

SECTOR 10 INC  
Form 10-Q  
November 20, 2009

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

**FORM 10-Q**

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

For the quarterly period ended: **September 30, 2008**

or

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

For the transition period from: \_\_\_\_\_ to \_\_\_\_\_

**SECTOR 10, Inc.**

*(Exact name of small business issuer as specified in its charter)*

**Delaware**  
*(State or other jurisdiction of  
incorporation)*

**000-24370**  
*(Commission  
File No.)*

**33-0565710**  
*(IRS Employer  
Identification No.)*

Edgar Filing: SECTOR 10 INC - Form 10-Q

**14553 South 790 West**

**Bluffdale, Utah 84065**

*(Address of principal executive offices, including zip code)*

**(206) 853-4866**

*Issuer's telephone number, including area code*

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  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  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

As of November 20, 2009 the issuer had 39,277,043 shares of common stock outstanding.

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

**SECTOR 10, INC.**

**TABLE OF CONTENTS**

**PAGE**

**PART I FINANCIAL INFORMATION**

Item 1. Unaudited Consolidated Financial Statements

3

Consolidated Balance Sheets as of September 30, 2009 (Unaudited) and March 31, 2009

3

Unaudited Consolidated Statements of Operations for the Six Months Ended September 30, 2009 and 2008 and for the Period From Inception, September 16, 2002 to September 30, 2009

4

Unaudited Consolidated Statements of Operations for the Three Months Ended September 30, 2009 and 2008

5

Unaudited Consolidated Statement of Changes in Shareholders' Equity (Deficit) for the Period March 31, 2009 to September 30, 2009

6

Unaudited Consolidated Statements of Cash Flows for the Six Months Ended September 30, 2009 and 2008 and for the Period From Inception, September 16, 2002, to September 30, 2009

8

Notes to the Unaudited Consolidated Financial Statements

9

Item 2. Management's Discussion And Analysis Or Plan Of Operation

19

Item 3. Controls And Procedures

25

**PART II OTHER INFORMATION**

Item 1. Legal Proceedings

26

Item 2. Unregistered Sales Of Equity Securities And Use Of Proceeds

27

Item 6. Exhibits

27

---

**PART I FINANCIAL INFORMATION****ITEM 1.****FINANCIAL STATEMENTS****SECTOR 10, INC.****(A DEVELOPMENT STAGE COMPANY)****CONSOLIDATED BALANCE SHEETS**

ASSETS	<b>September 30, 2009</b> <i>(Unaudited)</i>	<b>March 31, 2009</b> <i>(Audited)</i>
Current assets:		
Cash	\$ 796	\$ 35,016
Accounts receivable		2,000
Inventory	18,409	18,409
Prepaid assets	1,022	37,291
Total current assets	20,227	92,716
Fixed Assets:		
Furniture	9,182	9,182
Computers	13,068	13,068
Total fixed asset cost	22,250	22,250
Less: accumulated depreciation	(7,935 )	(5,710 )
Net fixed assets	14,315	16,540
Other assets:		
Deposits		10,000
Network acquisition/development costs	1,147,995	1,147,995
Total other assets	1,147,995	1,157,995
Total assets	\$ 1,182,537	\$ 1,267,251

**LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)**

Current liabilities:		
Accounts payable and accrued liabilities	\$ 507,774	\$ 400,152
Deferred revenue	18,500	18,500
Note payable - short term	299,083	451,000
Note payable officer / shareholder	5,930	38,754
Total current liabilities	831,287	908,406

Edgar Filing: SECTOR 10 INC - Form 10-Q

Long term liabilities:		
Note payable	483,000	
Total long term liabilities	483,000	
Total liabilities	1,314,287	908,406
Shareholders' equity (deficit):		
Preferred shares - \$0.001 par value; 1,000,000 authorized, no shares issued or outstanding		
Common shares - \$0.001 par value; 199,000,000 authorized; 11,794,407 and 10,143,530 shares issued and outstanding, respectively	11,795	10,144
Additional paid- in-capital	1,261,882	1,009,008
Deficit accumulated during the development stage	(1,405,427 )	(660,307 )
Total shareholders' equity (deficit)	(131,750 )	358,845
Total liabilities and shareholders' equity (deficit)	\$ 1,182,537	\$ 1,267,251

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

**SECTOR 10, INC.****(A DEVELOPMENT STAGE COMPANY)**

**UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS  
FOR THE SIX MONTHS ENDED SEPTEMBER 30, 2009 AND 2008 AND  
FOR THE PERIOD FROM INCEPTION,  
SEPTEMBER 16, 2002 TO SEPTEMBER 30, 2009**

	Six Months Ended		Inception to
	September 30, 2009	September 30, 2008	September 30, 2009
Sales	\$	\$ 6,000	\$ 18,500
Cost of Sales		(3,800 )	(18,032 )
Gross Profit		2,200	468
Expenses:			
General and administrative	722,415	370,736	1,867,930
Depreciation	2,225	2,225	7,935
Total expenses	724,640	372,961	1,875,865
Income (loss) from operations	(724,640 )	(370,761 )	(1,875,397 )
Interest expense	(20,480 )	(7,842 )	(47,230 )
Other income: debt restructuring		517,200	517,200
Net Income (loss) before income taxes	(745,120 )	138,597	(1,405,427 )
Provision for income taxes			
Net Income (loss) after income taxes	\$ (745,120 )	\$ 138,597	\$ (1,405,427 )
Weighted Average Shares Outstanding basic and diluted	11,216,923	9,039,767	
Basic and diluted income (loss) per share			
Continuing Operations	\$ (0.07 )	\$ 0.02	
Net Income (Loss)	\$ (0.07 )	\$ 0.02	

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





**SECTOR 10, INC.****(A DEVELOPMENT STAGE COMPANY)****UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS  
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008**

	<b>Three Months Ended</b>	
	<b>September 30, 2009</b>	<b>September 30, 2008</b>
Sales	\$	\$ 6,800
Cost of Sales		(3,800 )
Gross Profit		2,200
Expenses:		
General and administrative	311,191	131,716
Depreciation	1,112	1,113
Total expenses	312,203	132,829
Income (loss) from operations	(312,203 )	(130,629 )
Interest expense	(12,121 )	(4,517 )
Other income: debt restructuring		
Net Income (loss) before income taxes	(324,424 )	(135,146 )
Provision for income taxes		
Net Income (loss) after income taxes	\$ (324,424 )	\$ (135,146 )
Weighted Average Shares Outstanding basic and diluted	11,448,789	9,406,029
Basic and diluted income (loss) per share		
Continuing Operations	\$ (0.03 )	\$ (0.01 )
Net Loss	\$ (0.03 )	\$ (0.01 )

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

**SECTOR 10, INC.****(A DEVELOPMENT STAGE COMPANY)****UNAUDITED CONSOLIDATED STATEMENT OF CHANGES IN  
SHAREHOLDERS' EQUITY (DEFICIT)**

	Common stock		Additional Paid-In Capital	Deficit Accumulated During the Development Stage
	Shares	Amount		
Balance at March 31, 2009	10,143,530	\$ 10,144	\$ 1,009,008	\$ (660,307 )
Issue shares on April 8, 2009 @\$.30 per share to John Gargett for Director Fees (unaudited)	50,000	50	14,950	
Issue shares on April 22, 2009 to Layne Davis @\$.20 per share for Product Design (unaudited)	27,500	28	5,472	
Issue shares on April 24, 2009 to QualityStocks, LLC @\$.30 per share for Investor Relations (unaudited)	37,500	37	11,213	
Issue shares on April 24, 2009 to Illuminated Financial @\$.20 per share for Investor Relations (unaudited)	25,000	25	4,975	
Issue shares to John Gargett on May 8, 2009 @\$.10 per share per employment contract (unaudited)	50,000	50	4,950	
Issue shares to Patrick Love on May 15, 2009 @\$.20 per share per employment contract (unaudited)	10,000	10	1,990	
Issue Shares on May 19, 2009 as a result of Reverse stock split (unaudited)	43			
Issue shares to John Gargett on July 13, 2009 @.27 per share per employment contract due at July 1, 2009 (unaudited)	50,000	50	13,450	
Issue shares to Patrick Love on July 13, 2009 @.27 per share per employment contract due at July 1, 2009 (unaudited)	10,000	10	2,690	
	25,000	25	3,350	

Issue shares to John McCloskey,  
Jr on September 24, 2009 @.135  
per share for Board of Advisor  
Fees due on July 14, 2009  
(unaudited)

Issue shares to Hugh  
Cholmondeley on September 24,  
2009 @.135 per share for Board  
of Advisor Fees due on July 14,  
2009 (unaudited)

25,000	25	3,350
--------	----	-------

Issue shares to Pericles DeAvila  
on September 28, 2009 based on  
May 1, 2009 authorization @.10  
per share for prior year accrued  
services and current year board  
services. (unaudited)

550,000	550	54,450
---------	-----	--------

Issue shares to Laurence A.  
Madison on September 28, 2009  
based on May 1, 2009  
authorization @.10 per share for  
prior year accrued services and  
current year board services.  
(unaudited)

400,000	400	39,600
---------	-----	--------

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

	Common stock		Additional Paid-In Capital	Deficit Accumulated During the Development Stage
	Shares	Amount		
Issue shares to Alan Rouleau on September 28, 2009 based on May 1, 2009 authorization @.10 per share for prior year accrued services and current year board services. (unaudited)	100,000	100	9,900	
Issue shares to John Ketcham on September 28, 2009 @.11 per share for R&D services (unaudited)	5,000	5	545	
Issue shares to Patrick Madison on September 28, 2009 @.11 per share for short term investment (unaudited)	15,000	15	1,635	
Issue shares to Sector 10 Holdings, Inc. on September 30, 2009 @.30 per share to reimburse stock transferred to Illuminated Financial on behalf of Company. Accrued in prior quarter (unaudited)	250,000	250	77,250	
Issue shares to Sector 10 Holdings, Inc. on September 30, 2009 @/15 per share to stock transfer to Moody Capital, LLC (unaudited)	20,834	21	3,104	
Net loss for the period (unaudited)				(745,120 )
Balance at September 30, 2009 (unaudited)	11,794,407	\$ 11,795	\$ 1,261,882	\$ (1,405,427 )

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



**SECTOR 10, INC.****DEVELOPMENT STAGE COMPANY)****UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Six Months Ended</b>		<b>Inception to</b>
	<b>September 30,</b>	<b>September 30,</b>	<b>September 30,</b>
	<b>2009</b>	<b>2008</b>	<b>2009</b>
<b>Cash Flows from Operating Activities:</b>			
Net income (loss)	\$ (745,120 )	\$ 138,597	\$ (1,405,427 )
Adjustments to reconcile net income (loss) to net cash used in operating activities:			
Stock for services	290,794	278,330	837,502
Depreciation	2,225	2,225	7,935
Gain on debt restructuring		(517,200 )	(517,200 )
Changes in assets and liabilities			
(Increase) decrease in accounts receivable	2,000	(3,000 )	
(Increase) in inventory			(18,409 )
(Increase) decrease in deposits	10,000	(25,000 )	
Increase in accounts payable and accrued liabilities	374,919	80,795	855,685
Increase in deferred revenue			18,500
Net cash used in operating activities	(65,182 )	(45,253 )	(221,414 )
<b>Cash Flows from Investing Activities:</b>			
Fixed asset purchases			(22,250 )
Network acquisition / development costs		(97,995 )	(147,995 )
Net cash used in investing activities		(97,995 )	(170,245 )
<b>Cash Flows from Financing Activities:</b>			
Bank overdraft		(692 )	
Proceeds from general financing	63,786	200,000	514,786
Proceeds from Shareholder /Officers	31,396	112,548	914,217
Payments to Shareholder/Officers	(64,220 )	(167,151 )	(1,040,134 )
Proceeds from issuance of common stock			3,586
Net cash provided by financing activities	30,962	144,705	392,455
Net increase (decrease) in cash and cash equivalents	(34,220 )	1,457	796
Beginning of the period cash balance	35,016		

Edgar Filing: SECTOR 10 INC - Form 10-Q

Ending of the period	cash balance	\$	796	\$	1,457	\$	796
Cash Paid for interest		\$	762	\$	3,001	\$	5,531
Cash paid for income taxes		\$		\$		\$	

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

**SECTOR 10, INC.**

**(A DEVELOPMENT STAGE COMPANY)**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1 BASIS OF PRESENTATION**

The accompanying unaudited consolidated condensed financial statements of Sector 10, Inc. ( Sector 10 or the Company ), have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and required by Rule 10-01 of Regulation S-X. They do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, considered necessary for a fair presentation, have been included in the accompanying unaudited consolidated financial statements. Operating results for the periods presented are not necessarily indicative of the results that may be expected for the full year.

**Note 2 INVENTORY**

The Company uses Dutro Company as an outsourced manufacturing company. The Dutro Company provides the Company with details regarding inventory on hand and related costs. The inventory on hand at March 31, 2009 was \$18,409. Sales activity and related purchase orders were minimal for the fiscal year ended March 31, 2009 and no sales activity occurred in the six month period ended September 30, 2009.

All inventory on hand is available for sale. As sales and related production activity increases the Company will with the assistance of the outsourced manufacturer periodically makes judgments and estimates regarding the future utility and carrying value of its inventory. The carrying value of inventory is periodically reviewed and impairments, if any, are recognized when the expected future benefit from the inventory is less than its carrying value. If applicable, the Company will establish inventory reserves for estimated obsolescence or unmarketable inventory which is equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. For the period ended September 30, 2009, the Company has no inventory reserve.

Dutro Company was the outside manufacturer of Sector 10 Products under an agreement dated October 1, 2007. The agreement expired on September 30, 2009 and was not renewed. Finished inventory was retrieved from the Dutro Company manufacturing facility and is stored in facilities controlled by the Company. The Company is soliciting quotes from potential new manufacturers. There are interim sources that are immediately available for production until a new manufacturer is identified.

**Note 3 NETWORK ACQUISITION/DEVELOPMENT COSTS**

On May 19, 2008 Sector 10, Inc. ( Sector 10 or Company ) entered into an agreement with its major shareholder Sector 10 Holdings, Inc. ( Holdings ). Holdings currently owns over 50% of the outstanding shares of Sector 10, Inc. Holdings had developed a Server Network to maintain and administer products and services that had been developed within specifications to manage the SRU and MRU safety products.

The network has fully integrated capabilities for distribution services including the worldwide transmission of video and audio broadcasts, with content management services that archive data under a redundant system with various server clusters across the nation to service Sector10 s National and world-wide requirements. In addition to providing for the normal Sector 10 products such as the SRU and SRU- Media, the Network also has the capability to provide other services. The development costs include the licensed rights to proprietary software including the PLX-3D



software which is used for the monitoring and tracking services provided with the SRU/MRU.

The network was transferred from Holdings to the Company at a cost of \$1,000,000 which reflects the prior development costs incurred by Holdings prior to the transfer. As part of the agreement, the Company agreed to pay for development costs that were due in the month of transfer. This expense amounted to \$97,995 in May 2008. An additional \$50,000 was accrued for development expenses incurred prior to the year ended March 31, 2009. The transfer was reflected as Network acquisition /development costs and the Company issued 1,250,000 common shares that were valued at \$.80 per share for total value of \$1,000,000. The shares and related conversion price were adjusted to reflect the subsequent reverse stock split.

**SECTOR 10, INC.**

**(A DEVELOPMENT STAGE COMPANY)**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

The Network is treated as a Long Lived Asset which is reviewed regularly for impairment. In its review for impairment, the Company prepares estimates of future cash flows to assist in the determination of the asset's recoverability. If there is an issue regarding recoverability, an independent valuation will be obtained to determine any required adjustment for impairment. The estimates used in determining for recoverability are updated by the Company on a regular basis to provide guidance for Management's quarterly and annual reporting. Based on the estimates prepared for the fiscal year end March 31, 2009, Management has determined that the Network Asset is recoverable and not subject to an adjustment for impairment.

The Network is not in service as of the period ended September 30, 2009. It is expected to be placed in service in the fiscal year ended March 31, 2010. Once, placed in service, the asset will be depreciated over its estimated useful life which is currently estimated to be 7 to 10 years. The Company has not completed its review of the final depreciable life for the Network asset.

The Company has determined that the performance of the administrator has been inadequate and the administration agreement was cancelled. The performance issues have resulted in various disagreements with the administrator. As part of the termination, the Company has requested the return of all servers and related software and other equipment for deployment in other secure facilities with a new administrator. The administrator has not provided the return of the equipment at this stage. In addition, the administrator is seeking payment of fees and has filed a claim for \$58,732 of fees due. Although the fees at issue are attributable to services for the Company, the claim was not filed against the Company.

The Company disagrees with the total fees but has recorded the full amount in the financial statements. The Company has disputed this claim and considering legal options to provide the transfer of the equipment to another administrator. The disputed fees include charges for consulting fees that are being challenged since the network is not in service. Removing the consulting fees included in the \$58,732 and the consulting fees paid with the acquisition of the equipment, the Company has a credit balance of \$4,000. The dispute is expected to be resolved before any significant sales activity begins. If needed, the Company will purchase additional servers as required to perform any required administration for new business in the next fiscal year. Any additional expenses needed to cover the IT administration during this dispute will be included as potential damages in any future legal considerations.

**Note 4 DEPOSIT**

The Company was approached by DPO Medical, Inc. with respect to the possible acquisition of a medical product that (if acquired) could produce immediate revenues to assist in providing the Company with cash flow during their growth period. In order to hold the rights during its due diligence review, the Company on September 15, 2008, placed a \$25,000 refundable deposit with DPO Medical, Inc. The Company completed its due diligence review subsequent to the quarter ended September 30, 2008 and decided that it was not in the Company's best interest to pursue the acquisition of the medical product offered by DPO Medical. Accordingly, the Company has requested the full refund of the \$25,000 deposit. The deposit has been recorded as an asset on the balance sheet for the period ended December 31, 2008. A total of \$15,000 of the deposit was received in January 2009. The balance of \$10,000 was still outstanding as of the year ended March 31, 2009. The final \$10,000 deposit was received in May 2009.

**Note 5 DEBT CONVERSION**

On May 8, 2008, Sector 10, Inc. ( Sector 10 ) and Jeffrey Martin ( Martin ) agreed to convert all outstanding debt owed Martin to common shares of Sector 10, Inc. A brief description of the transaction and the related background is as follows.

Martin transferred 120,000 (adjusted for reverse stock split) SKRM Interactive, Inc. common shares ( Martin Transfer ) that were owned by Martin and/or related parties to various individuals in satisfaction of pre-acquisition debt. As a result of the Martin transfer, Sector 10 recorded \$649,200 in liabilities due Martin on its books for the fiscal year end March 31, 2008.

**SECTOR 10, INC.**

**(A DEVELOPMENT STAGE COMPANY)**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

Martin agreed to convert the debt into Sector 10 shares in an amount equal to the number of shares used by Martin in the Martin Transfer. Sector 10 agrees to issue 120,000 new shares (adjusted for reverse stock split) of Sector 10, Inc. in complete and total satisfaction of the \$649,200 debt to Martin and in satisfaction of any other unrecorded debt that may exist between Martin and Sector 10.

The 120,000 shares were issued during the quarter ended June 30, 2008. The accounting for the debt conversion consisted of reclassification of the note payable of \$649,200 to additional paid-in-capital (\$131,880) and capital stock (\$120). The value of the shares issued on May 8, 2008 was \$132,000. The \$517,200 difference between the value and the debt converted was treated as other income.

**Note 6 NOTES PAYABLE**

*Related Parties - Shareholder / Officer*

Subsequent to the merger transaction on November 20, 2007, the Company received funding from both Sector 10 Holdings, Inc. (Majority Shareholder) and Pericles DeAvila (an Officer/Shareholder). This continued in the fiscal year ended March 31, 2009. Funding and/or disbursements transactions with the respective sources is accounted for in a separate account for Sector 10 Holdings, Inc. and Pericles DeAvila. Interest is charged on the account at a rate of 8% per annum. Total interest accrued during the quarter ended September 30, 2009 on the accounts is \$762 which is comprised of Pericles DeAvila - \$288 and Sector 10 Holdings - \$474.

*Johnson Financing*

On May 11, 2008, Sector 10, Inc. ( Sector 10 ) entered into an agreement with Edward Johnson ( Johnson ) to provide short term financing to provide assistance with the development and expansion of the business of Sector 10.

The loan will be for term of 9 months with 1 automatic extension of 6 months allowed if so requested by Sector 10. The 6 month loan extension was requested by Sector 10 on February 5, 2009. Interest on the loan is fixed at rate equal to prime plus 1 (As published in the Wall Street Journal as of the effective date of this agreement). The effective prime rate as of May 11, 2008 was 5%. The rate under the agreement is 6%. The investor has proposed that the interest on the loan is 6.5%. We have accrued the total loan at 6.5% for book purposes. Total interest accrued at September 30, 2009 is \$17,997 of which \$6,500 was accrued during the six months ending September 30, 2009.

A loan extension until August 11, 2009 was requested on February 5, 2009. The Company is currently negotiating financing with another investor group. The new financing will be used in part to repay the extended loan plus interest. The investor notified the Company on May 23, 2009 that the loan was due on June 11, 2009. We did not close on financing prior to June 11 and the loan will continue until financing is received and the loan is paid. Financing has not yet been secured as of the reporting date and the principal payment was not be made on the due date of August 11. The Company will work with the Investor to work out an agreed payment arrangement. Upon the receipt of financing, the Company intends on making payments under this arrangement until all principal and accrued interest is paid in full.

*Dutro Financing:*

Dutro Company is the Company's outsourced manufacturing resource. The owners of Dutro Company include Vicki Davis and William Dutro. Lee Allen is the nephew of William Dutro. Vicki Davis, William Dutro and Lee Allen as individuals (referred to as Dutro Group) have made funds available to the Company to assist in financing. All funding has been provided by the individuals from the Dutro Group and Dutro Company has not provided any funding. The funds from Vicki Davis were received from the Vicki K. Davis, Living Trust TDT 5/19/95.

In 2008, Dutro Group had provided funding through Sector 10 Holdings at various times in the year. In most situations, the funding was either repaid or stock was provided in lieu of cash payments in settlement of any proceeds received. In November, 2008, the Company was approached by the Dutro Group to consider them as their sole source of working capital funding. Based on the previous relationship, a funding arrangement was initiated as the terms were to be negotiated.

**SECTOR 10, INC.**

**(A DEVELOPMENT STAGE COMPANY)**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

Effective January 2, 2009, all Dutro Funding was transferred from Holdings to the Company and all obligations and future proceeds were assumed by the Company. An adjustment was made to the NP Sector 10 Holdings to reflect all outstanding Dutro debt as January 2, 2009. Total transferred amount was \$98,000 broken down as follows: Vicki Davis \$15,000; William Dutro \$65,000 and Lee Allen \$18,000.

Discussions regarding financing began in November 2008. The funding was anticipated to provide full funding needs so that no other outside source may be required. Discussions of the terms was not completed and it was decided that the terms requested for long term funding were not acceptable by the Company. Accordingly all funding was terminated as of the end of the fiscal year ended March 31, 2009. The final funding proceeds were received on March 24, 2009 and were reflected in the financial statements.

At March 31, 2009, the Company and the Dutro Group individuals did not have a signed document for the loan proceeds. The books were recorded to reflect the principal amounts as transferred to the Company on January 2, 2009. Interest has accrued on the amounts from the date of transfer to June 30, 2009 at an annual rate of 7.5%. From January 2, 2009 through March 31, 2009, total proceeds of \$153,000 were received. All of these proceeds were received from the Vicki K. Davis, Living Trust TDT 5/19/95. Interest has been accrued on these additional proceeds from the date received through September 30, 2009 at an annual rate of 7.5%.

On June 10, 2009, the Company signed a loan document with the Vicki K. Davis, Living Trust TDT 5/19/9 to cover the \$168,000 principal loaned to the company. The loan term expires on May 31, 2014. The interest rate under the agreement is computed at an annual rate of 7.5%. An agreement with the same terms was signed on June 24, 2009 by William Dutro for his respective loan amount. At the filing of the financial report for the fiscal year ended March 31, 2009, the Company believed that Lee Allen would sign a similar loan agreement. Accordingly, a draft agreement was forwarded to Mr. Allen for signature. Mr. Allen has rejected the loan agreement and the loan has been transferred to general accounts available where it will be paid as funds become available. No further interest is being accrued on the amount due Mr. Allen.

In addition to the loan agreements for the above individuals, the Dutro Company and Reality Engineering (Managed by Lee Allen and a related party to Dutro Company) have discussed the issue of getting reimbursed for research and development fees associated with their work on Sector 10 products. Dutro Company has presented old invoices totaling \$264,872 plus additional future amounts of \$162,415 for a total of \$427,287. If a liability were to be generated, it is agreed that a loan agreement would be established for any agreed amount under the same terms as set forth under the individual Dutro Group loan agreements.

The Company reached final agreement with Dutro Company on August 6, 2009 to settle any past differences regarding research and development costs and all past production costs. The Company agreed to pay Dutro Company \$250,000. Included in this is \$41,213 of current accounts payable, \$48,787 of additional R&D expenses recorded in the period ended September 30, 2009 and \$160,000 allocated to research and development allocated in prior periods as follows: a total of \$50,000 R&D expense was recorded in the previous fiscal year and an additional \$110,000 of R&D expenditures was recorded in the period ended June 30, 2009. Dutro Company agreed to record the \$250,000 in a promissory note agreement under the same terms as agreed to by William Dutro and Vicki Davis. Total interest accrued for the Dutro Group at September 30, 2009 is \$12,481 of which \$9,075 was accrued during the six months ending September 30, 2009.

Reality Engineering is a company managed by Lee Allen and related to Dutro Company. The Company Board authorized Management to engage Reality Engineering to provide \$50,000 of software consultation services to assist in preparing the PLX-3D software for customer demonstrations. Any additional fees required further Board approval. The Company booked the \$50,000 fee as an addition to the development cost at March 31, 2009. At the end of the project, Lee Allen informed the Company that the services cost approximately \$168,000. Any useable end product was withheld from the Company by Reality Engineering pending payment of the increased amounts. The Company agreed to \$50,000. No additional fees were authorized by Management nor were they approved by the Board. The Company has made proposals regarding the review of any documentation to support an additional price to the project.

## SECTOR 10, INC.

## (A DEVELOPMENT STAGE COMPANY)

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Reality Engineering has not provided the Company with any useable end product from their services until the higher fee is paid. Based on the refusal to present a useable product and information needed to allow us to perform future modifications, the Company has presented two final options to Mr. Allen for settlement of the fee dispute. The options were presented on September 29, 2009. Reality Engineering has rejected all offers proposed by the Company to settle the difference in fee arrangement and has still never provided the Company with any useable end product from their services. On October 24, 2009, the Company informed Reality Engineering that they will no longer seek the end product derived from their services since no agreement could be reached on the fees. Accordingly, no fees will be paid to Reality as a result of their final rejection

*Employee Group*

John Gargett signed an employment agreement on April 24, 2009. Patrick Love signed an employment agreement dated May 8, 2009. They have agreed to a loan arrangement for any unpaid amounts due under the employment agreements. Loan agreements were established in July 2009 to begin accounting for unpaid amounts. Interest on any outstanding balance is accrued at an annual rate of 8%. The maturity term is May 14, 2014. However, the funds will be paid earlier if funds are available in the Company. It is not intended to be a long term program. Total interest accrued at September 30, 2009 is \$1,271 of which \$1,271 was accrued during the six months ending September 30, 2009.

*Other Notes*

In order to generate short term funding, the Company provided individual investors with an opportunity to receive common shares equal to their investment plus a promissory note to return principal within 180 days. Interest is accrued at a annual rate of 8%. A conversion option is provided at the end of the term to provide the investor with a right to convert all or a portion of the principal into common shares of the Company. The agreement further provides the issuance of warrants to provide the investor with subsequent opportunities to acquire Company common shares. Only \$15,000 was received under this program on or before September 30, 2009. Total interest accrued for the period was \$50.

Summary of Interest and Notes Payable

	September 30, 2009	September 30, 2008
<u>Interest expense</u>		
Sector 10 Holdings, Inc. Shareholder	\$ 474	\$ 3,001
Pericles DeAvila Officer	288	228
Total related party interest expense	762	3,229
Interest Johnson	6,500	4,613
Interest Dutro Group	11,898	
Interest - Employee Group	1,270	



Interest	Other Notes		50	
Total interest expense		\$	20,480	\$ 7,842

**SECTOR 10, INC.****(A DEVELOPMENT STAGE COMPANY)****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

<u>Note Payable Balance</u>	<b>September 30, 2009</b>	<b>March 31, 2009</b>
Sector 10 Holdings, Inc. Shareholder	\$ 383	\$ 27,595
Pericles DeAvila Officer	5,547	11,159
Total Note Payable Officer / Shareholder	\$ 5,930	\$ 38,754
Edward Johnson Johnson Financing	\$ 200,000	\$ 200,000
Vicki Davis - Dutro Group		168,000
William Dutro Dutro Group		65,000
Lee Allen Dutro Group		18,000
John Gargett Employee Group	52,083	
Patrick Love Employee Group	32,000	
Patrick Madison Other Notes	15,000	
Total Note Payable short term	\$ 299,083	\$ 451,000
Vicki Davis	\$ 168,000	\$
William Dutro	65,000	
Dutro Company	250,000	
Total Note Payable long term	\$ 483,000	\$
Total Notes Payable	\$ 788,013	\$ 489,754

**Note 7 REVERSE STOCK SPLIT**

The Company filed a definitive Form 14C on April 24, 2009 to inform shareholders of the authorization to file a 1 to 10 reverse split of common shares.

The Board has unanimously adopted a resolution approving the Reverse Split whereby common shareholders would receive 1 share of post reverse split common shares for each 10 shares of pre-reverse split common shares. The majority shareholders also approved the reverse split. Management anticipates that the principal effects of the Reverse Split will be that:

1.

The number of outstanding shares of Common Stock will be reduced from approximately 102,210,292 to approximately 10,221,029;

2.

The number of shares of Post-Split Common Stock held by each Stockholder will be equal to 1/10<sup>th</sup> of the number of shares of pre-split Common Stock held by that stockholder;

3.

The trading price of the Post-Split Common Stock will be greater than the current trading price of a share of Common Stock (the exact trading price of the Post-Split Common Stock will depend on the reaction, if any, of the public market for the Post-Split Common Stock, as well as other factors, all as discussed in greater detail below);

4.

Stockholders who would otherwise be entitled to receive a fractional share of Post-Split Common Stock, after all Shares of Common Stock held by such Stockholder are consolidated, as a result of the Reverse Split will be entitled, upon surrender of the certificate(s) representing such Stockholder's Common Stock, if any, to have the fractional share rounded up to one share of Post-Split Common Stock; and

5.

The Company will be authorized to issue 199,000,000 shares of Common Stock, of which approximately 10,221,029 shares will be issued and outstanding.

The amendment to the articles of incorporation reflecting the reverse split was approved by the Delaware Secretary of State on April 30, 2009.

**SECTOR 10, INC.**

**(A DEVELOPMENT STAGE COMPANY)**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

The Company was notified on May 18, 2009 that NASDAQ has received all necessary information to process the reverse split. The Company was informed that the 1 for 10 reverse split transaction was approved and would be effective at the opening of business on May 19, 2009. Due to this transaction, the trading symbol for the Company has been changed. The new symbol is SECI. The former symbol was SECT. The new symbol takes effect on May 19, 2009.

**Note 8 EQUITY**

During the Quarter ended: June 30, 2009:

In April 2009, John Gargett was added to the Board of Directors and was later hired to be the Company COO. In accordance with an employment agreement dated April 24, 2009, Mr. Gargett received 50,000 shares of Common stock for joining the Board of Directors and received 50,000 shares of stock under the terms of the employment agreement. The employment agreement provides for Mr. Gargett to receive an additional 150,000 shares of common shares in 50,000 share installments due on 7/1/2009, 9/1/2009 and 11/1/2009. The shares for 7/1/2009 were requested to be issued by the transfer agent in accordance with this agreement.

In April 2009, the Company issued at total of 27,500 common shares as follows: 25,000 shares to Layne Davis and 2,500 shares to his son Layne Davis. These shares were issued in consideration for product design work performed in the development of Sector 10 MRU and SRU design through the Dutro Company. No other obligations or consideration is expected.

In April 2009, 37,500 shares were issued to QualityStocks, LLC in accordance with the terms of an Investor Relations Agreement. No additional equity is required under the terms of the agreement.

In April 2009, Illuminated Financial received 25,000 of newly issued restricted stock from the Company. In addition, Sector 10 Holdings, Inc. transferred 250,000 free trading shares to Illuminated for services rendered to the Company. New shares were issued to Sector 10 Holdings, Inc. to replace the shares transferred on behalf of the Company. The 250,000 shares were issued during the period ended September 30, 2009. The value of the shares was determined to be \$77,500. This amount was accrued as a future stock award. When the shares are issued, the accrual will be adjusted to additional paid in capital.

In May 2009, Patrick Love was hired as Director of Business Development for the Company. In accordance with the terms of his employment agreement, he received \$10,000 common shares. The employment agreement provides for Mr. Love to receive an additional 40,000 shares of common shares in 10,000 share installments due on 7/1/2009, 10/1/2009, 1/1/2010 and 4/1/2010. The shares for 7/1/2009 were requested to be issued by the transfer agent in accordance with this agreement.

In May 2009, the Board of Directors authorized the issuance of 900,000 shares to officers and directors for prior services. The shares were issued based on services performed on or before March 31, 2009. The shares were authorized on May 1, 2009.

In May 2009, the Board of Directors authorized the issuance of 150,000 shares to directors (on the Board as of April 1, 2009) for Board services for the fiscal year ended March 31, 2010. This adjustment was completed to be consistent with the stock issued for the new director added in April 2009. The shares were authorized on May 1, 2009.

In May 2009, the Company affected a 1 to 10 reverse stock split. Total outstanding shares at the time of the split was 103,435,292 shares. Total shares outstanding after the reverse split was 10,343,573. Approximately 43 shares were issued in the split to account for fractional shares. All shares noted in this report are reflected as post split amounts.

During the Quarter ended: September 30, 2009:

In July 2009, the Company issued 50,000 shares to John Gargett in accordance with the requirements set forth in his employment agreement. The shares were required to be issued based on his employment as of 7/1/2009.

**SECTOR 10, INC.**

**(A DEVELOPMENT STAGE COMPANY)**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

In July 2009, the Company issued 10,000 shares to Patrick Love in accordance with the requirements set forth in his employment agreement. The shares were required to be issued based on his employment as of 7/1/2009.

In September 2009, issued a total of 50,000 shares - 25,000 shares to John McCloskey and 25,000 shares to Hugh Cholmondeley for their acceptance as members of the Company Board of Advisors. The membership was accepted in July 2009.

In September 2009, issued 1,050,000 shares to officers and directors for past services rendered and for current director services. The shares were authorized on May 1, 2009 by the Board. Shares were allocated as follows: Pericles DeAvila 550,000 shares, Laurence A Madison 400,000 shares and Alan Rouleau 100,000 shares.

In September 2009, issued 5,000 shares to John Ketcham for services in connection with R&D and development of manufacturing specs of all Sector 10 products.

In September 2009, issued 15,000 shares to Patrick Madison in connection with short term promissory note agreement dated September 14, 2009

In September 2009, issued a total of 270,834 shares to Sector 10 Holdings for reimbursement for shares provided to Illuminated Financial Services and Moody Capital on behalf of the Company.

**Note 9 GOING CONCERN**

The Company generated initial revenues of \$18,500 through the year ended March 31, 2009. No revenues were generated for the six month period ended September 30, 2009. This level of revenues is not sufficient for the Company to meet its future obligations. This factor raises substantial doubt about the Company's ability to continue as a going concern.

Management has several contracts under review and three large transactions under negotiation as of September 30, 2009. Management expects revenues to increase in the 4<sup>th</sup> quarter of the fiscal year ended March 31, 2010. Management also intends to seek additional capital through equity and/or debt financing to assist the Company until profitable operations can be achieved. There can be no assurance that such increase in revenues will be generated or that financed funds will be available to the Company or available on terms acceptable to the Company. The financial statements do not include any adjustments that might result from the outcome of these uncertainties.

**Note 10 INCOME TAX**

Income taxes are accounted for using the asset and liability method. Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carryforwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Income taxes are accounted for using the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and net operating loss carryforwards. Valuation allowances are established when necessary to reduce net deferred tax assets to the amount expected to be realized.

The Company's financial statements for the six month period ended September 30, 2009 and 2008 do not include any provision for income taxes. No income tax accrual has been recorded based on the expectation that the Company will be in a net loss position for the overall applicable fiscal year. Accordingly, deferred tax assets have been entirely offset by valuation allowances. The difference between the amounts of income tax benefit that would result from applying domestic federal statutory income tax rates to the net loss and the net deferred tax assets is related to certain nondeductible expenses, state income taxes, and the change in the valuation allowance.

**SECTOR 10, INC.**

**(A DEVELOPMENT STAGE COMPANY)**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

The Financial Accounting Standards Board ("FASB") has issued ASC 740 for Accounting for Income Taxes that clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements. ASC 740 requires a company to determine whether it is more likely than not that a tax position will be sustained upon examination based upon the technical merits of the position. If the more-likely-than-not threshold is met, a company must measure the tax position to determine the amount to recognize in the financial statements. As a result of the implementation of ASC 740, the Company performed a review of its material tax positions in accordance with recognition and measurement standards established by ASC 740.

The Company had no unrecognized tax benefit which would affect the effective tax rate if recognized.

The Company includes interest and penalties arising from the underpayment of income taxes in the consolidated statements of operations in the provision for income taxes. As of September 30, 2009 the Company had no accrued interest or penalties related to uncertain tax positions.

The Company files income tax returns in the U.S. federal jurisdiction and in the states of Delaware, Utah and any other jurisdiction where required. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2005.

**Note 11 SUBSEQUENT EVENTS**

We have evaluated our financial statements for subsequent events through November 20, 2009.

*Distribution Agreement:*

On October 30, 2009, the Company amended the Distribution Agreement to make the following changes:

1)

Remove the restriction on telecom and advertising revenues that were retained by Sector 10 Holdings, Inc. ( Holdings ). This change was made to address the impact of the transfer of the Network from Holdings to the Company n May 2008.

2)

To formally transfer the Manufacturing rights to produce all Sector 10 products for the authorized territories to the Company. The agreement was changed to remove Holdings as the Manufacturing entity. Holdings shall provide the Company with an opportunity to propose for the rights to manufacture any Sector 10 products for other authorized Sector 10 Distributors including foreign distributors. Holdings reserves the right to engage Distributor in its efforts to expand into international markets.

3)



The computation of the \$5 Million royalty payment was changed to compute at 20% of the aggregate gross sales in excess of \$100,000. The computation is no longer dependent on the sales in a specific authorized territory.

4)

Due to the lack of significant sales activity, the Company formally provides a conversion option for all or a portion of the unpaid fees to common shares of the Company. The conversion price shall be equal to 110% of the average 10 day bid price computed immediately before the election to convert. The conversion is limited to 50% of the total royalty fee for any calendar quarter. The changes were made to document the changes authorized by the Board on August 1, 2008.

*Anti-dilution Agreement*

On November 6, 2009, the Company agreed to provide Sector 10 Holdings, Inc. an anti-dilution provision for all shares that Holdings provides to third parties that will benefit the Company through investor relations and/or financing. The provision is applicable for all transactions that have occurred for the benefit of the Company since November 20, 2007. All shares provided for the benefit of the Company shall be reimbursed equal to the amounts of shares provided plus additional shares needed to prevent dilution of Holdings interest immediately before the initial transfer of shares. All transactions completed on or after November 6, 2009 will provide Holdings with an additional 10% benefit with the reimbursement. The Company will review all transactions and determine the impact of the policy. The Company authorized and issued 1,544,000 additional shares to Holdings for reimbursement transactions

**SECTOR 10, INC.**

**(A DEVELOPMENT STAGE COMPANY)**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

incurred prior to November 6, 2009. The Company authorized 14,525,000 shares to be issued as a result of the financing transaction entered into on November 10, 2009 on behalf of the Company.

*Financing Transaction*

Sector 10 Holdings, Inc. ( Holdings ) has elected to convert \$2,500,000 of the Distribution Agreement royalty fee to additional common shares of the Company to be used for the benefit of funding the Company. A financing transaction was entered into on November 10, 2009 between Sector 10 Holdings, Inc. and Mariennie & Associates. The transaction is expected to yield in excess of \$1 Million in funding which will be used for the benefit of the Company. Under the agreement, Sector 10 Holdings, Inc. shall assign all of its shares from the conversion of the \$2,500,000 distribution fee to various investment sources to assist in providing the Company with financing that will provide needed capital to continue operations. A total of 11,363,636 shares have been assigned under this agreement. The assigned shares have been issued and distributed to the assignees as agreed in the agreement. The financing is expected to be received over the next several weeks and be completed by the end of December. However, there may be a delay resulting from the Thanksgiving and Christmas Holidays that may extend the period until mid January.

*Dispute*

Doty Scott is a consultant that delivered services to the Company prior to November 20, 2007 which was the date of the merger between SKRM Interactive, Inc. and Sector 10 USA, Inc. (now Sector 10, Inc.) The amount due the consultant at that time was approximately \$16,000. This amount was treated as pre-acquisition debt and included in accounts payable. The Company has been informed of an agreement that was signed on November 13, 2007 (pre-acquisition) that the consultant argues that carried a promissory note arrangement should the fees not be paid within a specific time period. Under the promissory note, additional compensation may be due. The consultant claims that they are entitled to over 3 million shares of common shares of the Company to fulfill their obligation. The Company reviewed the details of the claims presented by the consultant and has rejected their claims. The Consultant's attorney provided an e-mail of a complaint that he filed in a court in San Diego, CA. on October 16, 2009. The Company Registered Agent was served regarding the Complaint on October 20. The Company disagrees with the consultant claims and argues that the benefits requested are far in excess of any reasonable benefits that should be due if the original \$16,000 fees can be validated. There is no signed promissory note contained in any agreement. Nor is there any signed promissory note contained in the claim documentation that was filed. The Company will vigorously argue against any claims presented by the consultant in this matter. An attorney has been engaged to respond to the claim filed on October 16, 2009. The attorney filed a response on November 19, 2009 and requested that the case be removed to Federal Court in an effort to better protect the Company from frivolous claims that may be asserted by the consultant. The Company believes that sufficient reserves are included in the financial statements for exposures for this case.



## ITEM 2.

### MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

This report contains forward-looking statements within the meaning of Section 29a of the Securities Act of 1933, as amended, and Section 21e of the Securities Exchange Act of 1934, as amended. These forward-looking statements are subject to numerous risks and uncertainties that could cause actual results to differ materially from historical or anticipated results. You should not place undue reliance on such forward-looking statements, and, when considering such forward-looking statements, you should keep in mind the risk factors noted in this report, including the section of this report entitled "Risks Related to Our Business and Operations." You should also keep in mind that all forward-looking statements are based on management's existing beliefs about present and future events outside of management's control and on assumptions that may prove to be incorrect. The following discussion and analysis should be read in conjunction with the Company's financial statements and notes thereto, which are included elsewhere in this report.

#### Overview

Sector 10, Inc. ( "The Company" ) is in the business of providing emergency disaster response equipment and related support services. The Company was structured to provide manufacturing, sales and distribution of Sector 10 emergency response equipment and supplies needed by first responders to an emergency situation. The Mobile Response Unit ( "MRU" ) and the Stationary Response Unit ( "SRU" ) were developed to promote the concept of pre-deploying life saving tools and supplies in office buildings, factories, schools, construction sites, airports and cruise ships.

Sector 10, Inc. is more than a sales and distribution company. It also is responsible for the manufacturing and development of products. The Company has full rights to all Sector 10 products. The technology incorporated Slocate employees and communicate with first responders in an emergency situation. The system provides customers with the ability to comply with the ever changing Domestic and International Fire Codes. The SRU-M also provides a unique opportunity to media companies by providing advertising through a new distribution channel that will be located in high traffic areas.

Sector 10, Inc. is a systems integration company exclusively representing a unique line of proprietary products and technologies focused on the pre-deployment of emergency and leveraging other incorporated Asset system such as communication channels and interactive advertising. Sector 10's life saving services center around the placement of stationary kiosks called SRU's in high traffic venues and high-rise buildings. The SRU's or stationary response units contain personal protective equipment (PPE) that can help people, prevent fatalities and injuries during natural disasters, terrorist attacks, and other life threatening situations such as fires. In addition the SRU provides four channels of communication and tracking capabilities that are linked to a command center and can interact with first responders to ensure the greatest number of lives can be saved.

The SRU-M product contains two large video screens and is placed in high traffic areas such as convention centers, arenas and malls. The screens combined with the network used for the emergency response services provides both the Company and the customers with additional revenue sources by placing media on its screens. SRU products will be placed in high rise, office buildings and other non-high traffic areas without the media screens. The Company will coordinate sales activity both domestically and internationally.

Edgar Filing: SECTOR 10 INC - Form 10-Q

On September 1, 2007, Sector 10 USA, Inc. entered into a Distribution Agreement with Sector 10 Holdings, Inc. This agreement was assumed by Sector 10, Inc. as a result of the merger with SKRM Interactive. Under the terms of the agreement, Sector 10, Inc. has exclusive rights to manufacture, sell and distribute Sector 10 products within the assigned Territories under the agreement. The assigned territories include the following metropolitan areas:

New York	Miami	Atlanta
Los Angeles	Washington DC	San Francisco
Chicago	Houston	Salt Lake City
Philadelphia	Detroit	Phoenix
Dallas	Boston	Seattle

The fee for the acquisition of the distribution rights was established under the agreement. No liability for this fee is incurred in any respective market until a minimum of \$100,000 in sales are generated in the respective authorized distribution market. Each of the initial markets identified in the agreement require a distribution rights fee of \$250,000 to \$500,000 per market (depending on market size) with a maximum cumulative fee of \$5 Million. The fee

may not exceed 20% of the cumulative sales in the market. Therefore, the fee may be paid over a period of time as sales are initiated in a new market.

Sector 10 Inc will have rights to acquire other distribution territories. This includes other areas within the United States, Canada and other international markets. The agreement sets pricing requirements and establishes minimum performance standards. Pricing requirements set the price at which the specific Sector 10 Product will be acquired prior to sale by Sector 10, Inc. The pricing will be set by agreement when the products are available for sale. The pricing requirements will be adjusted to reflect the price available for the fiscal year ended March 31, 2010. The performance standards are effective when product is available and the sales process has begun. Minimum performance standards are the minimum sales results that are required to continue the exclusive distribution rights in the specific territory. Sales activity has been minimal to date. The Company has engaged various sales representatives that project more significant activity Sales Activity for the fiscal year ended March 31, 2010. Minimum performance standards provide a transition for each territory. The term for the agreement is 5 years and is renewable with an automatic renewable feature.

Due to the lack of significant sales activity, there have been two changes adopted to the Distribution Agreement as it relates to the payment of the \$5 Million Fee. First, the fee payment has been adjusted to be computed at 20% of sales regardless of the specific Metropolitan Territory. The payment computation s not initiated until there have been at least \$100,000 of aggregate sales. In addition, the Company provides a conversion option for all or a portion of the unpaid fees. Sector 10 Holdings, Inc. has elected to convert \$2.5 Million of the fee under this option. This is expected to be completed as part of a financing transaction which is expected to be completed in the 3<sup>rd</sup> Quarter.

### **Going Concern Qualification**

The notes to the Company s consolidated financial statements disclose that the limited cash flow of the Company has been absorbed in operating activities and the Company has incurred net losses since inception, and the Company has a working capital deficiency. In the event that funding from internal sources or from public or private financing is insufficient to fund the Company s business, the Company will have to substantially cut back its level of spending, which could substantially curtail the Company s operations. These factors raise substantial doubt about the Company s ability to continue as a going concern. The Company s going concern uncertainty may affect its ability to raise additional capital, and may also affect its ability to raise additional capital, and may also affect its relationships with suppliers and customers. Investors should carefully examine the Company s financial statements.

### **Results of Operations**

#### Six Months Ended September 30, 2009 as Compared to the Six Months Ended September 30, 2008

Revenues -

The Company had no revenues for the six months ended September 30, 2009.

The Company had initial revenues of \$6,000 for the six months ended September 30, 2008. The Company is currently negotiating various contracts which the Company s management currently believes will generate additional revenues in the 3<sup>rd</sup> and 4<sup>th</sup> quarter for the fiscal year ending March 31, 2009.

Other Income-

The Company had no other income for the six months ended September 30, 2009.

The company had other income of \$517,200 for the period ended June 30, 2008. The income was a result of the difference in the value of the shares provided in the conversion of debt to equity. No other income was reported during the six months ended September 30, 2008.

Operating Expenses -

The Company had no operating expenses for the six months ended September 30, 2009.

The Company had sales of \$6,000 during the six months ended September 30, 2008. The Cost of Sales associated with the sales for this period was \$3,800 which was \$1,900 per MRU unit.

General and Administrative Expenses -

General and administrative expenses were \$722,415 for the six months ended September 30, 2009 which was made up primarily of Wages - \$263,533, R&D expenses - \$161,336, Professional fees - investor relations \$140,895, Professional fees - Legal & Accounting - \$83,901, Director and Business Advisory Board fees - \$36,750, Expense allocation from Sector 10 Holdings of \$10,000, Filing fees - \$7,165, Other professional fees of \$5,500 and other expenses of \$13,335.

General and administrative expenses were \$370,736 for the six months ended September 30, 2008. These expenses are made up of professional fees - investor relations - CGC - \$278,330, expense allocation from Sector 10 Holdings of \$60,000, other professional fees of \$19,562 and other expenses of \$12,844.

Depreciation Expense

Depreciation expense for the six months ended September 30, 2009 was \$2,225.

Depreciation expense for the six months ended September 30, 2008 was \$2,225.

Interest Expense

Interest expense for the six month period ended September 30, 2009 was \$7,842.

Interest expense for the six month period ended September 30, 2008 was \$7,842.

Three Months Ended September 30, 2009 as Compared to the Three Months Ended September 30, 2008

Revenues -

The Company had no revenues for the three months ended September 30, 2009.

The Company had initial revenues of \$6,000 for the three months ended September 30, 2008.

Other Income-

The Company had no other income for the three months ended September 30, 2009.

The company had no other income for the three months ended September 30, 2008.

Operating Expenses -

The Company had no operating expenses for the three months ended September 30, 2009.

The Company had sales of \$6,000 during the three months ended September 30, 2008. The Cost of Sales associated with the sales for this period was \$3,800 which was \$1,900 per MRU unit.

General and Administrative Expenses -



General and administrative expenses were \$311,191 for the three months ended September 30, 2009 which was made up primarily of Wages - \$161,200, Professional fees - Legal & Accounting - \$75,000, R&D expenses - \$51,336, Professional fees - investor relations \$9,270, Business Advisory Board fees - \$6,750, Filing fees - \$2,365 and other expenses of \$5,270.

General and administrative expenses were \$131,716 for the three months ended September 30, 2008. These expenses are made up of professional fees - investor relations - CGC - 83,499, expense allocation from Sector 10 Holdings of \$30,000, other professional fees of \$10,005 and other expenses of \$8,212.

#### Depreciation Expense

Depreciation expense for the three months ended September 30, 2009 was \$1,112.

Depreciation expense for the three months ended September 30, 2008 was \$1,113.

#### Interest Expense

Interest expense for the three month period ended September 30, 2009 was \$12,121.

Interest expense for the three month period ended September 30, 2008 was \$4,517.

#### Liquidity and Capital Resources

As of September 30, 2009, Sector 10 had cash of \$796. This amount is not sufficient to meet the Company's working capital requirements for the balance of the fiscal year ending March 31, 2010 or for any future period.

Sector 10 has had minimal sales activity in the past. There are significant opportunities that are under review with the City of San Francisco Fire Department and other sources that may have a significant impact on the future operations of the Company. Management is hopeful that the negotiations may be completed by the end of the 3rd quarter with placement of product beginning in the 4th quarter for the year ended March 31, 2010. The Company may consider also generating funding from the sale of shares of Common Stock to in private transactions. There is no guarantee that the Company will be successful in arranging financing on acceptable terms. If the Company is not able to raise additional debt or equity, the Company's ability to continue its business operations is highly unlikely.

The Company currently is working with investment bankers regarding various financing arrangements. No significant financing has been closed as of November 5, 2009 and there is no guarantee that any significant financing will be completed. Obtaining additional financing would be subject to a number of factors, including investor sentiment. Market factors may make the timing, amount, terms or conditions of additional financing unavailable to the Company.

The Company's continuation as a going concern is dependent upon continued financial support from the Company's shareholders or other parties.

#### Total Assets -

The Company had \$1,182,537 in total assets as of September 30, 2009, comprised of cash - \$796, Inventory - \$18,409, Prepaid Assets - \$1,022, Net Fixed Assets - \$14,315 and Network Acquisition/Development Costs - \$1,147,995.

#### Total Liabilities -

The Company had \$1,314,287 in total liabilities as of September 30, 2009. The Company's total liabilities as of September 30, 2009 were comprised of \$507,774 of accounts payable and accrued liabilities; \$5,930 in notes payable to a shareholder/officer and \$782,083 other notes payable. A total of \$483,000 of the other notes payable is classified as long term liabilities. All of the other outstanding debt is classified as current liabilities.

#### Operating Activities -

Cash used in operations for the six months ended September 30, 2009 was (\$65,182). Operating activities were affected by stock for services - \$290,794; depreciation expense - \$2,225; change in accounts receivable \$2,000; change in deposits \$10,000 and change in accounts payable and accrued liabilities -\$374,919.

Cash used in operations for the six months ended September 30, 2008 was (\$45,253). Operating activities were affected by stock for services - \$278,330; depreciation expense - \$2,225; change in accounts receivable (\$3,000); change in deposits (\$25,000) and change in accounts payable and accrued liabilities -\$80,795.

#### Investing Activities -

Edgar Filing: SECTOR 10 INC - Form 10-Q

Cash used from investing activities for the six months ended for September 30, 2009 was \$0.

Cash used from investing activities for the six months ended for September 30, 2008 was \$97,995.

Financing Activities -

Cash provided from financing activities for the six months ended September 30, 2009 was \$30,962 comprised of net proceeds from general financing - \$63,786 net payments on shareholder / officer notes (\$32,824).

Cash provided from financing activities for the six months ended September 30, 2008 was \$144,705 comprised of net proceeds from general financing - \$200,000 and net payments on shareholder / officer notes (\$54,603) and bank overdraft (\$692).

## **Risks Related to the Company's Business and Operations**

Investing in the Common Stock involves a high degree of risk. You should carefully consider the risks described below, and all of the other information set forth in this report before deciding to invest in shares of the Company's common stock. In addition to historical information, the information in this report contains forward-looking statements about the Company's future business and performance. The Company's actual operating results and financial performance may be different from what the Company's management expects as of the date of this report. The risks described in this report represent the risks that the Company's management has identified and determined to be material to the Company. Additional risks and uncertainties not currently known to the Company's management, or that the Company's management currently deems to be immaterial, may also materially harm the Company's business operations and financial condition.

### ***Going Concern Qualification***

The Company has generated limited cash flow, has incurred net losses since inception and has a working capital deficiency. In the event that contracts are not executed, the Company will not be able to generate revenues sufficient to cover anticipated expenses. Existing funding from internal sources or from public or private financing is insufficient to fund the Company's business. If the Company is unable to quickly generate capital from operating activities or from external sources, the Company will have to substantially curtail its operations and will likely need to suspend its operations entirely. These factors raise substantial doubt about the Company's ability to continue as a going concern. The Company's going concern uncertainty will likely affect its ability to raise additional capital, and may also affect its relationships with suppliers and prospective customers. Investors should carefully examine the Company's financial statements.

***The Company has not generated revenues and has not executed any contracts for the sale of the Company's products.***

The Company has not generated any revenues. Currently the Company is negotiating contracts that may generate revenues; however, none of those contracts has been executed, and the Company can provide no assurance that any such contracts will ever be executed. There can be no assurance that the Company will generate any revenues. If the Company does not generate revenues in the near term, the Company will have to substantially curtail its operations and will likely need to suspend its operations entirely.

***The Company uses outside sources to fulfill contract obligations and has limited control over the provider's ability to meet the Company obligations.***

The Company will be required to supply various equipment and services under the contracts currently under negotiation. If the contracts are executed, of which the Company can provide no assurance, the Company intends to engage third-party suppliers to manufacture the products the Company proposes to sell under the contracts. The Company has no control over such third-party suppliers. If any or all of those third-party suppliers fails to supply sufficient products on a timely basis to meet the terms of any contract, the Company would be unable to perform its obligations to its customers, if any. If the Company is successful in negotiating and executing contracts for the sale of its products and if a third-party supplier fails to perform its obligations under its arrangement with the Company, the Company's financial condition and results of operation would be materially and adversely affected.

***The directors, executive officers and principal shareholders of the Company have effective control of the Company, preventing non-affiliate shareholders from significantly influencing the Company's direction and future.***

The Company's directors, officers, and principal shareholders and their affiliates control in excess of 50% of the Company's outstanding shares of common stock and are expected to continue to control a majority of our outstanding common stock following any financing transactions projected for the foreseeable future. These directors, officers and affiliates effectively control all matters requiring approval by the Company's shareholders, including any determination with respect to the acquisition or disposition of assets, future issuances of securities, declarations of dividends and the election of directors. This concentration of ownership may also delay, defer, or prevent a change in control and otherwise prevent stockholders other than management's affiliates from influencing the Company's direction and future.

***The market for the Company's stock is thin and subject to manipulation.***

The volume of trading in the Common Stock is limited and can be dominated by a few individuals. The limited volume, if any, can make the price of the Common Stock subject to manipulation by one or more shareholders and will significantly limit the number of shares of Common Stock that one can purchase or sell in a short period of time. An investor may find it difficult to dispose of shares of Common Stock or obtain a fair price for the Common Stock in the market.

***The market price for the Common Stock is volatile and may change dramatically at any time.***

The market price of the Common Stock is highly volatile. The price for the Common Stock may change dramatically as the result of announcements of the Company's operating or financial results, the rate of the Company's expansion, significant litigation or other factors or events that would be expected to affect the Company's business or financial condition, results of operations and other factors specific to the Company's business and future prospects. In addition, the market price for the Common Stock may be affected by various factors not directly related to the Company's business, including the following:

- .  
intentional manipulation of the price of the Common Stock by existing or future stockholders;
- .  
short selling of the Common Stock or related derivative securities;
- .  
a single acquisition or disposition, or several related acquisitions or dispositions, of a large number of the Company's shares of Common Stock;
- .  
the interest, or lack of interest, of the market in the Company's business sector, without regard to the Company's financial condition or results of operations;
- .  
the adoption of governmental regulations and similar developments in the United States or abroad that may affect the Company's ability to offer the Company's products and services or affect the Company's cost structure;
- .  
developments in the businesses of companies that purchase the Company's products; and
- .

economic and other external market factors, such as a general decline in market prices due to poor economic indicators or investor distrust.

***Our business may be affected by increased compensation and benefits costs.***

The Company is currently negotiating various contracts that may generate revenues beginning in the 4<sup>th</sup> quarter for the fiscal year ended March 31, 2010. If the Company is able to execute any such contracts, of which there can be no assurance, the Company intends to new personnel to assist in the development and conduct of the Company's business operations. The increased compensation and benefits associated with any new hires will impact the net results of the Company.

***The Company has not paid dividends and does not anticipate paying dividends in the future.***

The Company has not paid any cash dividends on its common stock to date and does not anticipate any cash dividends being paid to holders of its common stock in the foreseeable future. While the Company's dividend policy will be based on the operating results and capital needs of the business, it is anticipated that any earnings will be retained to finance the Company's future expansion. As the Company has no plans to issue cash dividends in the future, its common stock could be less desirable to other investors and as a result, the value of our common stock may decline, or fail to reach the valuations of other similarly situated companies who have issued cash dividends.

***The Common Stock is a low-priced stock and subject to regulation that limits or restricts the potential market for the stock.***

Shares of the Common Stock should be considered to be low-priced or penny stock, resulting in increased risks to investors and certain requirements being imposed on some brokers who execute transactions in the common stock. In general, a low-priced stock is an equity security that:

.

Is priced under five dollars;

.

Is not traded on a national stock exchange, the Nasdaq Global Market or the Nasdaq Capital Market;

.

Is issued by a company that has less than \$5 million in net tangible assets (if it has been in business less than three years) or has less than \$2 million in net tangible assets (if it has been in business for at least three years); and

.

Is issued by a company that has average revenues of less than \$6 million for the past three years.

The Company believes the Common Stock is presently a penny stock. At any time that the Common Stock qualifies as a penny stock, the following requirements, among others, will generally apply:

.

Certain broker-dealers who recommend penny stock to persons other than established customers and accredited investors must make a special written suitability determination for the purchaser and receive the purchaser's written agreement to a transaction prior to sale.

.

Prior to executing any transaction involving a penny stock, certain broker-dealers must deliver to certain purchasers a disclosure schedule explaining the risks involved in owning penny stock, the broker-dealer's duties to the customer, a toll-free telephone number for inquiries about the broker-dealer's disciplinary history and the customer's rights and remedies in case of fraud or abuse in the sale.

.

In connection with the execution of any transaction involving a penny stock, certain broker-dealers must deliver to certain purchasers the following:

o  
bid and offer price quotes and volume information;

o  
the broker-dealer's compensation for the trade;

o  
the compensation received by certain salespersons for the trade;

o  
monthly accounts statements; and

o



a written statement of the customer's financial situation and investment goals.

***Compliance with existing and new regulations of corporate governance and public disclosure may result in additional expenses.***

Compliance with changing laws, regulations, and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002 and other SEC regulations, requires large amounts of management attention and external resources. This may result in increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities.

### **ITEM 3.**

#### **CONTROLS AND PROCEDURES**

(a)

Based on the evaluation of our disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) or 15d-15(e)) required by paragraph (b) of Rules 13a-15 or 15d-15, the Company's principal executive officer and principal financial officer concluded that as of September 30, 2009, the Company's disclosure controls and procedures were effective.

(b)

There have been no changes in the Company's internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that occurred during the Company's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II - OTHER INFORMATION

### ITEM 1.

#### LEGAL PROCEEDINGS

The Company is aware of the following situation regarding litigation, pending or threatened, to which it is a party.

##### Syptec, Inc.

Syptec, Inc. was engaged by Sector 10 Holdings, Inc. and Sector 10 Connex, Inc. (a company owned by Sector 10 Holdings) to provide administration services for the system network. The network was transferred from Holdings to the Company in May 2009 along with the administration.

The Network is not in service as of September 30, 2009. The Company has determined that the performance of the administrator has been inadequate and the administration agreement was cancelled. The performance issues have resulted in various disagreements with the administrator. As part of the termination, the Company has requested the return of all servers and related software and other equipment for deployment in other secure facilities with a new administrator. The administrator has not provided the return of the equipment at this stage. In addition, the administrator is seeking payment of fees and has filed a claim for \$58,732 of fees due. Although the fees at issue are attributable to services for the Company, the claim was not filed against the Company.

The Company disagrees with the total fees but has recorded the full amount in the financial statements. The Company has disputed this claim and considering legal options to provide the transfer the equipment to another administrator. The disputed fees include charges for consulting fees that are being challenged since the network is not in service. Removing the consulting fees included in the \$58,732 and the consulting fees paid with the acquisition of the equipment, the Company has a credit balance of approximately \$4,000.

##### Dutro Company & Reality Engineering

The Company resolved all outstanding issues regarding research and development expenses and other expenses incurred by Dutro Company on behalf of the Company. An agreement was signed on August 6, 2009 with all parties agreeing to payment. Subsequent to the agreement, the Company requested the return of detail information concerning the R&D expenditures including drawings, engineering information and other property and supplies held by Dutro Company. Dutro Company has refused to provide any requested information and/or property.

The Company also learned that Dutro Company and members of the Dutro Group may be involved in the manufacturing, sale and /or distribution of a product that is similar to the Sector 10 MRU. Such activity is in violation of the Master Product Manufacturing and Purchase Agreement dated October 1, 2007, between Dutro Company and the Company and possibly a violation of patents held on the MRU. The Company sent Dutro Company and members of the Dutro Group a Cease and Desist letter on August 25, 2009 to stop such activity. The Company is monitoring the status of this request.

Reality Engineering is managed by Lee Allen, a member of the Dutro Group. Reality Engineering agreed to assist the Company in enhancing the PLX-3D software. The agreed fee was \$50,000. Reality completed the project and has attempted to collect over \$168,000 for the services. Reality Engineering has not provided the Company with any

useable product until the higher fee is paid. Reality Engineering has rejected all offers proposed by the Company to settle the difference in fee arrangement and has still never provided the Company with any useable end product from their services. On October 24, 2009, the Company informed Reality Engineering that they will no longer seek the end product derived from their services since no agreement could be reached on the fees. Accordingly, no fees will be paid to Reality as a result of their final rejection. The Company will review all actions taken by Reality Engineering and their impact on the Company.

No complaint or other litigation is currently filed for any of the above Dutro or Reality Engineering issues.

Edward Johnson

The Company is past due on the \$200,000 note payable plus accrued interest to Edward Johnson. The Company is currently negotiating financing with another investor group. The new financing will be used in part to repay the extended loan plus interest. The Company continues to work with the Investor to work out an agreed payment arrangement. Upon the receipt of financing, the Company intends on making payments under this arrangement until all principal and accrued interest is paid in full. No claim has been filed by the investor as of November 20, 2009

Doty Scott

Doty Scott is a consultant that delivered services to the Company prior to November 20, 2007 which was the date of the merger between SKRM Interactive, Inc. and Sector 10 USA, Inc. (now Sector 10, Inc.) The amount due the consultant at that time was approximately \$16,000. This amount was treated as pre-acquisition debt and included in accounts payable. The Company has been informed of an agreement that was signed on November 13, 2007 (pre-acquisition) that the consultant argues that carried a promissory note arrangement should the fees not be paid within a specific time period. Under the promissory note, additional compensation may be due. The consultant claims that they are entitled to over 3 million shares of common shares of the Company to fulfill their obligation. The Company reviewed the details of the claims presented by the consultant and has rejected their claims. The Consultant's attorney provided an e-mail of a complaint that he filed in a court in San Diego, CA. on October 16, 2009. The Company Registered Agent was served regarding the Complaint on October 20, 2009. The Company disagrees with the consultant claims and argues that the benefits requested are far in excess of any reasonable benefits that should be due if the original \$16,000 fees can be validated. There is no signed promissory note contained in any agreement. Nor is there any signed promissory note contained in the claim documentation that was filed. The Company will vigorously argue against any claims presented by the consultant in this matter. An attorney has been engaged to respond to the claim filed on October 16, 2009. The attorney filed a response on November 19, 2009 and requested that the case be removed to Federal Court in an effort to better protect the Company from frivolous claims that may be asserted by the consultant.

**ITEM 2.**

**UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

On September 12, 2007, the Company, Jeffrey Martin, Sector 10 Services, Sector 10 Holdings, and the DeAvila Institute the Section 10 Transaction Exchange Agreement. The offer and sale of shares of common stock in the Sector 10 Transaction were effected in reliance upon the exemptions for sales of securities not involving a public offering, as set forth in Section 4(2) of the Securities Act and/or Regulation D promulgated thereunder, based upon the following: (a) there was no public offering or general solicitation with respect to the Sector 10 Transaction offering; (b) each of Sector 10 Holdings and the DeAvila Institute investor was provided with certain disclosure materials and all other information requested with respect to the Company; (c) each of Sector 10 Holdings and the DeAvila Institute acknowledged that all securities being purchased were restricted securities for purposes of the Securities Act, and agreed to transfer such securities only in a transaction registered under the Securities Act or exempt from registration under the Securities Act; and (d) a legend was placed on the certificates representing each such security stating that it was restricted and could only be transferred if subsequently registered under the Securities Act or transferred in a transaction exempt from registration under the Securities Act.

**ITEM 6.**

**EXHIBITS**

See the Exhibit Index attached hereto following the signature page.



**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.

**SECTOR 10, INC.**

November 20, 2009  
Date

By: /s/ Pericles DeAvila  
Pericles DeAvila, President

November 20, 2009  
Date

By: /s/ Laurence A. Madison  
Laurence A. Madison  
Chief Financial Officer

**EXHIBIT INDEX**

<b>Exhibit No.</b>	<b>Exhibit</b> <b>[Discuss other exhibits]</b>	<b>Incorporated by Reference/ Filed Herewith</b>
<u>31.1</u>	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer	Filed herewith
<u>31.2</u>	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer	Filed herewith
<u>32.1</u>	Section 1350 Certification of Chief Executive Officer	Filed herewith
<u>32.2</u>	Section 1350 Certification of Chief Financial Officer	Filed herewith