. Effective March 31, 2004 we were obligated to make monthly payments of \$5,500 per month for the sublease of office and manufacturing space in which our equipment is located. The total future minimum payments under this sublease as of June 30, 2004 were \$22,000.

Off-balance Sheet Arrangements - None.

Results of Operations

The following discussions are based on the consolidated operations of Flexpoint Sensor, its 90% owned subsidiaries, Sensitron, Inc. and Flexpoint, Inc. The information should be read in conjunction with our unaudited consolidated financial statements included in this report at Part I, Item 1, above. The charts below present a

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summary of our unaudited consolidated statement of operations for the three month period ended June 30, 2004 and further details are presented in our unaudited consolidated financial statements and the accompanying notes.

Summary Operating Results for the Three Months Ended June 30, 2004

	Three months ended June 30, 2004 -----
Sales	\$ 39,750

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Cost of goods sold	(18,871)
Gross profits	20,879
General and administrative expenses	538,483
Interest expense	(1,377)
Net loss	(518,981)
Net loss per share	\$ (0.03)

Revenue from the sale of a product is recorded at the time of shipment to the customer. Revenue from research and development engineering contracts is recognized as the services are provided and accepted by the customer. Revenue from contracts to license technology to others is deferred until all conditions under the contract are met and then the sale is recognized as licensing royalty revenue over the remaining term of the contract.

Sales for the 2004 second quarter were primarily from licensing fees and royalties and engineering services. General and administrative expenses consisted of professional fees and consulting expense. Consulting expense represented \$285,513 of the general and administrative expense and was related to the partial vesting of warrants to purchase 650,000 shares granted to Summit Resource Group in consideration for public and investor relations consulting services. Interest expense was primarily from our convertible line of credit.

Summary Balance Sheet Information as of June 30, 2004

Cash	\$ 68,155
Total assets	8,558,077
Total current liabilities	621,347
Accumulated deficit	(1,117,154)
Total stockholders equity	\$ 7,936,730

Our total assets at June 30, 2004 included total current assets of \$104,947, property and equipment valued at \$1,702,882 and patents and proprietary technology of \$6,750,248.

Total current liabilities included accounts payable, accrued liabilities, deferred revenue and notes payable to a related party. Accounts payable of \$212,864 and deferred revenue of \$331,250 represented the majority of total

current liabilities. Deferred revenues consisted of \$250,000 prepaid licensing royalties to be deferred and recognized as the related licensing royalty sales are reported to the company by the customer over the remaining term of the agreement, and \$81,250 of deferred sales related to software license rights sold to the customer that are being amortized over the six-year

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term of the contract.

Factors Affecting Future Performance

We have recorded a net loss since inception and may be unable to attain or maintain profitability.

We are unable to fund our day-to-day operations with our revenues and must obtain additional financing. In the past we have not been successful at marketing our sensor products on the scale contemplated in the bankruptcy reorganization plan and we may be unable to attain those levels. In addition, we may not realize revenues from our subsidiaries or may be unable to increase revenues to the point that we attain and are able to maintain profitability.

Research and development may result in problems which may become insurmountable to fulfill implementation of production.

Customers may request that we create prototypes and perform pre-production research and development. As a result, we are exposed to the risk that we may find problems in our designs that are insurmountable to fulfill production. However, we are currently unaware of any insurmountable problems with ongoing research and development that may prevent further development of an application.

ITEM 3. CONTROLS AND PROCEDURES

Our Chief Executive Officer, who acts in the capacity of principal financial officer, has reevaluated the effectiveness of our disclosure controls and procedures, as defined by the Securities and Exchange Act of 1934. He determined that there continued to be no significant deficiencies in these procedures as of the end of the period covered by this report. Also, we have not made any changes to or taken corrective actions related to our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 2. CHANGES IN SECURITIES AND ISSUER'S PURCHASES OF EQUITIES

On June 2, 2004 we announced that we were approved for corporate listing in Standard and Poor's Corporation Records. This listing is a recognized securities manual for the Blue Sky standard manual exemption for secondary trading in more than 35 states. The listing on Standard and Poor's can assist the brokerage and investment communities in making a market for Flexpoint Sensor Systems' common stock.

ITEM 5. OTHER INFORMATION

On April 7, 2004 our board of directors appointed Donald E. Shelley as Secretary of the company. Mr. Shelley has served as a director of the company since April 2001.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

Part I Exhibits

- 31.1 Chief Executive Officer Certification
- 31.2 Principal Financial Officer Certification
- 32 Section 1350 Certification

