

APPLIED ENERGETICS, INC.  
Form 10-Q  
August 09, 2011

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

FORM 10-Q

☒ Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2011

OR

☐ 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 001-14015

APPLIED ENERGETICS, INC.  
(Exact Name of Registrant as Specified in Its Charter)

Delaware  
(State or Other Jurisdiction of Incorporation  
or Organization)

77-0262908  
(IRS Employer Identification Number)

3590 East Columbia Street  
Tucson, Arizona  
(Address of Principal Executive Offices)

85714  
(Zip Code)

Registrant's telephone number, including area code (520) 628-7415

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 ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  
Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

|                                                   |                                                        |                                                 |                                                                |
|---------------------------------------------------|--------------------------------------------------------|-------------------------------------------------|----------------------------------------------------------------|
| Large accelerated filer: <input type="checkbox"/> | Accelerated filer: <input checked="" type="checkbox"/> | Non-accelerated filer: <input type="checkbox"/> | Smaller reporting company: <input checked="" type="checkbox"/> |
|                                                   |                                                        | (Do not check if a smaller reporting company)   |                                                                |

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Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) Yes  
" No x

Indicate the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date. As of August 5, 2011, there were 91,371,192 shares of the issuer's common stock, par value \$.001 per share, outstanding.

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\*The company has determined that it qualifies as a smaller reporting company based on the market value of its public float.

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QUARTERLY REPORT ON FORM 10-Q  
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## PART I. FINANCIAL INFORMATION

## ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

APPLIED ENERGETICS, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS

|                                                                                                                                                                                            | June 30,<br>2011<br>(Unaudited) | December<br>31, 2010 |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------|----------------------|
| <b>ASSETS</b>                                                                                                                                                                              |                                 |                      |
| Current assets                                                                                                                                                                             |                                 |                      |
| Cash and cash equivalents                                                                                                                                                                  | \$6,950,451                     | \$8,983,281          |
| Accounts receivable                                                                                                                                                                        | 527,464                         | 2,022,292            |
| Inventory                                                                                                                                                                                  | 259,302                         | 683,546              |
| Prepaid expenses and deposits                                                                                                                                                              | 152,293                         | 365,506              |
| Other receivables                                                                                                                                                                          | 47,945                          | 48,717               |
| Total current assets                                                                                                                                                                       | 7,937,455                       | 12,103,342           |
| Long term receivables - net                                                                                                                                                                | 205,313                         | 205,313              |
| Property and equipment - net                                                                                                                                                               | 2,426,514                       | 2,507,814            |
| Other assets                                                                                                                                                                               | -                               | 10,000               |
| <b>TOTAL ASSETS</b>                                                                                                                                                                        | <b>\$ 10,569,282</b>            | <b>\$ 14,826,469</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                                                                                                                                |                                 |                      |
| Current liabilities                                                                                                                                                                        |                                 |                      |
| Accounts payable                                                                                                                                                                           | \$245,645                       | \$870,009            |
| Accrued expenses                                                                                                                                                                           | 234,850                         | 1,005,682            |
| Accrued compensation                                                                                                                                                                       | 480,359                         | 507,341              |
| Customer deposits                                                                                                                                                                          | 42,954                          | 126,282              |
| Billings in excess of costs                                                                                                                                                                | 1,614                           | 6,505                |
| Total current liabilities                                                                                                                                                                  | 1,005,422                       | 2,515,819            |
| <b>Total liabilities</b>                                                                                                                                                                   | <b>1,005,422</b>                | <b>2,515,819</b>     |
| <b>Commitments and contingencies - See Note 9</b>                                                                                                                                          |                                 |                      |
| <b>Stockholders' equity</b>                                                                                                                                                                |                                 |                      |
| Series A Convertible Preferred Stock, \$.001 par value, 2,000,000 shares authorized; 107,172 shares issued and outstanding at June 30, 2011 and at December 31, 2010                       | 107                             | 107                  |
| Common stock, \$.001 par value, 125,000,000 shares authorized; 91,371,191 shares issued and outstanding at June 30, 2011 and 91,068,357 shares issued and outstanding at December 31, 2010 | 91,371                          | 91,068               |
| Additional paid-in capital                                                                                                                                                                 | 79,040,055                      | 78,738,520           |
| Accumulated deficit                                                                                                                                                                        | (69,567,673)                    | (66,519,045)         |
| Total stockholders' equity                                                                                                                                                                 | 9,563,860                       | 12,310,650           |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                                                                                                                          | <b>\$ 10,569,282</b>            | <b>\$ 14,826,469</b> |

See accompanying notes to condensed consolidated financial statements (unaudited)

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APPLIED ENERGETICS, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited)

|                                                                     | For the three months ended<br>June 30, |              |
|---------------------------------------------------------------------|----------------------------------------|--------------|
|                                                                     | 2011                                   | 2010         |
| Revenue                                                             | \$1,022,765                            | \$2,879,932  |
| Cost of revenue                                                     | 927,728                                | 2,794,693    |
| Gross profit                                                        | 95,037                                 | 85,239       |
| Operating expenses                                                  |                                        |              |
| General and administrative                                          | 903,884                                | 525,354      |
| Selling and marketing                                               | 341,060                                | 232,699      |
| Research and development                                            | 445,588                                | 3,658        |
| Total operating expenses                                            | 1,690,532                              | 761,711      |
| Operating loss                                                      | (1,595,495 )                           | (676,472 )   |
| Other (expense) income                                              |                                        |              |
| Interest expense                                                    | (928 )                                 | (1,667 )     |
| Interest income                                                     | 892                                    | 2,110        |
| Total other                                                         | (36 )                                  | 443          |
| Net loss                                                            | (1,595,531 )                           | (676,029 )   |
| Preferred stock dividends                                           | (45,834 )                              | (57,557 )    |
| Deemed dividend from induced conversion of Series A Preferred Stock | -                                      | (11,478 )    |
| Net loss attributable to common stockholders                        | \$(1,641,365 )                         | \$(745,064 ) |
| Net loss per common share – basic and diluted                       | \$(0.02 )                              | \$(0.01 )    |
| Weighted average number of shares outstanding, basic and diluted    | 91,096,836                             | 89,687,321   |

See accompanying notes to condensed consolidated financial statements (unaudited)

APPLIED ENERGETICS, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited)

|                                                                     | For the six months ended<br>June 30, |                |
|---------------------------------------------------------------------|--------------------------------------|----------------|
|                                                                     | 2011                                 | 2010           |
| Revenue                                                             | \$3,839,343                          | \$6,474,709    |
| Cost of revenue                                                     | 3,599,842                            | 6,163,369      |
| Gross profit                                                        | 239,501                              | 311,340        |
| Operating expenses                                                  |                                      |                |
| General and administrative                                          | 1,898,570                            | 1,602,586      |
| Selling and marketing                                               | 665,901                              | 304,353        |
| Research and development                                            | 631,788                              | 36,520         |
| Total operating expenses                                            | 3,196,259                            | 1,943,459      |
| Operating loss                                                      | (2,956,758 )                         | (1,632,119 )   |
| Other (expense) income                                              |                                      |                |
| Interest expense                                                    | (2,339 )                             | (3,334 )       |
| Interest income                                                     | 2,140                                | 4,572          |
| Total other                                                         | (199 )                               | 1,238          |
| Net loss                                                            | (2,956,957 )                         | (1,630,881 )   |
| Preferred stock dividends                                           | (91,670 )                            | (115,541 )     |
| Deemed dividend from induced conversion of Series A Preferred Stock | -                                    | (11,478 )      |
| Net loss attributable to common stockholders                        | \$(3,048,627 )                       | \$(1,757,900 ) |
| Net loss per common share – basic and diluted                       | \$(0.03 )                            | \$(0.02 )      |
| Weighted average number of shares outstanding, basic and diluted    | 91,076,429                           | 89,281,990     |

See accompanying notes to condensed consolidated financial statements (unaudited)

APPLIED ENERGETICS, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

|                                                                             | For the six months ended<br>June 30, |               |
|-----------------------------------------------------------------------------|--------------------------------------|---------------|
|                                                                             | 2011                                 | 2010          |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                |                                      |               |
| Net loss                                                                    | \$(2,956,957)                        | \$(1,630,881) |
| Adjustments to reconcile net loss to net cash used in operating activities: |                                      |               |
| Depreciation and amortization                                               | 179,434                              | 216,600       |
| Loss on equipment disposal                                                  | 96                                   | 5,726         |
| Provision for inventory reserves                                            | (73,830 )                            | 22,000        |
| Provision for losses on projects                                            | -                                    | 15,154        |
| Non-cash stock based compensation expense                                   | 186,192                              | 658,139       |
| Changes in assets and liabilities:                                          |                                      |               |
| Accounts receivable                                                         | 1,494,828                            | (884,469 )    |
| Other receivable                                                            | 772                                  | (1,294 )      |
| Inventory                                                                   | 498,074                              | 23,420        |
| Prepaid expenses, deposits and other assets                                 | 223,213                              | 302,204       |
| Accounts payable                                                            | (624,364 )                           | 151,010       |
| Billings in excess of costs                                                 | (4,891 )                             | (39,124 )     |
| Accrued expenses, deposits and deferred rent                                | (881,142 )                           | 14,668        |
| Net cash used in operating activities                                       | (1,958,575)                          | (1,146,847)   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                |                                      |               |
| Purchase of land, building and equipment                                    | (101,630 )                           | (16,498 )     |
| Proceeds from disposal of equipment                                         | 3,400                                | 14,061        |
| Net cash used in investing activities                                       | (98,230 )                            | (2,437 )      |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                |                                      |               |
| Exercise of stock options                                                   | 23,975                               | 473,177       |
| Net cash provided by financing activities                                   | 23,975                               | 473,177       |
| Net decrease in cash and cash equivalents                                   | (2,032,830)                          | (676,107 )    |
| Cash and cash equivalents, beginning of period                              | 8,983,281                            | 9,604,643     |
| Cash and cash equivalents, end of period                                    | \$6,950,451                          | \$8,928,536   |

See accompanying notes to condensed consolidated financial statements (unaudited)

## 1. BASIS OF PRESENTATION

The accompanying interim unaudited condensed consolidated financial statements include the accounts of Applied Energetics, Inc. and its wholly owned subsidiaries, Ionatron Technologies, Inc. and North Star Power Engineering, Inc. as of June 30, 2011 (collectively, "company," "Applied Energetics," "we," "our" or "us"). All intercompany balances and transactions have been eliminated. In the opinion of management, all adjustments (which include normal recurring adjustments) necessary for a fair presentation of the results for the interim periods presented have been made. The results for the three- and six- month periods ended June 30, 2011, may not be indicative of the results for the entire year. The interim unaudited condensed consolidated financial statements should be read in conjunction with the company's audited consolidated financial statements contained in our Annual Report on Form 10-K.

The following unaudited condensed financial statements are presented pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to those rules and regulations, although the company believes that the disclosures made are adequate to make the information not misleading.

## USE OF ESTIMATES

The preparation of consolidated financial statements in conformity with United States Generally Accepted Accounting Principles ("GAAP") requires management to make estimates, judgments and assumptions that affect the amounts reported in the financial statements and accompanying notes. Management bases its assumptions on historical experiences and on various other estimates that it believes 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. In addition, management considers the basis and methodology used in developing and selecting these estimates, the trends in and amounts of these estimates, specific matters affecting the amount of and changes in these estimates, and any other relevant matters related to these estimates, including significant issues concerning accounting principles and financial statement presentation. Such estimates and assumptions could change in the future, as more information becomes known which could impact the amounts reported and disclosed herein. Significant estimates include revenue recognition under the percentage of completion method of contract accounting, estimating costs at completion on a contract, the valuation of inventory, carrying amount of long-lived assets, expected forfeiture rate on stock-based compensation and measurements of income tax assets and liabilities.

## CASH AND CASH EQUIVALENTS

Cash equivalents are investments in money market funds or securities with an initial maturity of three months or less. These money market funds are invested in government and U. S. Treasury based securities.

## FAIR VALUE OF CURRENT ASSETS AND LIABILITIES

The carrying amount of the accounts receivable, accounts payable and accrued expenses approximate fair value due to the short maturity of these instruments.

## RECENT ACCOUNTING PRONOUNCEMENTS

The Financial Accounting Standards Board ("FASB") has issued Accounting Standards Update ("ASU") 2011-04, "Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U. S. GAAP and International Financial Reporting Standards". ASU 2011-04 is the result of by the FASB and the International Accounting Standards Board ("IASB") to develop common requirements for measuring fair

value, and will explain how to measure fair value. ASU 2011-04 is effective for us for reports after December 15, 2011. The adoption of the standard is not expected to have a significant impact on the company's consolidated financial statements.

FASB has issued ASU 2011-05, "Comprehensive Income (Topic 220): Presentation of Comprehensive Income". ASU 2011-05 is intended to improve the comparability, consistency and transparency of financial reporting, and to increase the prominence of items reported in other comprehensive income. The FASB has decided to eliminate the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. ASU 2011-05 is effective for us for reports after December 15, 2011. The adoption of the standard is not expected to have a significant impact on the company's consolidated financial statements.

## 2. ACCOUNTS RECEIVABLE

Accounts receivable consists of the following:

|                                                       | June 30, 2011 | December 31,<br>2010 |
|-------------------------------------------------------|---------------|----------------------|
| Contracts receivable                                  | \$ 526,936    | \$ 2,012,027         |
| Costs and estimated earnings on uncompleted contracts | 528           | 10,265               |
| Accounts receivable, net                              | 527,464       | 2,022,292            |
| Short term receivable (contract retention)            | 47,817        | 47,817               |
| Long term receivable (contract retention)             | 205,313       | 205,313              |
|                                                       | \$ 780,594    | \$ 2,275,422         |

Contracts receivable are expected to be collected within a year.

## Costs and Estimated Earnings on Uncompleted Contracts

|                                                                                                | June 30, 2011 | December 31,<br>2010 |
|------------------------------------------------------------------------------------------------|---------------|----------------------|
| Costs incurred on uncompleted contracts                                                        | \$ 33,079,293 | \$ 29,648,466        |
| Estimated earnings                                                                             | 2,499,802     | 2,359,922            |
| Total billable costs and estimated earnings                                                    | 35,579,095    | 32,008,388           |
| Less:                                                                                          |               |                      |
| Billings to date                                                                               | 35,580,181    | 32,004,628           |
| Total                                                                                          | \$ (1,086 )   | \$ 3,760             |
| Included in accompanying balance sheet:                                                        |               |                      |
| Unbilled costs and estimated earnings on uncompleted contracts included in accounts receivable | \$ 528        | \$ 10,265            |
| Billings in excess of costs and estimated earnings on uncompleted contracts                    | (1,614 )      | (6,505 )             |
| Total                                                                                          | \$ (1,086 )   | \$ 3,760             |

## 3. INVENTORY

Our inventories consist of the following:

|                               | June 30, 2011 | December 31, 2010 |
|-------------------------------|---------------|-------------------|
| Raw materials                 | \$ 118,469    | \$ 81,646         |
| Work-in-process               | 140,833       | 675,730           |
| Provision for loss on project | -             | (73,830 )         |
| Total                         | \$ 259,302    | \$ 683,546        |

## 4. PROPERTY AND EQUIPMENT

Our property and equipment consist of the following:

|                                                    | June 30, 2011 | December 31, 2010 |
|----------------------------------------------------|---------------|-------------------|
| Land                                               | \$ 410,728    | \$ 410,728        |
| Buildings and improvements, leasehold improvements | 2,342,160     | 2,246,153         |
| Equipment                                          | 2,233,813     | 2,261,115         |
| Furniture                                          | 282,278       | 282,278           |
| Software                                           | 813,799       | 813,799           |
| Total                                              | 6,082,778     | 6,014,073         |
| Less accumulated depreciation and amortization     | (3,656,264 )  | (3,506,259 )      |
| Net property and equipment                         | \$ 2,426,514  | \$ 2,507,814      |

We review long-lived assets, including intangible assets subject to amortization, for possible impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable.

We assess the recoverability of such long-lived assets by determining whether the amortization of the balances over their remaining lives can be recovered through undiscounted future operating cash flows. The amount of impairment, if any, is measured based on projected discounted future operating cash flows. The assessment of the recoverability of long-lived assets will be impacted if estimated future operating cash flows are not achieved. We conducted an impairment test for property and equipment in February 2011 for the December 31, 2010 reporting period and concluded that the carrying value of these assets is recoverable through expected future operating cash flows.

## 5. SHARE-BASED COMPENSATION

Share-Based Compensation – Employees and Directors

For the three months ended June 30, 2011 and 2010, share-based compensation expense totaled approximately \$95,000 and \$132,000, respectively. For the six months ended June 30, 2011 and 2010, share-based compensation expense totaled approximately \$186,000 and \$658,000, respectively.

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There was no related income tax benefit recognized because our deferred tax assets are fully offset by a valuation allowance.

During the three months ended June 30, 2011, the compensation committee granted options to purchase 16,000 shares of our common stock to members of our Senior Advisory Board pursuant to the terms of their independent consultant agreements. As of June 30, 2011, \$252,000 of total unrecognized compensation cost related to restricted stock and restricted stock units is expected to be recognized over a weighted average period of approximately 2.6 years.

We determine the fair value of share-based awards at their grant date, using a Black-Scholes-Merton Option-Pricing Model applying the assumptions in the following table.

|                                                      | Six Months Ended June 30, |               |
|------------------------------------------------------|---------------------------|---------------|
|                                                      | 2011                      | 2010          |
| Expected life (years)                                | 2.5 years                 | 2.9 - 3 years |
| Dividend yield                                       | 0.0%                      | 0.0%          |
| Expected volatility                                  | 93.6%                     | 93.6%         |
|                                                      | .85% -                    |               |
| Risk free interest rates                             | 1.105%                    | 1.5%          |
| Weighted average fair value of options at grant date | \$0.48                    | \$0.24        |

During the six months ended June 30, 2011, 4,326 shares of restricted stock vested or were forfeited, options to purchase 48,084 shares were exercised, and options to purchase 108,916 shares were forfeited.

#### Warrants – Non-Employees

At June 30, 2011 and December 31, 2010 there were outstanding warrants to purchase approximately 1.0 million shares of common stock, which were issued in connection with the August 2006 financing. The exercise price of the warrants is \$9.15. On August 8, 2011, all outstanding warrants expired unexercised.

## 6. SIGNIFICANT CUSTOMERS

Approximately 98% and 99% of revenues for the three-month periods ended June 30, 2011 and 2010, respectively, are generated from either the U.S. Government or contractors to the U.S. Government. Approximately 96% and 100% of revenues for the six-month periods ended June 30, 2011 and 2010, respectively, are generated from either the U.S. Government or contractors to the U.S. Government.

## 7. NET LOSS PER SHARE

Basic net loss per common share is computed by dividing net loss available to common shareholders by the weighted average number of common shares outstanding during the period before giving effect to stock options, stock warrants, restricted stock units and convertible securities outstanding, which are considered to be dilutive common stock equivalents. Diluted net loss per common share is calculated based on the weighted average number of common and potentially dilutive shares outstanding during the period after giving effect to convertible preferred stock, stock options, warrants and restricted stock units. Contingently issuable shares are included in the computation of basic loss per share when issuance of the shares is no longer contingent. Due to the losses from continuing operations for the six months ended June 30, 2011 and 2010, basic and diluted loss per common share were the same, as the effect of potentially dilutive securities would have been anti-dilutive.



Potentially dilutive securities not included in the diluted loss per share calculation, due to net losses from continuing operations, were as follows:

|                                       | Six Months Ended June 30, |           |
|---------------------------------------|---------------------------|-----------|
|                                       | 2011                      | 2010      |
| Options to purchase common shares     | 4,093,921                 | 4,480,130 |
| Warrants to purchase common shares    | 923,272                   | 1,024,939 |
| Unvested restricted stock units       | 321,310                   | -         |
| Convertible preferred stock           | 107,172                   | 134,572   |
| Total potentially dilutive securities | 5,445,675                 | 5,639,641 |

## 8. DIVIDENDS

As of June 30, 2011, we had 107,172 shares of our 6.5% Series A Convertible Preferred Stock outstanding. A dividend was declared and paid in common stock on August 1, 2011 to the holders of record as of July 15, 2011.

Dividends on Preferred Stock are accrued when the amount and kind of the dividend is determined and are payable quarterly on the first day of February, May, August and November, in cash or shares of common stock, at the discretion of the company.

## 9. COMMITMENTS AND CONTINGENCIES

### LITIGATION

On or about January 14, 2010, NewOak Capital Markets LLC ("NewOak"), formerly known as J. Giordano Securities, LLC, the placement agent for our October 2005 private placement of preferred stock, filed a Statement of Claim against us with Financial Industry Regulatory Authority ("FINRA"). NewOak alleges that we made material misrepresentations between May 2005 and May 10, 2006 concerning the status of our products.

We previously settled class action and derivative lawsuits relating to the alleged misrepresentations. NewOak, however, opted out of the class action and alleges that the alleged misrepresentations constituted breaches of its agreement with us and that we breached warranties we made to NewOak in connection with the 2005 private placement. NewOak seeks indemnification and recovery for alleged breach of contract, unjust enrichment, quantum meruit, fraudulent misrepresentation, tortious interference with prospective economic relations and violation of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, and seeks an award of monetary damages in excess of \$50,000,000, plus punitive damages and attorney's fees and costs.

This litigation is in the preliminary stage and no discovery has been initiated by the plaintiff. It is too early to estimate whether a loss will be incurred, and no accrual for loss has been established in connection with this pending litigation as a reasonable estimate of the loss or range of loss cannot be made at this time.

In addition, we may from time to time be involved in legal proceedings arising from the normal course of business. As of the date of this report, we have not received notice of any other legal proceedings.

## 10. SUBSEQUENT EVENTS

During this period of uncertain government fiscal policy and downward pressures on defense spending, we reduced our work force and overall expenditures to preserve cash resources. In July, we reduced the annual base salaries of each of the executive officers and the members of the Board by approximately 15% in a cost reduction measure and reduced our workforce by approximately 22%. These actions and other cuts in overall expenditures will result in estimated annual savings of approximately \$1.75 million after a one time charge of approximately \$90,000.

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

Our discussion and analysis of the financial condition and results of operations should be read in conjunction with the unaudited condensed consolidated financial statements and the related disclosures included elsewhere herein and in Management's Discussion and Analysis of Financial Condition and Results of Operations included as part of our Annual Report on Form 10-K for the year ended December 31, 2010.

### CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this Quarterly Report on Form 10-Q constitute forward-looking statements within the meaning of the securities laws. Forward-looking statements include all statements that do not relate solely to the historical or current facts, and can be identified by the use of forward looking words such as "may", "believe", "will", "would", "could", "should", "expect", "project", "anticipate", "estimates", "possible", "plan", "strategy", "target", "prospect" or "continue" and other similar terms and phrases. These forward looking statements are based on the current plans and expectations of our management and are subject to a number of uncertainties and risks that could significantly affect our current plans and expectations, as well as future results of operations and financial condition and may cause our actual results, performances or achievements to be materially different from any future results, performances or achievements expressed or implied by such forward-looking statements. Important factors that could cause our actual results to differ materially from our expectations are described in Item 1A. (Risk Factors) of our Annual Report on Form 10-K, as amended, for the year ended December 31, 2010. In making these forward-looking statements, we claim the protection of the safe-harbor for forward-looking statements contained in the Private Securities Reform Act of 1995. Although we believe that the expectations reflected in such forward-looking statements are reasonable, there can be no assurance that such expectations will prove to have been correct. We do not assume any obligation to update these forward-looking statements to reflect actual results, changes in assumptions, or changes in other factors affecting such forward-looking statements.

### OVERVIEW

Applied Energetics develops and manufactures applied energy systems for military and commercial applications. Through our technology development efforts, we have gained expertise and proprietary knowledge in high performance lasers and high-voltage electronics. We deliver innovative technologies and systems to address urgent military requirements, including neutralizing improvised explosive devices ("IEDs") and other high priority missions of U.S. military forces. We have developed what we believe to be an effective and robust counter-IED ("C-IED") system. Additionally, we develop and manufacture high-voltage and ultra-short pulse ("USP") laser systems for government and commercial customers for a range of applications.

During the second quarter of 2011, we completed all testing related to C-IED technologies developed under our US Marine Corps ("USMC") contract. We have not yet been informed of the official results of this testing. We do not expect to learn of the USMC plans for future activities in this area until after the customer has completed its review of the Final Test Report.

During the second quarter of 2011, we received a \$285,000 funding increase from our customer, the U.S. Army's Armament Research, Development and Engineering Command, to improve high voltage systems and optics to advance the Laser Guided Energy ("LGE") technology toward a fielded capability. We conducted a technology demonstration for senior Army managers at the end of July to inform them of the technology development progress as they evaluate future funding priorities during a challenging federal fiscal environment for research and development activities.

During the second quarter of 2011, we continued work on our High Voltage project for the Air Force Research Laboratory Phase II SBIR. This project utilizes our nested high voltage generator architecture to power a compact Marx generator for U.S. Air Force High Power Microwave applications. The project has a value of \$746,000.

We continue our investment in our USP laser technologies and our nested high voltage generator electron beam technologies to expand sales to non-governmental customers. We believe that these new products offer superior performance to competing products currently available for commercial applications. Our proprietary USP laser systems, which are a direct spinoff of our LGE technology, offer higher pulse energy, higher average power and a higher repetition rate for micromachining and other commercial applications. Micromachining applications include drilling, cutting, and engraving metals, composites and ceramics. A major part of our strategy for the introduction of our new USP laser product is the construction of our state of the art USP laser application center at our facility in Tucson, Arizona. This new application center will enable potential customers and strategic partners to use our USP laser systems to demonstrate and validate new and emerging applications prior to purchasing new USP lasers.

We have developed a compact Electron Beam System powered by our nested high voltage generator which produces 800,000 – 1 million volts of electricity. This system can be used in a variety of commercial applications including materials processing and cross-linking of polymers. We have constructed an Electron Beam application center to demonstrate our nested high voltage generator products to potential manufacturing customers who use electron and ion beams in their manufacturing processes. This center will also enable these potential customers and strategic partners to use our nested high voltage generator system to develop and validate new and emerging applications prior to purchasing new Electron Beam systems.

We are pursuing the establishment of teaming arrangements and co-marketing agreements with established laser manufacturers and process equipment manufacturers to accelerate the introduction of these new products and capabilities. Potential examples include partnering with companies involved in laser beam precision micromachining and high power semi-conductor fabrication systems.

During this period of uncertain government fiscal policy and downward pressures on defense spending, we reduced our work force and overall expenditures to preserve cash resources. In July, we reduced the annual base salaries of each of the executive officers and the members of the Board by approximately 15% in a cost reduction measure and reduced our workforce by approximately 22%. These actions and other cuts in overall expenditures will result in estimated annual savings of approximately \$1.75 million after a one time charge of approximately \$90,000.

## RESULTS OF OPERATIONS

### COMPARISON OF OPERATIONS FOR THE THREE MONTHS ENDED JUNE 30, 2011 AND 2010:

|                            | 2011           | 2010          |
|----------------------------|----------------|---------------|
| Revenue                    | \$ 1,022,765   | \$ 2,879,932  |
| Cost of revenue            | 927,728        | 2,794,693     |
| General and administrative | 903,884        | 525,354       |
| Selling and marketing      | 341,060        | 232,699       |
| Research and development   | 445,588        | 3,658         |
| Other (expense) income:    |                |               |
| Interest expense           | (928 )         | (1,667 )      |
| Interest income            | 892            | 2,110         |
| Net loss                   | \$ (1,595,531) | \$ (676,029 ) |

## REVENUE

Revenue decreased by approximately \$1.9 million to \$1.0 million for the three months ended June 30, 2011 compared to \$2.9 million for the three months ended June 31, 2010, primarily as a result of completion of our C-IED related contracts with the US Marine Corp (“USMC”). Revenues from the C-IED product line decreased by \$1.7 million to \$441,000 as we completed all deliverables and testing required under the USMC contract. LGE revenues decreased by \$160,000 to \$506,000 and USP laser revenues decreased by \$65,000 to \$35,000 for the three months ended June 30, 2011 compared to the three months ended June 30, 2010. High Voltage revenues increased by \$23,000 to \$41,000 for the three months ended June 30, 2011 compared to the three months ended June 30, 2010.

## COST OF REVENUE

Cost of revenue includes manufacturing labor, benefits and overhead, and an allocation of allowable general and administration and research and development costs in accordance with the terms of our government contracts.

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Cost of revenue decreased by approximately \$1.9 million to \$900,000 for the three months ended June 30, 2011, compared to \$2.8 million for the three months ended June 30, 2010. The decrease in cost of revenue is mostly tied to the decrease in sales.

## GENERAL AND ADMINISTRATIVE

General and administrative expenses increased approximately \$379,000 to \$904,000 for the three months ended June 30, 2011 compared to \$525,000 for the three months ended June 30, 2010. This increase is attributable to the lack of absorption of \$781,000 of applied labor and overheads previously charged to government contracts. This lack of absorption was offset by decreases in salaries, wages and benefits of \$166,000, professional services of \$110,000, legal expenses of \$45,000, recruiting expenses of \$40,000, non-cash compensation costs \$38,000, and depreciation and amortization expense of \$18,000.

## SELLING AND MARKETING

Selling and marketing and business development expenses increased by \$108,000 to \$341,000 for the three months ended June 30, 2011 compared to \$233,000 for the three months ended June 30, 2010 as we increased our efforts to introduce our new products to expand sales to non-governmental customers.

## RESEARCH AND DEVELOPMENT

Research and development expenses increased by \$442,000 to \$446,000 during the three months ended June 30, 2011 as compared to \$4,000 for the three months ended June 30, 2010. During the second quarter of 2011, we accelerated development of commercial applications for our USP laser technologies and our Electron Beam Nested High Voltage technologies. These two key projects involve establishing commercial product lines for USP Lasers offering higher energy and average power than currently available and for our nested high voltage electron beam gun technologies to enable a wider range of commercial applications.

## INTEREST INCOME AND INTEREST EXPENSE

Net interest income for the three months ended June 30, 2011 was lower by approximately \$1,000 as compared to the three months ended June 30, 2010.

## NET LOSS

Our operations for the three months ended June 30, 2011 resulted in a net loss of approximately \$1.6 million, an increase of approximately \$920,000 compared to the \$676,000 loss for the three months ended June 30, 2010.

## COMPARISON OF OPERATIONS FOR THE SIX MONTHS ENDED JUNE 30, 2011 AND 2010:

|                            | 2011         | 2010         |
|----------------------------|--------------|--------------|
| Revenue                    | \$ 3,839,343 | \$ 6,474,709 |
| Cost of revenue            | 3,599,842    | 6,163,369    |
| General and administrative | 1,898,570    | 1,602,586    |
| Selling and marketing      | 665,901      | 304,353      |
| Research and development   | 631,788      | 36,520       |
| Other (expense) income:    |              |              |
| Interest expense           | (2,339 )     | (3,334 )     |
| Interest income            | 2,140        | 4,572        |

|          |    |             |    |             |
|----------|----|-------------|----|-------------|
| Net loss | \$ | (2,956,957) | \$ | (1,630,881) |
|----------|----|-------------|----|-------------|

## REVENUE

Revenue decreased approximately \$2.6 million to \$3.8 million for the six months ended June 30, 2011 compared to \$6.5 million for the six months ended June 30, 2010, primarily as a result of completion of our C-IED related contracts with the USMC during the second quarter. Revenues from the C-IED product line decreased by \$2.1 million to \$2.2 million, as we completed all deliverables and testing required under the USMC contract. USP laser revenue decreased by \$484,000 to \$181,000 and the LGE product line revenue decreased \$291,000 to \$1.2 million. Offsetting these decreases was the increase in the High Voltage line of \$249,000 to \$274,000.

## COST OF REVENUE

Cost of revenue includes manufacturing labor, benefits and overhead, and an allocation of allowable general and administration and research and development costs in accordance with the terms of our government contracts.

Cost of revenue decreased approximately \$2.6 million to \$3.6 million for the six months ended June 30, 2011, compared to \$6.2 million for the six months ended June 30, 2010. The decrease in cost of revenue is mostly tied to the decrease in sales.

## GENERAL AND ADMINISTRATIVE

General and administrative expenses increased approximately \$296,000 to \$1.9 million for the six months ended June 30, 2011 compared to \$1.6 million for the six months ended June 30, 2010. The increase is attributable to the lack of absorption of \$1.0 million of applied labor and overheads previously charged to government contracts. There was also an increase in legal professional fees of \$76,000, increases to recruitment costs of approximately \$55,000 and an increase to travel costs of \$26,000. These increases were offset by reductions in non-cash compensation costs of approximately \$463,000, reductions in salaries, wages and benefits of \$261,000, in professional services of \$84,000, and supplies and building related expenses of \$51,000.

## SELLING AND MARKETING

Selling and marketing and business development expenses increased by approximately \$362,000 to \$666,000 for the six months ended June 30, 2011 compared to \$304,000 for the six months ended June 30, 2010 as we increased our efforts to introduce our new products to expand sales to non-governmental customers.

## RESEARCH AND DEVELOPMENT

Research and development expenses increased by \$596,000 to \$632,000 for the six months ended June 30, 2011 as compared to \$37,000 for the six months ended June 30, 2010. During 2011, we accelerated development of commercial applications for our USP laser technologies and our Electron Beam Nested High Voltage technologies. These two key projects involve establishing commercial product lines for USP Lasers offering higher energy and average power than currently available and for our nested high voltage electron beam gun technologies to enable a wider range of commercial applications

## INTEREST INCOME AND INTEREST EXPENSE

Net interest income for the six months ended June 30, 2011 was lower by approximately \$2,400 as compared to the six months ended June 30, 2010.

## NET LOSS

Our operations for the six months ended June 30, 2011 resulted in a net loss of approximately \$2.9 million, an increase of approximately \$1.3 million compared to the \$1.6 million loss for the six months ended June 30, 2010. Our net loss attributable to common stockholders per common share – basic and diluted - increased by \$0.01 per share, largely due to an increase in our net loss.

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## LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2011, we had approximately \$7.0 million of cash and cash equivalents. Our cash position decreased during the first half of 2011 by approximately \$2.0 million. During the first half of 2011, we received approximately \$5.3 million in cash from customers, and paid approximately \$7.3 million to our suppliers and employees. Investing activities resulted in net cash outflow of approximately \$98,000 and financing activities resulted in net cash inflow of approximately \$24,000.

We anticipate that short-term funding needs will be provided by existing cash and cash equivalents. If we do not receive any further C-IED orders from the USMC, based on our current level of cash expenditures, we would then anticipate net cash outflows in the range of \$2.5 – \$3.0 million during the next twelve month period ending June 30, 2012. We expect to continue to have negative cash outflows until such time, if ever, that we begin to generate meaningful sales of our non-defense commercial products. We believe that we have sufficient working capital to fulfill existing contracts and expected contracts for at least the next twelve months.

## BACKLOG OF ORDERS

At June 30, 2011, we had a backlog (workload remaining on signed contracts) of approximately \$1.1 million, to be completed within the next twelve months.

## ITEM 4. CONTROLS AND PROCEDURES

### EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Our management, with the participation of our Principal Executive Officer and Principal Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2011. Based on that evaluation, our Principal Executive Officer and Principal Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

During the three months ended June 30, 2011, there was no significant change in our internal controls over financial reporting that has materially affected or which is reasonably likely to materially affect our internal controls over financial reporting.

## PART II – OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

On or about January 14, 2010, NewOak Capital Markets LLC ("NewOak"), formerly known as J. Giordano Securities, LLC, the placement agent for our October 2005 private placement of preferred stock, filed a Statement of Claim against us with Financial Industry Regulatory Authority ("FINRA"). NewOak alleges that we made material misrepresentations between May 2005 and May 10, 2006 concerning the status of our products.

We previously settled class action and derivative lawsuits relating to the alleged misrepresentations. NewOak, however, opted out of the class action and alleges that the alleged misrepresentations constituted breaches of its agreement with us and that we breached warranties we made to NewOak in connection with the 2005 private placement. NewOak seeks indemnification and recovery for alleged breach of contract, unjust enrichment, quantum meruit, fraudulent misrepresentation, tortious interference with prospective economic relations and violation of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, and seeks an award of monetary damages in excess of \$50,000,000, plus punitive damages and attorney's fees and costs.

We filed a petition in the Supreme Court of New York, New York County to stay the arbitration on the ground that the claims are not subject to arbitration. NewOak removed the proceeding to the United States District Court, Southern District of New York, and filed a motion to compel arbitration. United States District Judge Richard Berman rejected the Magistrate Judge's Recommendation and granted NewOak's motion to compel arbitration.

On July 13, 2011, the Second Circuit reversed the District Court's order compelling arbitration. The Second Circuit remanded the matter with direction to grant the petition to stay arbitration. On July 19, 2011, NewOak filed with the Second Circuit a petition for rehearing en banc or, alternatively, panel rehearing. The petition for rehearing is currently pending.

### ITEM 6. EXHIBITS

| EXHIBIT<br>NUMBER | DESCRIPTION                                                                                                                                                                                  |
|-------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 31.1              | Certification of Principal Executive Officer pursuant to Rule 13a-14 or 15d-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2              | Certification of Principal Financial Officer pursuant to Rule 13a-14 or 15d-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1              | Principal Executive Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                                          |
| 32.2              | Principal Financial Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                                          |
| 101.INS           | XBRL Instance Document                                                                                                                                                                       |
| 101.SCH           | XBRL Schema Document                                                                                                                                                                         |
| 101.CAL           | XBRL Calculation Linkbase Document                                                                                                                                                           |
| 101.LAB           | XBRL Label Linkbase Document                                                                                                                                                                 |
| 101.PRE           | XBRL Presentation Linkbase Document                                                                                                                                                          |

SIGNATURES

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

APPLIED ENERGETICS, INC.

By           /s/ Joseph C. Hayden  
              Joseph C. Hayden  
              President and  
              Principal Executive  
              Officer

Date: August 9, 2011

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