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CLEAN SYSTEMS TECHNOLOGY GROUP LTD  
Form 10QSB  
June 08, 2004

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

FORM 10-QSB

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

For the quarterly period ended JUNE 30, 2003  
-----

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE EXCHANGES ACT

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

Commission file number 000-14646

CLEAN SYSTEMS TECHNOLOGY GROUP, LTD.  
(Exact name of Small Business Issuer as Specified in Its Charter)

NEW YORK  
-----  
(State or other jurisdiction of  
incorporation or organization)

06-1113228  
-----  
(I.R.S. Employer  
Identification Number)

4 Ashlagan Street, P.O. Box 8624,  
Kiryat Gat, Israel  
-----  
(Address of principal executive offices)

82021  
-----  
(Zip Code)

011 972 8 660 2108 (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

The number of shares outstanding of the registrant's Common Stock, \$0.01 Par  
Value, on June 7, 2004 was 82,663,122 shares.

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

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-QSB contains forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements, which are other than statements of historical facts. These statements are subject to uncertainties and risks including, but not limited to, product and service demand and acceptance, changes in technology, economic conditions, the impact of competition and pricing, government regulation, and other risks defined in this document and in statements filed from time to time with the Securities and Exchange Commission. These cautionary statements and any other cautionary statements that may accompany the forward-looking statements expressly qualify all such forward-looking statements. In addition, Clean Systems Technology Group, Ltd. disclaims any obligation to update any forward-looking statements to reflect events or circumstances after the date hereof.

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## PART I - FINANCIAL INFORMATION

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### CLEAN SYSTEMS TECHNOLOGY GROUP, LTD.

#### CONSOLIDATED BALANCE SHEET AS OF JUNE 30, 2003. (UNAUDITED) (IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

#### ASSETS:

##### CURRENT ASSETS:

Cash and cash equivalents	\$ 54
Accounts receivable - net	2,099
Inventory	2,280
Refundable value added tax	88
Employee advances	21
Deferred taxes	6
Other	278
	-----
TOTAL CURRENT ASSETS	4,826
PROPERTY AND EQUIPMENT - NET	1,572

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OTHER ASSETS	300
	-----
TOTAL ASSETS	\$ 6,698
	=====
LIABILITIES AND SHAREHOLDERS' EQUITY:	
CURRENT LIABILITIES:	
Short-term bank borrowings	\$ 925
Bank line of credit	77
Accounts payable	2,008
Accrued compensation	590
Accrued expenses	382
Short-term loans	447
Short term loans - related party	112
Deferred taxes	54
Other liabilities	52
	-----
TOTAL CURRENT LIABILITIES	4,647
	-----
LONG-TERM BANK DEBT	1,382
	-----
COMMITMENTS AND CONTINGENCIES	
SHAREHOLDERS' EQUITY:	
Common stock, \$.01 par value, 110,000,000 shares authorized, 53,693,851, issued and outstanding	537
Additional paid-in capital	2,102
Accumulated deficit	(1,970)
	-----
TOTAL SHAREHOLDERS' EQUITY	669
	-----
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 6,698
	=====

See Notes to the Consolidated Financial Statements.

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(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2 0 0 3	2 0 0 2	2 0 0 3	2 0 0 2
REVENUES	\$ 980	\$ 1,578	\$ 2,332	\$ 4,000
COST OF REVENUE	845	1,407	1,624	3,000
GROSS PROFIT	135	171	708	1,000
OPERATING EXPENSES:				
Selling, general and administrative	328	752	655	1,000
[LOSS] INCOME FROM OPERATIONS	(193)	(581)	53	1,000
INTEREST EXPENSE	199	117	369	1,000
FINANCIAL COSTS	27	--	27	1,000
OTHER EXPENSE (INCOME)	375	(24)	396	1,000
INCOME (LOSS) BEFORE PROVISION FOR INCOME TAXES	(794)	(674)	(739)	1,000
PROVISION FOR INCOME TAXES	49	2	56	1,000
NET (LOSS)	\$ (843)	\$ (676)	\$ (795)	\$ 1,000
NET (LOSS) PER SHARE - BASIC	\$ (.02)	\$ (.02)	\$ (.02)	\$ 1,000
NET (LOSS) PER SHARE - DILUTED	\$ (.02)	\$ (.02)	\$ (.02)	\$ 1,000
WEIGHTED AVERAGE NUMBER OF COMMON SHARES - BASIC	49,328,287	42,766,087	47,549,210	42,766,087
WEIGHTED AVERAGE NUMBER OF COMMON SHARES - DILUTED	49,328,287	42,766,087	47,549,210	42,766,087

See Notes to the Consolidated Financial Statements.

CLEAN SYSTEMS TECHNOLOGY GROUP, LTD.  
 CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY  
 (UNAUDITED)  
 (IN THOUSANDS, EXCEPT NUMBER OF SHARE DATA)

	COMMON STOCK NUMBER OF SHARES	AMOUNT	ADDITIONAL PAID-IN CAPITAL	ACCUMULATED DEFICIT	SHARE EQUITY
BALANCE DECEMBER 31, 2002	42,766,087	\$ 428	\$ 428	\$ (1,175)	\$
ISSUANCE RELATED TO CONVERSION OF CONVERTIBLE NOTES	7,627,176	76	1,278		
ISSUANCE OF NEW SHARES	3,300,588	33	396		
NET (LOSS)	-----	-----	-----	(795)	-----
BALANCE JUNE 30, 2003	53,693,851 =====	\$ 537 =====	\$ 2,102 =====	\$ (1,970) =====	\$ =====

See Notes to the Consolidated Financial Statements.

CLEAN SYSTEMS TECHNOLOGY GROUP, LTD.  
 CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (UNAUDITED)  
 (IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

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	SIX MONTHS ENDED	
	-----	
	JUNE 30,	
	-----	
	2 0 0 3	2 0 0 2
	-----	
OPERATING ACTIVITIES:		
Net (loss)	\$ (795)	\$ (170)
Adjustments to reconcile net income to net cash (used for) operating activities:		
Amortization and depreciation	149	158
Gain from the sale of property and equipment	10	--
Change in accrued severance pay - net	--	23
Changes in assets and liabilities:		
(Increase) decrease in:		
Accounts receivable - net	(372)	(914)
Accounts receivable - related party	--	129
Inventory	127	42
Costs incurred in excess of billings on contracts in progress	--	(238)
Refundable value added tax	36	14
Employee advances	--	8
Deferred taxes	85	3
Other current assets	(23)	(202)
Increase (decrease) in:		
Accounts payable	280	522
Accrued compensation	(146)	48
Accrued expenses	40	(149)
Other liabilities	4	87
	-----	-----
NET CASH - OPERATING ACTIVITIES	(605)	(639)
	-----	-----
INVESTING ACTIVITIES:		
Acquisition of property and equipment	--	(443)
Proceeds from sale of property and equipment	44	--
Investment in unconsolidated subsidiary	--	(94)
Other assets	(57)	(4)
	-----	-----
NET CASH - INVESTING ACTIVITIES	(13)	(541)
	-----	-----
FINANCING ACTIVITIES:		
Proceeds from short-term loans - net	217	--
Proceeds from convertible notes	--	948
Changes in bank line of credit - net	(88)	566
Repayment of short-term loans - net	--	(157)
Proceeds of short-term bank borrowings	14	--
Deferred loan costs	--	(117)
Common stock issuance	429	--
Proceeds from long term bank credit	86	--
Prepayment of long term bank credit	(9)	--
	-----	-----
NET CASH - FINANCING ACTIVITIES	649	1,240
	-----	-----
NET INCREASE IN CASH AND CASH EQUIVALENTS - FORWARD	\$ 31	\$ 60

See Notes to the Combined Financial Statements.

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CLEAN SYSTEMS TECHNOLOGY GROUP, LTD.  
 CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (UNAUDITED)  
 (IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

	SIX MONTHS ENDED	
	-----	
	JUNE 30,	
	-----	
	2 0 0 3	2 0 0 2
	-----	-----
NET INCREASE IN CASH AND CASH EQUIVALENTS - FORWARD	\$ 31	\$ 60
CASH AND CASH EQUIVALENTS - BEGINNING OF PERIODS	23	107
	----	----
CASH AND CASH EQUIVALENTS - END OF PERIODS	\$ 54	\$167
	====	====
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for:		
Interest	\$152	\$ 91
Income taxes	\$--	\$ 12

See Notes to the Consolidated Financial Statements.



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CLEAN SYSTEMS TECHNOLOGY GROUP, LTD.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)  
(ALL AMOUNTS IN THOUSANDS, EXCEPT SHARE AND  
PER SHARE DATA OR AS OTHERWISE NOTED)

[1] BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of Clean Systems Technology Group, Ltd. (the "Company") have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-QSB and Item 310(b) of Regulation S-B. Accordingly, they do not include all information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments [consisting of normal recurring accruals] considered necessary in order to make the interim financial statements not misleading have been included. Results for the six months ended June 30, 2003 are not necessarily indicative of the results that may be expected for the year ending December 31, 2003. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto of the Company and management's discussion and analysis of financial condition and results of operations included in the Company's annual report on Form 10-KSB for the year ended December 31, 2002.

On October 17, 2001, Entertainment International Ltd. ("ENTI"), through its wholly-owned subsidiary ENTI Acquisition I Corp., closed a transaction (the "Transaction") providing for the acquisition of CSTI Hi-Tec, Ltd. an Israeli corporation. All of the issued and outstanding shares of CSTI Hi-Tec, Ltd. were exchanged for shares of ENTI's unregistered restricted common stock. Simultaneously with the closing, the Board of Directors authorized a one for twenty reverse stock split of all ENTI's issued and outstanding common stock. All references in the accompanying consolidated financial statements to the number of shares have been restated to reflect the reverse stock split.

For accounting purposes, the Transaction has been treated as a recapitalization of CSTI Hi-Tec, Ltd., with CSTI Hi-Tec, Ltd. as the acquirer. The shares issued in the Transaction are treated as being issued for cash and are shown as outstanding for all periods presented in the same manner as for a stock split. The consolidated financial statements reflect the results of operations of CSTI Hi-Tec, Ltd. and its subsidiaries and ENTI as of and for the three and six months ended June 30, 2003 and 2002. Pro forma information on the Transaction is not presented as, at the date of the Transaction, ENTI was considered a public shell and accordingly, the Transaction was not considered a business combination. On December 27, 2001, ENTI amended its certificate of incorporation

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to change its name from Entertainment International, Ltd. to Clean Systems Technology Group, Ltd. (the "Company" or "CSTI").

### [2] SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies followed by the Company are set forth in Note 2 to the Company's consolidated financial statements included in the Company's Form 10-KSB for the year ended December 31, 2002.

USE OF ESTIMATES - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Significant estimates include the Company's estimate of allowance for doubtful accounts and its revenue recognition policy using the percentage of completion method of accounting for contracts.

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CLEAN SYSTEMS TECHNOLOGY GROUP, LTD.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)  
(ALL AMOUNTS IN THOUSANDS, EXCEPT SHARE AND  
PER SHARE DATA OR AS OTHERWISE NOTED)

### [2] SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES [CONTINUED]

REVENUE RECOGNITION - The Company follows the percentage-of-completion method of accounting for contracts that extend for periods in excess of one year. Accordingly, income is recognized in the ratio that costs incurred bears to estimated total costs. Adjustments to cost estimates are made periodically, and losses expected to be incurred on contracts in progress are charged to operations in the period such losses are determined. The aggregate of costs incurred on contracts in progress in excess of related billings is shown as a current asset, and the aggregate of billings on contracts in progress in excess of related costs incurred as shown as a current liability.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS - In January 2003, the Financial Accounting Standards Board FASB issued FASB Interpretation No- 46 ("FIN 46"), "Consolidation of Variable Interest Entities - an interpretation of ARB No. 51. "FIN 46 requires existing unconsolidated variable interest entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. FIN 46 applies immediately to variable interest entities created after January 31, 200 and the variable interest entities in which an enterprise obtains an interest after that date. It applies in the first fiscal year or interim period beginning after June 15, 2003 to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. We believe that we have no unconsolidated variable interest entities that would be considered under the requirements of FIN 46.

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In April 2003, the FASB issued Statement of Financial Accounting Standards No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" (SFAS 149), which clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 149 is effective for contracts entered into or modified after September 30, 2003 and for hedging relationships designated after September 30, 2003.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" ("SFAS 150"), which established standards for how an issuer classifies and measures certain financial instruments. SFAS 150 requires that an issuer classify certain financial instruments as liabilities (or assets in some circumstance) that were previously classified as equity. Financial instruments which embody an unconditional obligation requiring the issuer to redeem or repurchase it by the transfer of assets or by issuing a variable number of its equity shares must be classified as a liability. SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003.

We expect that the adoption of the new statements will not have a significant impact on our financial statements.

### [3] INVENTORY

Inventory, which consists of raw materials, is valued at the lower of cost or market. Cost is determined by the weighted average method.

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CLEAN SYSTEMS TECHNOLOGY GROUP, LTD.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)  
(ALL AMOUNTS IN THOUSANDS, EXCEPT SHARE AND  
PER SHARE DATA OR AS OTHERWISE NOTED)

### [4] NET INCOME PER SHARE

Earnings per share are calculated in accordance with the provisions of Statement of Accounting Standards No. 128, "Earnings per Share" ("SFAS 128"). SFAS 128 requires the reporting of both basic earnings per share, which is the weighted-average number of common shares outstanding, and diluted earnings per share, which includes the weighted-average number of common shares outstanding and all dilutive potential common shares outstanding, utilizing the treasury stock method. For the three and six months ended June 30, 2003 and 2002, the shares issued in the Transaction are treated as outstanding for all periods presented.

### [5] CONVERTIBLE NOTES

During the six months ended June 30, 2003, the Company did not issue any convertible notes.

During the second quarter of 2003, 7,627,176 common shares were issued to

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convert certain convertible notes issued during October 2001 to February 2002 by several investors in the Company. According to the terms and conditions of the notes, each note holder has received a number of shares which reflect his investment plus interest of 8% annually for a period of 18 months.

According to section 4 of the notes the conversion rate was fixed at \$ 0.1775 as of May 15, 2003.

### [6] ISSUANCE OF SHARES

During the second quarter of 2003, an aggregate of \$402,000 was invested in the Company in exchange for 3,300,588 shares of common stock.

### [7] OTHER (EXPENSE)

Aggregate amounts in other (expense) are primarily the result of foreign currency translation adjustments. Substantially all of the Company's sales are made in U.S. dollars. In addition, a substantial portion of the Company's costs are incurred in U.S. dollars. Since the U.S. dollar is the primary currency in the economic environment in which the Company operates, the U.S. dollar is its functional currency.

During the six months ended June 30, 2003, certain assets and liabilities were denominated in the new Israeli shekel while the payments to suppliers were linked to the U.S. dollar. This caused a substantial translation adjustment due to relative strength of the U.S. Dollar to the NIS in 2003.

### [8] GEOGRAPHIC REPORTING

Revenues by geographic classifications are as follows:

	[IN U.S. \$ THOUSANDS]			
	ISRAEL	ITALY	INDIA	FRANCE
For the period ended June 30, 2003	\$ 2,075	\$ 30	\$ --	\$ 227
For the period ended June 30, 2002	\$ 4,406	\$ 253	\$ 18	\$ -

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

### FORWARD-LOOKING STATEMENTS

When used in this Form 10-QSB and in future filings by Clean Systems with the Securities and Exchange Commission, the words or phrases "will likely result" and "the Company expects," "will continue," "is anticipated," "estimated," "project," or "outlook" or similar expressions are intended to identify

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"forward-looking statements." Clean Systems wishes to caution readers not to place undue reliance on any such forward-looking statements, each of which speak only as of the date made. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. Clean Systems has no obligation to publicly release the result of any revisions which may be made to any forward-looking statements to reflect anticipated or unanticipated events or circumstances occurring after the date of such statements.

### OVERVIEW

CSTI designs, engineers, manufactures, installs and services ultra high purity systems for transportation of clean gases and liquids from the source, where the gases and liquids are stored, to the point of use for the following processing industries:

- o Micro-electronics (semi conductors);
- o Optical fibers;
- o Pharmaceuticals and Bio-technology; and
- o Metal blades.

CSTI product lines provide a total solution for the four major gas and chemical systems from source to the point of use referenced above. Since the gases and the chemicals are pure and extremely dangerous, the systems that CSTI manufactures must have the highest levels of safety and quality.

CSTI products are divided into three main categories:

- o Systems for ultra high purity gases from source to point of use;
- o Pre-manufactured products sub-systems; and
- o System upgrades.

### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

This discussion and analysis of the Company's financial condition and results of operations is based on its consolidated financial statements that have been prepared under accounting principles generally accepted in the United States of America. All significant accounting policies are disclosed in note 2 to the consolidated financial statements included in Form 10-KSB. The consolidated financial statements and the related notes thereto should be read in conjunction with the following discussion of the Company's critical accounting policies. Critical accounting policies and estimates are:

- o Revenue Recognition
- o Use of Estimates

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REVENUE RECOGNITION - The Company follows the percentage-of-completion method of accounting for contracts that extend for periods in excess of one year. Accordingly, income is recognized in the ratio that costs incurred bears to estimated total costs. Adjustments to cost estimates are made periodically, and losses expected to be incurred on contracts in progress are charged to operations in the period such losses are determined. The aggregate of cost incurred on contracts in progress in excess of related billings is shown as a

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current asset, and the aggregate of billings on contracts in progress in excess of related costs incurred as shown as a current liability.

USE OF ESTIMATES - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS - In January 2003, the Financial Accounting Standards Board FASB issued FASB Interpretation No- 46 ("FIN 46"), "Consolidation of Variable Interest Entities - an interpretation of ARB No. 51. "FIN 46 requires existing unconsolidated variable interest entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. FIN 46 applies immediately to variable interest entities created after January 31, 200 and the variable interest entities in which an enterprise obtains an interest after that date. It applies in the first fiscal year or interim period beginning after June 15, 2003 to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. We believe that we have no unconsolidated variable interest entities that would be considered under the requirements of FIN 46.

In April 2003, the FASB issued Statement of Financial Accounting Standards No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" (SFAS 149"), which clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 149 is effective for contracts entered into or modified after September 30, 2003 and for hedging relationships designated after September 30, 2003.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" ("SFAS 150"), which established standards for how an issuer classifies and measures certain financial instruments. SFAS 150 requires that an issuer classify certain financial instruments as liabilities (or assets in some circumstance) that were previously classified as equity. Financial instruments which embody an unconditional obligation requiring the issuer to redeem or repurchase it by the transfer of assets or by issuing a variable number of its equity shares must be classified as a liability. SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003.

We expect that the adoption of the new statements will not have a significant impact on our financial statements.

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### RESULTS OF OPERATIONS

The following table sets forth, as a percentage of total revenue, certain consolidated statements of operations data for the periods indicated. These

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operating results are not necessarily indicative of the results for any future period.

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2003	2002	2003	2002
	%	%	%	%
Revenues	100	100	100	100
Cost of Revenues	86	89	70	68
Gross Profit	14	11	30	32
Selling General and Administrative	34	48	28	27
(Loss) Income from Operations	(20)	(37)	2	5
Interest Expense	20	8	16	3
Financial Costs	3	--	1	--
Other (Income)Expense	38	(2)	17	5
Income (loss) Before Taxes on Income	(81)	(43)	(32)	(3)
Income Taxes	5	--	2	1
Net (Loss)	(86)	(43)	(34)	(4)

THREE MONTHS ENDED JUNE 30, 2003 COMPARED WITH THREE MONTHS ENDED JUNE 30, 2002  
(AMOUNTS IN THOUSANDS UNLESS OTHERWISE INDICATED)

### REVENUES

Revenues in 2003 of \$980 decreased \$598 (or 38%) from \$1,578 in 2002. This decrease was due to the general slow down in the Israeli economy and the slowdown in particular in the industrial sector. Management's strategic decision is to continue to be a premier industry leader in Israel as well as to continue to gain market share in the European and Central Asian markets. During the three months ended June 30, 2003 and 2002, revenues to customers in Israel amounted to \$965 and \$ 1,399, respectively. Revenues to non-domestic customers amounted to \$15 and \$179for the three months ended June 30, 2003 and 2002, respectively. In general, the Company is not dependent upon any single customer or group of customers. The nature of the Company's business is such that it works on several large contracts at any one time. Therefore, several customers may comprise a significant portion of CSTI's revenues during any fiscal period. Once the Company installs a system for its customer, the customer is generally dependent on the Company for future upgrades of that system.

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### COST OF REVENUES

The following table sets forth a comparison of the costs of revenues for the periods indicated:

	THREE MONTHS ENDED	
	JUNE 30,	
	2 0 0 3	2 0 0 2
	-----	-----
Cost of materials and inventory	\$ 379	\$ 443
Salaries, subcontractors and related expenses	305	692
Cost of service abroad	13	17
Rent and taxes	9	20
Vehicles and transportation	53	113
Equipment maintenance and insurance	43	61
Depreciation and Amortization	37	45
Miscellaneous	6	16
	-----	-----
Cost of Revenues	\$ 845	\$1,407
	=====	=====

Cost of revenues has decreased by \$562 (or 40%) to \$845 in 2003 from \$1,407 in 2002. The decrease is in line with the overall decline in Company revenues. The purchase cost of materials did not significantly increase in 2003 over 2002. Materials, inventory costs and labor as a percentage of revenues was 70% in 2003 as compared to 72% in 2002. The average number of employees during 2003 was 60 as compared to 140 for 2002. Other costs such as rent and taxes, transportation, equipment maintenance and insurance and depreciation have changed in relative proportion to the decrease in revenues.

### GROSS PROFIT

Gross profit has decreased by \$36 (or 21%) to \$135 in 2003 from \$171 in 2002. Gross profit margins remained consistent at 14% in 2003 versus 11% in 2002.

### SELLING, GENERAL AND ADMINISTRATIVE

The following table sets forth details regarding selling, general and administrative expenses for the periods indicated:

	THREE MONTHS ENDED	
	JUNE 30,	
	2 0 0 3	2 0 0 2
	-----	-----
Salaries and related expenses	\$ 99	\$ 307
Professional fees	56	250
Telephone and office maintenance	101	72
Travel vehicles and transportation	9	38
Depreciation	24	22
Sales and marketing	39	63
	-----	-----
	\$ 328	\$ 752
	=====	=====

Selling, General and Administrative Expenses ("SG&A") have decreased \$424 (or 56%) to \$328 in 2003 from \$752 in 2002. The decrease is primarily attributable



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to the termination of three senior positions at the end of 2002. Management also instituted a cost cutting plan due to the decrease in revenue generating activities.

### INTEREST EXPENSE

Interest expense increased by \$122 to \$199 in 2003 from \$77 in 2002. The increase is primarily attributable to a higher level of outstanding debt in 2003 as compared to 2002.

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### OTHER INCOME (EXPENSE)

The increase in other expense of \$399 to \$375 in 2003 as compared to an income of \$24 in 2002 is primarily the result of foreign currency translation adjustments. Substantially all of the Company's sales are made in U.S. dollars. In addition, a substantial portion of the Company's costs are incurred in U.S. dollars. Since the U.S. dollar is the primary currency in the economic environment in which the Company operates, the U.S. dollar is its functional currency.

During the three months ended June 30, 2003 and 2002, certain assets and liabilities were denominated in NIS while the payments to suppliers was linked to the U.S. dollar.

SIX MONTHS ENDED JUNE 30, 2003 COMPARED WITH THE SIX MONTHS ENDED JUNE 30, 2002 (AMOUNTS IN THOUSANDS UNLESS OTHERWISE INDICATED).

### REVENUES

Revenues in 2003 of \$2,332 decreased \$2,345 (or 50%) from \$4,677 in 2002. This decrease was due to the general slow down in the Israeli economy and the slowdown in particular in the industrial sector. During the six months ended June 30, 2003 and 2002, revenues to customers in Israel amounted to \$2,075 and \$201, respectively. Revenues to Italian and other non-domestic costumers amounted to \$257 and \$9,922 for the six months ended June 30, 2003 and 2002, respectively.

### COST OF REVENUES

The following table sets forth a comparison of the costs of revenues for the periods indicated:

	SIX MONTHS ENDED JUNE 30,	
	2 0 0 3	2 0 0 2
	-----	-----
Cost of materials and inventory	\$ 622	\$ 571
Salaries subcontractors and related expenses	584	1,388
Cost of service abroad	68	56
Rent and taxes	58	42
Vehicles and transportation	106	187
Equipment maintenance and insurance	85	70
Depreciation	89	89
Miscellaneous	12	27

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Changes in work in process	--	734
	-----	-----
Cost of revenues	\$1,624	\$3,164
	=====	=====

Cost of revenues has decreased by \$1,540 (or 49%) to \$1,624 in 2003 from \$3,164 in 2002. The decrease is in line with the overall decline in Company revenues. The purchase cost of materials increased 8% in 2003 over 2002. Materials, inventory costs and labor as a percentage of revenues was 52% in 2003 as compared to 42% in 2002 reflecting increased materials costs. The average number of employees during 2003 was 60 as compared to 140 for 2002. Other costs such as rent and taxes, transportation, equipment maintenance and insurance and depreciation have changed in relative proportion to the decrease in revenues.

### GROSS PROFIT

Gross profit has decreased by \$805 to \$708 in 2003 from \$1,513 in 2002. Gross profit percentage decreased to 30% in 2003 from 32% in 2002 due to the lower margins attained on revenues in Israel due to the pricing environment. During the six months ended June 30, 2003, a substantial portion of revenues was earned in Israel as well as revenues earned in the comparative six month period for 2002. Further, the projects worked on in the first six months of 2003 were more labor intensive than the materials intensive projects of the first six months of 2002.

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### SELLING, GENERAL AND ADMINISTRATIVE

The following table sets forth details regarding selling, general and administrative expenses for the periods indicated:

	SIX MONTHS ENDED	
	JUNE 30,	
	2 0 0 3	2 0 0 2
	-----	-----
Salaries and related expenses	\$ 177	\$ 550
Professional fees	161	269
Telephone and office maintenance	154	123
Travel vehicles and transportation	19	83
Depreciation	57	43
Sales and marketing	87	199
	-----	-----
	\$ 655	\$ 1,267
	=====	=====

Selling, general and administrative expenses ("SG&A") have decreased by \$ 612 (or 48%) to \$655 in 2003 from \$1,267 in 2002. The decrease is primarily attributable to the cut in three executive management positions in end of 2002 and cost cutting as a result the decrease in revenue generating activities.

### INTEREST EXPENSE

Interest expense increased by \$216 to \$369 in 2003 from \$153 in 2002. The

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increase is primarily attributable to the higher level of outstanding debt in 2003 as compared to 2002.

### OTHER INCOME (EXPENSE)

The increase in other expense of \$145 to \$396 in 2003 as compared to \$251 in 2002 is primarily the result of a foreign currency translation adjustment.

### LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2003, the Company had cash and cash equivalents of \$54 as compared to \$167 at June 30, 2002.

Net cash used in operating activities was \$605 for the six months ended June 30, 2003 as compared to \$639 for the six months ended June 30, 2002. The use of net cash for operating activities for 2003 is due primarily to net losses and an increase in net accounts receivables offset by increases in accounts payable.

Net cash used in investing activities was \$13 and \$541 for the six months ended June 31, 2003 and 2002, respectively. During 2002 the Company invested in property and equipment as a consequence of an arrangement with the Israeli tax authorities regarding a benefit program on new investment.

Net cash provided by financing activities was \$649 and \$1,240 for the six months ended June 30, 2003 and 2002, respectively. The decrease was primarily due to a lower level of new borrowings to support the Company's working capital position in 2003 versus 2002.

### THE FOLLOWING SUMMARIZES CERTAIN FINANCING OUTSTANDING AS OF JUNE 30, 2003:

[a] Bank Guarantees - Certain customers require the Company to obtain bank guarantees of a portion of the contract undertaken. The Company has an agreement with the bank under which such guarantees are available. In the event the Company is unable to perform all aspects of the contracts, the bank will make contractual payments to customers and then seek reimbursement from the Company. As of June 30, 2003, the bank had extended approximately \$383 in guarantees to five customers.

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Assuming there is no significant adverse change affecting the business, the Company believes that additional equity funding and cash flow from operations will be sufficient to fund its needs for at least the next twelve months.

### ITEM 3. CONTROLS AND PROCEDURES.

Our Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of the end of the period covered by this report, that our disclosure controls and procedures are effective for gathering, analyzing and disclosing the information we are required to disclose in our reports filed under the Securities Exchange Act of 1934. There have been no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of the previously mentioned evaluation.

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PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Other than as previously disclosed in the Company's Form 10-KSB, the Company is not party to any other material legal proceedings.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits.

99.1 - Certification of Chief Executive Officer pursuant to the Sarbanes-Oxley Act of 2002  
99.2 - Certification of Chief Financial Officer pursuant to the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K.

There were no reports filed on Form 8-K during the quarter ended March 31, 2003.

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SIGNATURES

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

CLEAN SYSTEMS TECHNOLOGY GROUP, LTD.

Dated: June 6, 2004

By: /s/JACOB LUSTGARTEN

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Jacob Lustgarten  
Chief Executive Officer and  
Chairman of the Board

Dated: June 6, 2004

By: /S/ YONA LIEBOWITZ

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Yona Liebowitz  
Chief Financial Officer