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PROFILE TECHNOLOGIES INC
Form 10QSB
November 14, 2005

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

FORM 10-QSB

(Mark One)

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

For the quarterly period ended:
September 30, 2005

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

For the transition period from _____ to _____

Commission file number
0-21151

PROFILE TECHNOLOGIES, INC.

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

| | |
|---|--|
| DELAWARE | 91-1418002 |
| ----- | ----- |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification Number) |

| | |
|--|------------|
| 2 Park Avenue, Suite 201 | |
| Manhasset, New York | 11030 |
| ----- | ----- |
| (Address of Principal Executive Office) | (Zip Code) |

516-365-1909

(Issuer's telephone number)

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 ☐

As of October 31, 2005, the number of shares outstanding of the issuer's common stock, the only class of common equity, were 8,543,445.

Transitional Small Business Disclosure Format (Check one): Yes ☐ No ☒

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PROFILE TECHNOLOGIES, INC. Balance Sheet (unaudited)

| | |
|---|---|
| | September 30, 2005 |
| | <hr style="border-top: 1px dashed black;"/> |
| Assets | |
| Current assets: | |
| Cash | \$ 318,239 |
| Prepaid expenses and other current assets | 21,264 |
| | <hr style="border-top: 1px dashed black;"/> |
| Total current assets | 339,503 |

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| | |
|---|-------|
| Equipment, net of accumulated depreciation of \$540,230 | 6,336 |
| Deferred financing fees | 1,050 |
| Other assets | 2,415 |
| | ----- |

| | |
|--------------|------------|
| Total assets | \$ 349,304 |
| | ===== |

Liabilities and Stockholders' Deficit

Current Liabilities:

| | |
|-------------------------------------|------------|
| Accounts payable | \$ 195,132 |
| Notes payable to stockholders | 653,990 |
| Current portion of convertible debt | 127,500 |
| Deferred wages | 661,710 |
| Accrued professional fees | 174,150 |
| Accrued interest | 110,307 |
| Other accrued expenses | 14,344 |
| | ----- |

| | |
|---------------------------|-----------|
| Total current liabilities | 1,937,133 |
|---------------------------|-----------|

| | |
|---|----|
| Long-term convertible debt, net of unamortized discount of \$95,454 | 46 |
|---|----|

Stockholders' deficit:

| | |
|--|--------------|
| Common stock, \$0.001 par value. Authorized 25,000,000 shares; issued and outstanding 8,081,445 shares | 8,081 |
| Common stock issuable; 297,000 shares | 297 |
| Additional paid-in capital | 10,420,949 |
| Accumulated deficit | (12,017,202) |
| | ----- |

| | |
|-----------------------------|-------------|
| Total stockholders' deficit | (1,587,875) |
|-----------------------------|-------------|

Commitments, contingencies and subsequent events

| | |
|---|------------|
| Total liabilities and stockholders' deficit | \$ 349,304 |
| | ===== |

See accompanying notes to financial statements.

PROFILE TECHNOLOGIES, INC.
Statements of Operations
(unaudited)

For the three months ended
September 30,

| | |
|-------|-------|
| 2005 | 2004 |
| ----- | ----- |

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| | | | | |
|---|----|-----------|----|-----------|
| Revenue | \$ | -- | \$ | -- |
| Cost of revenues | | -- | | -- |
| | | ----- | | ----- |
| Gross profit | | -- | | -- |
| | | ----- | | ----- |
| Operating expenses: | | | | |
| Research and development | | 57,100 | | 22,870 |
| General and administrative | | 160,306 | | 180,602 |
| | | ----- | | ----- |
| Total operating expenses | | 217,406 | | 203,472 |
| | | ----- | | ----- |
| Loss from operations | | (217,406) | | (203,472) |
| Interest expense | | 194,657 | | 105,763 |
| | | ----- | | ----- |
| Net loss | \$ | (412,063) | \$ | (309,235) |
| | | ===== | | ===== |
| Basic and diluted net loss per share | \$ | (0.06) | \$ | (0.06) |
| Weighted average shares outstanding used to calculate basic and diluted net loss per share | | 7,254,048 | | 5,494,661 |

See accompanying notes to financial statements.

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PROFILE TECHNOLOGIES, INC.
Statements of Cash Flows
(unaudited)

For

Cash flows from operating activities:

Net loss

Adjustments to reconcile net loss to net cash used in operating activities:

 Depreciation and amortization

 Accreted discount on convertible debt

 Amortization of convertible debt discount included in interest expense

 Accrued interest on convertible debt converted to equity

 Amortization of debt issuance costs

 Equity issued for services

Changes in operating assets and liabilities:

 Prepaid expenses and other current assets

 Accounts payable

 Deferred wages

 Accrued professional fees

 Accrued interest

 Other accrued expenses

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Net cash used in operating activities

Cash flows from financing activities:

- Allocated proceeds from issuance of convertible debt
- Allocated proceeds from issuance of warrants attached to convertible debt
- Convertible debt issuance costs
- Common stock issuance costs
- Allocated proceeds from issuance of common stock
- Allocated proceeds from issuance of warrants attached to issuance of common stock
- Proceeds from issuance of notes payable to stockholders
- Repayments of note payable to stockholders

Net cash provided by financing activities

Increase (decrease) in cash

Cash at beginning of period

Cash at end of period

Supplemental disclosure of cash flow information:

- Debt discount recorded for beneficial conversion feature
- Cash paid for interest
- Convertible debt converted into 360,740 and 171,044 shares of common stock during the three months ended September 30, 2005 and 2004, respectively

See accompanying notes to financial statements.

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PROFILE TECHNOLOGIES, INC September 30, 2005 Notes to Financial Statements (Unaudited)

1. Description of Business

Profile Technologies, Inc. (the "Company"), was incorporated in 1986 and commenced operations in fiscal year 1988. The Company is in the business of inspecting pipelines for corrosion and is in the final stages of researching and developing a patented, non-destructive and non-invasive, high speed scanning process, using electro magnetic waves to remotely inspect buried, encased and insulated pipelines for corrosion.

2. Basis of Presentation

The unaudited interim financial statements and related notes of the Company have been prepared pursuant to the instructions to Form 10-QSB. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted

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in the United States of America have been omitted pursuant to such instructions. The preparation of financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses. On an on-going basis, the Company evaluates its estimates, including contract revenue recognition and impairment of long-lived assets. Actual results and outcomes may differ materially from these estimates and assumptions.

The financial statements and related notes should be read in conjunction with the audited financial statements and notes thereto included in the Company's annual report on Form 10-KSB for the year ended June 30, 2005. The information furnished reflects, in the opinion of management, all adjustments, consisting of only normal recurring items, necessary for fair presentation of the results of the interim periods presented. Interim results are not necessarily indicative of results for a full year.

3. Significant Accounting Policies

Contract Revenue Recognition

The Company recognizes revenue from service contracts using the percentage of completion method of accounting. Contract revenues earned are measured using either the percentage of contract costs incurred to date to total estimated contract costs or, when the contract is based on measurable units of completion, revenue is based on the completion of such units. This method is used because management considers total cost or measurable units of completion to be the best available measure of progress on contracts. Because of the inherent uncertainties in estimating costs, it is at least reasonably possible that the estimates used may change in the near term.

Anticipated losses on contracts, if any, are charged to earnings as soon as such losses can be estimated. Changes in estimated profits on contracts are recognized during the period in which the change in estimate is known.

Cost of revenues include contract costs incurred to date as well as any idle time incurred by personnel scheduled to work on customer contracts.

The Company records claims for additional compensation on contracts upon revision of the contract to include the amount to be received for the additional work performed. Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools and repairs, and depreciation costs. Selling, general, and administrative costs are charged to expense as incurred. Service contracts generally extend no more than six months.

Research and Development

Research and development costs are expensed when incurred. During the three months ended September 30, 2005 and 2004, the Company incurred \$57,100 and \$22,870, respectively on research and development activities.

Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of

The Company reviews long-lived assets, such as equipment and purchased intangibles subject to amortization, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be

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recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset.

Valuation of Warrants and Options

The Company estimates the value of warrants and option grants using a Black-Scholes pricing model based on management assumptions regarding the warrant and option lives, expected volatility, and risk free interest rates.

4. Stock Based Compensation

The Company has elected to follow the measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations in accounting for its employee stock options rather than the alternative fair value accounting provided for by Statements of Financial Accounting Standards No. 123 (SFAS No. 123), Accounting for Stock Based Compensation. Compensation cost for stock options issued to employees is measured as the excess, if any, of the fair market price of the Company's stock at the date of grant over the amount an employee must pay to acquire the stock. The Company did not grant any stock options to employees during the three months ended September 30, 2005 and 2004 so net loss as reported is the same as the Company's pro forma net loss as determined in accordance with SFAS No. 123. Therefore, no reconciliation in accordance with SFAS No. 123 is required to be presented.

5. Net Loss Per Share

Basic net loss per share is computed by dividing the net loss by the weighted average number of common shares outstanding during the period. Diluted net loss per share is computed by dividing the net loss by the weighted average number of common and dilutive common equivalent shares outstanding during the period. As the Company had a net loss attributable to common shareholders in each of the periods presented, basic and diluted net loss per share are the same.

Excluded from the computation of diluted net loss per share for the three months ended September 30, 2005, because their effect would be antidilutive, are options and warrants to acquire 7,912,618 shares of common stock with a weighted-average exercise price of \$1.22 per share. Also excluded from the computation of diluted net loss per share for the three months ended September 30, 2005 are 446,000 shares of common stock that may be issued if investors exercise their conversion right under the Debentures related to the 2003 Offering as discussed in footnote 7 because their effect would be antidilutive.

Excluded from the computation of diluted net loss per share for the three months ended September 30, 2004, because their effect would be antidilutive, are options and warrants to acquire 3,718,818 shares of common stock with a weighted-average exercise price of \$1.55 per share. Also excluded from the computation of diluted net loss per share for the three months ended September 30, 2004 are 660,000 shares of common stock that may be issued if investors exercise their conversion right under the Debentures related to the 2003 Offering as discussed in footnote 7 because their effect would be antidilutive.

For the three months ended September 30, 2005 and 2004, additional potential dilutive securities that were excluded from the diluted net loss per share computation are the exchange rights discussed in footnote 7 that could result in options to acquire up to 223,000 shares of common stock with an exercise price of \$1.00 per share at September 30, 2005 and 2004.

6. Notes Payable - Stockholders

In April 2002, the Company issued a non-interest bearing bridge note payable to an officer of the Company in the amount of \$7,500. The note is payable in full when the Company determines it has sufficient working capital to do so. On September 29, 2002, the officer who was owed the \$7,500 died.

The Company has entered into various loan agreements with Murphy Evans, President, a director and stockholder of the Company. On March 6, 2003, the Company's Board of Directors approved the Loan Amendment and Promissory Note (the "Amended Evans Loan") between the Company and Murphy Evans. The Amended Evans Loan aggregates all previous debt and supercedes and replaces all of the terms of the previous loans with Mr. Evans, including any conversion features. The Amended Evans Loan bears interest on the aggregate principal balance at a rate of 5% per annum, payable on June 30 and December 31 of each year, with the principal balance due and payable in full on December 31, 2003. The Amended Evans Loan is exempt from registration under Section 4(2) of the Securities Act.

During the three months ended September 30, 2005, Mr. Evans converted \$475,000 of the Amended Evans Loan pursuant to the terms of the 2005 Offering. Accordingly, Mr. Evans received 950,000 shares of common stock and warrants to purchase 950,000 shares of common stock at an exercise price of \$0.75 per share. The warrants are exercisable any time prior to the fifth anniversary from the date of grant.

Accrued interest and the outstanding principal balance of the Amended Evans Loan were \$107,063 and \$596,490, respectively as of September 30, 2005. Due to insufficient funds, the Company has not made the interest payments due on the Amended Evans Loan on June 30 and December 31 of each year and did not repay the outstanding principal balance. Corresponding interest expense related to the Amended Evans Loan was \$8,734 and \$10,730 for the three months ended September 30, 2005 and 2004, respectively. All advances from Mr. Evans are convertible into any debt or equity offerings made by the Company. Mr. Evans has not made any demand for payment, or exercised any of his remedies, under the Amended Evans Loan.

On May 9, 2002, the Company cancelled 150,000 warrants held by Mr. Evans with exercise prices ranging from \$3.00 per share to \$7.50 per share issued under the terms of a previous loan with Mr. Evans ("Old Warrants"), and issued to Mr. Evans 150,000 five-year warrants with an exercise price of \$1.05 per share, which expire on May 13, 2007.

The cancellation of the Old Warrants is an effective re-pricing and will be accounted for as a "variable plan" until such time as the warrants are exercised, expire or are forfeited. Variable plan accounting will result in intrinsic value associated with the warrants being adjusted to compensation expense based on each reporting period's ending stock value. As of September 30, 2005 and 2004, no intrinsic value had been recorded related to these warrants as the stock price was equal to or below the exercise price.

In September 2002, the Company entered into two non-interest bearing bridge loans in the respective principal amounts of \$40,000 and \$10,000 (the "Stockholder Loans") payable to two stockholders of the Company. The terms of the Stockholder Loans provide for payment at such time as the Company determines it has sufficient working capital to repay the principal balances of the Stockholder Loans. The Stockholder Loans are convertible into 57,142 and 14,286

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equity units, respectively, at any time prior to re-payment. Each equity unit is comprised of one share of the Company's common stock, with a detachable 5-year warrant to purchase one additional share at an exercise price of \$1.05 per share. Neither stockholder has converted either Stockholder Loan into equity units.

On June 19, 2003, the Board of Directors approved a promissory note (the "2003 Gemino Note") in the principal amount of \$34,047 payable to Henry E. Gemino, the Chief Executive Officer, Chief Financial Officer and a director and stockholder of the Company. From time to time, Mr. Gemino loaned the Company additional money and the Company repaid various amounts under the terms of the 2003 Gemino Note. The 2003 Gemino Note bears interest at the rate of 5% per annum, payable on June 30 and December 31 of each year. During the year ended June 30, 2005, the Company repaid the then outstanding principal balance of \$48,270 and accrued interest to Mr. Gemino. Interest expense related to the 2003 Gemino Note was \$0 and \$552 for the three months ended September 30, 2005 and 2004, respectively.

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The following is a summary of notes payable to stockholders as of September 30, 2005.

| | |
|-----------------------|-----------|
| Amended Evans Loan | \$596,490 |
| 2003 Gemino Note | -- |
| Deceased Officer Note | 7,500 |
| Stockholder Loans | 50,000 |
| | ----- |
| Total | \$653,990 |
| | ===== |

7. Liquidity and Subsequent Events

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. The Company incurred cumulative losses of \$12,017,202 through September 30, 2005 and had negative working capital of \$1,597,630 as of September 30, 2005. Additionally, the Company has expended a significant amount of cash in developing its technology and patented processes. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management recognizes that in order to meet the Company's capital requirements, and continue to operate, additional financing, including seeking industry-partner investment through joint ventures or other possible arrangements, will be necessary. The Company is evaluating alternative sources of financing to improve its cash position and is undertaking efforts to raise capital. If the Company is unable to raise additional capital or secure additional revenue contracts and generate positive cash flow, it is unlikely that the Company will be able to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Deferred Wages and Accrued Professional Fees

To reduce cash outflows, certain of the Company's employees, officers, consultants, and directors have agreed to defer a portion of their salaries and professional fees until the Company has sufficient resources to pay the amounts owed or to exchange such amounts into options as described below. At September 30, 2005, the Company has accrued \$835,860 related to the deferred payment of salaries and professional fees of which \$661,710 is included under deferred

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wages and \$174,150 in accrued professional fees. On March 18, 2002, the Board approved a conversion right on all deferred wages and accrued professional fees deferred as of March 18, 2002. Pursuant to this conversion right, employees, officers, consultants, and directors may elect to convert \$1.00 of fees owed to them as of March 18, 2002 for an option to purchase two shares of the Company's common stock, at an exercise price of \$1.00 per share for a term of five years. Deferred salaries and fees as of March 18, 2002 were \$111,500, resulting in the potential issuance of 223,000 options under the terms mentioned above. No conversions have occurred to date. At March 18, 2002, there was no intrinsic value associated with these exchange rights. As such, no additional compensation cost was recorded.

Long-Term Convertible Debt

On June 19, 2003, the Board of Directors approved the offering (the "2003 Offering") of \$1,000,000 in convertible debentures (the "Debentures"). The Debentures are convertible into that number of shares of the Company's common stock equal to the amount of the converted indebtedness divided by \$0.50 per share. The Debentures bear interest at a rate of 5% per annum, payable quarterly. Delinquent interest payments bear interest at a rate of 12% per annum. The Company is required to redeem each Debenture on the 5th anniversary of the date of the Debenture. The Company may, in its discretion, redeem any Debenture at any time prior to the mandatory redemption date of the Debenture by providing no less than 60 days' prior written notice to the holder of the Debenture. Certain events of default will result in the Debentures being redeemable by the Company upon demand of the holder.

Upon the purchase of, and for each \$0.50 of the Debenture's principal amount, the Company issued to each investor a warrant (the "Warrant") to purchase one (1) share of the Company's common stock at an exercise price of \$0.75 per share. The Warrants are exercisable at any time prior to the 5th anniversary date of the redemption of the Debenture.

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Warrants issued in connection with the 2003 Offering were recorded based on their relative fair value as compared to the fair value of the debt at issuance. The relative fair value of the warrants was recorded as paid-in capital, estimated at \$0 and \$37,815 for the three months ended September 30, 2005 and 2004, respectively. The fair value of the warrants issued during the three months ended September 30, 2004, was determined based on an option pricing model with the following assumptions: warrant lives of 10 years, risk free interest rates ranging from 4.24% to 4.30%, volatility of 120%, and a zero dividend yield. The intrinsic value of the Debentures results in a beneficial conversion feature that reduces the book value of the convertible debt to not less than zero. Accordingly, the Company recorded a discount of \$0 and \$32,185 during the three months ended September 30, 2005 and 2004, respectively on the convertible debt issued under the 2003 Offering. The Company amortizes the discount using the effective interest method over the five-year life of the Debentures.

During the quarter ended March 31, 2005, the Board of Directors terminated the 2003 Offering. As of the closing date of the 2003 Offering, the Company had raised \$503,000 from the 2003 Offering.

During the three months ended September 30, 2005, four investors exercised their conversion right under the terms of the Debentures. Accordingly, the carrying value of the convertible debt was reclassified as equity upon conversion. Since the convertible debt instruments include a beneficial conversion feature, the remaining unamortized discount of approximately \$170,000

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at the conversion date was recognized as interest expense.

During the three months ended September 30, 2004, four investors exercised their conversion right under the terms of the Debentures. Accordingly, the carrying value of the convertible debt was reclassified as equity upon conversion. Since the convertible debt instruments include a beneficial conversion feature, the remaining unamortized discount of approximately \$85,000 at the conversion date was recognized as interest expense.

As of September 30, 2005, accrued interest on the Debentures was \$3,245. The Company recorded interest expense related to the accretion of the discount on the Debentures and amortization of the convertible debt discount of \$169,985 and \$100,583 for the three months ended September 30, 2005 and 2004, respectively. As of September 30, 2005 the carrying value of the long-term debt debenture was \$46, net of unamortized debt discount of \$95,454.

Common Stock

On January 19, 2005, the Board of Directors approved the offering (the "2005 Offering") of 2,000,000 units (the "Units") for a total offering price of \$1,000,000, consisting of shares of common stock and attached warrants. The purchase price of one Unit is \$0.50. Each Unit consists of one share of common stock and a warrant to purchase one share of common stock at an exercise price of \$0.75 per share. The warrants are exercisable at any time prior to the fifth anniversary from the date of grant.

During the three months ended September 30, 2005, the Company raised \$548,500 under the terms of the 2005 Offering. Accordingly, the Company issued 1,097,000 shares of common stock and warrants to purchase up to 1,097,000 shares of common stock at an exercise price of \$0.75 per share.

The Company engaged a brokerage firm to help in the fund raising efforts of the 2005 Offering. Pursuant to the terms of the agreement with the brokerage firm, the Company will pay the brokerage firm a ten percent cash commission on all funds that the brokerage firm helps raise. Additionally, the Company will issue warrants to purchase shares of common stock at \$0.75 per share equal to ten percent of the total warrants issued in connection with the 2005 Offering. The warrants may be exercised up to five years from the date of issuance, which is the date the proceeds are received under the 2005 Offering. During the three months ended September 30, 2005, the Company incurred \$51,650 of fees to be paid in cash to the brokerage firm and issued warrants to purchase 103,300 shares of common stock. The Company recorded \$68,178 as a reduction to paid-in capital for the fair value of the warrant grants. The fair value of the warrant grants were estimated using the Black-Scholes option pricing model with the following weighted average assumptions: expected volatility of 168%, risk-free interest rate of 4.14%, expected life of five years, and a 0% dividend yield.

Subsequent Events

Subsequent to September 30, 2005, one investor exercised their conversion right under the terms of the 2003 Offering. Accordingly, \$40,000 of principal was converted into 80,000 shares of common stock.

Subsequent to September 30, 2005, the Company has raised \$57,000 and issued 114,000 shares of common stock and warrants to purchase up to 114,000 shares of common stock in accordance with the terms of the 2005 Offering. Additionally,

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pursuant to an agreement with a brokerage firm, the Company has incurred \$5,200 of commission related fees and issued warrants to purchase 10,400 shares of common stock at \$0.75 per share.

Subsequent to September 30, 2005, Mr. Evans provided a notice of conversion to the Company to convert \$422,000 of the outstanding principal balance and \$78,000 of accrued interest on the Amended Evans Loan pursuant to the terms of the 2005 offering. Accordingly, Mr. Evans will receive 1,000,000 shares of common stock and warrants to purchase 1,000,000 shares of common stock at an exercise price of \$0.75 per share.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

General

Profile Technologies, Inc. (the "Company"), a Delaware corporation, was incorporated in 1986 and commenced operations in fiscal year 1988. The Company is in the business of inspecting pipelines for corrosion and is in the final stages of researching and developing a patented, non-destructive and non-invasive, high speed scanning process using electro magnetic waves to remotely inspect buried, encased and insulated pipelines for corrosion (the "EMW Inspection"). The EMW Inspection process analyzes the waveforms of electrical impulses by extracting point-to-point information along a segment of pipeline to determine the integrity of the entire pipeline. During the EMW Inspection process electromagnetic pulses are directed along the length of a pipeline from either one ("Single-Pulse") or two ("Dual-Pulse") directions. In Dual-Pulse mode, the intersecting point of the two electro magnetic pulses is moved down the pipeline by computerized delays of one pulse and data received from these locations is analyzed to determine if an anomaly on the pipeline exists and whether such anomaly is likely to be identified as corrosion.

The EMW Inspection process provides a corrosion inspection method which does not require the inspector to physically remove the pipeline's insulation or otherwise dig up the pipeline to visually inspect for corrosion. In certain instances, limited access points to buried pipelines exist for reasons unrelated to corrosion inspection. As a result, corrosion inspection may be conducted at these access points. Where such access points are not already available, the EMW Inspection process permits the inspection of pipelines with a minimal amount of disturbance to the coating or insulation on the pipeline. In addition, the EMW Inspection process permits corrosion inspection over the entire pipeline, as opposed to other technologies, which only provide for spot point inspections. Such "spot inspections" are not necessarily accurate in indicating the overall condition of a pipeline.

Refineries, chemical plants, utilities, natural gas transmission companies and the petroleum industry have millions of miles of pipeline much of which may be exposed to harsh and severe environments subjecting such pipeline to higher incidence of corrosion. As a result of such environments these industries are continually challenged to ensure that the quality of its pipeline meets applicable standards established by relevant regulatory bodies to protect operating personnel and the environment.

During the summer of 1998, the Company completed work on its first commercial contract with ASCG Inspection, Inc. testing British Petroleum pipelines at approximately 100 road and caribou crossings located on the North Slope of Alaska. During the summer of 1999, the Company continued work testing pipelines under a contract with another large multi-national oil company related to the inspection of approximately 250 below-grade pipelines. During the summer of 2000, the Company expanded its Alaska efforts by testing a total of 372 below-grade pipelines. In 2001, the Company completed the testing of approximately 441 pipelines in Alaska and in 2002 the Company inspected 364

pipelines.

Based on estimates provided by its then current Alaska customers based on their recently completed road and caribou crossing inspections, the Company was expected to complete the inspection of approximately 400 to 500 below-grade pipelines in Alaska during the 2003 calendar year. However, the Company was able to successfully test only 250 below-grade pipelines during this time period as a result of lack of current budgeting for the remainder of such program.

The remainder of the inspection work is expected to be completed at some future date. In anticipation of this possibility, the Company designed, fabricated, and began testing new hardware for the inspection of direct-buried pipe in the lower-48 states. The new hardware has been designed with a view toward improving efficiency, ease of use, portability, accuracy of test data and customer acceptance.

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More importantly, the new hardware provides a different pulse waveform specifically tailored to the buried pipe requirement. The improved waveform has increased low frequency energy content, which enables efficient wave propagation through sand, soil, and moist earth.

The new hardware was designed to be much smaller than the previous generation hardware used in Alaska. The entire test hardware package weighs less than 25 pounds including data acquisition digitizer and battery power supply. The new hardware can be hand-carried and operated by a single person and does not require the gasoline powered AC generator, utility trailer, and external computer data acquisition system which were necessary with the previous generation hardware. The portable system is designed to allow testing of both underground and above-grade pipelines with one test set.

The buried pipe inspection hardware is currently being tested at the Company's Ferndale, Washington pipe test facility. The new hardware has demonstrated good results in initial testing. Proper pulse waveforms have been transmitted through several hundred feet of pipe buried in moist earth. The hardware is now being optimized and evaluated for ability to detect various types of anomalies. This work is currently the focus of the research effort at Ferndale. When this work is successfully completed, the improved highly portable system will increase field productivity, reduce operator training time, and significantly reduce the cost of field operations. The new system will also be compatible with production in quantity and operation with minimal training, enabling licensing of the technology to the industry.

Although several important milestones have been achieved in the fabrication and testing of this new hardware, there can be no assurance that the remaining portion of the testing program can be funded or that the new hardware can be successfully tested and deployed on a commercial basis. Failure to do so could have a serious and material effect on the business and financial condition of the Company.

On December 15, 2003, the U.S Department of Transportation ("DOT") issued regulations under the Pipeline Safety Improvement Act of 2002 requiring regulated companies to gather baseline integrity data on pipelines in so-called "high consequence areas" ("HCA's") (e.g., populated areas) initially over a ten-year period and then every seven years thereafter. Based on consultations with industry representatives, the Company believes that its new buried pipe inspection hardware will provide such regulated companies with a superior tool for gathering required baseline integrity data.

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Pending the deployment of its new hardware and the receipt of new contracts, and in an effort to reduce its out-of-pocket expenses to the lowest practicable level, the Company has furloughed all of its field crews. If and when commercial contracts are obtained, the Company may re-hire former crew personnel or may hire and train new crews.

Throughout its development stage, the Company has filed and continues to file many patents in order to protect the proprietary nature of its technology.

Pipeline Corrosion

A combination of federal state, and industry rules combine to regulate corrosion protection. The U.S. Department of Labor, operating through the Occupational Safety and Health Administration has jurisdiction over numerous plants and facilities containing corrosion protected pipeline that, if breached, could cause serious bodily injury or death to on-site workers. The U.S. Department of Transportation has jurisdiction over interstate natural gas and hazardous liquids pipelines. Counterpart state agencies have jurisdiction over intrastate natural gas and hazardous liquids pipelines. In addition, the American Petroleum Institute has promulgated a comprehensive Piping Inspection Code which requires that extensive corrosion testing be done by all members (which includes the vast majority of the petroleum and petrochemical industries). As a result of extensive regulation and testing requirements, the industry is faced with the requirement to engage in extensive testing for corrosion. In 1993, the American Petroleum Institute imposed even stricter test standards regarding the problem of corrosion under the insulation on pipelines. When pipeline is uninsulated and above ground, external corrosion can be identified visually. The petroleum and other related industries, however, insulate much of their piping to conserve energy and to prevent injury to personnel from high temperature levels on the pipelines. As soon as piping is insulated, a very complex situation is created. Corrosion can occur underneath the insulation due to moisture or corrosive products that find their way through broken or poorly sealed insulation. This corrosion under insulated pipelines is

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very difficult and costly to locate. In the past, testing for this problem had been on a limited sample basis and relied upon inspection processes that were very cumbersome and costly.

Two prevalent testing methods used to detect corrosion under insulated pipelines are X-ray and eddy current methods, which are methods of detecting defects in pipe by analyzing visual image and decay. After physically stripping away coating for visual inspection, depth gauges, ultrasonics and X-ray are then used to determine the severity of corrosion on questionable pipe. However, the stripping of insulation to determine corrosion is a costly testing method for the industry because it often involves the assembly of scaffolding for testing otherwise inaccessible above ground pipe (particularly in refineries and petrochemical plants) or an actual dig-up on below ground pipe. The Company's technology enables it to test pipe segments in a refinery setting for a distance up to three hundred feet and to use "cherry pickers" instead of costly scaffolding.

Corrosion under insulated pipelines presents a very complicated testing problem because corrosion cannot be easily identified by statistical sampling. If, for example, a segment of pipe has a small insulation part removed every ten feet and is visually inspected using eddy current or x-ray techniques, there is no statistical basis to assume that the external condition of the piping between

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the removed insulation parts is good or bad. The American Petroleum Institute testing standard adopted in 1993, in essence, mandates either stripping even larger amounts of coating or using an alternate system that will identify corrosion under the insulation without stripping the coating on suspected and unsuspected pipe. Because of the enormous cost involved in using the stripping and visual testing process, the Company believes that the industry will be receptive to an alternate testing system that is reliable and less costly. The Company believes that its EMW process provides an alternate testing system that could be widely accepted by the Industry. However, while the Company has obtained some commercial contracts and prospects for expanded commercial contracts in the future appear strong, there can be no assurance that such acceptance will continue to grow or that competitors will not develop newer and better technologies.

The Company's EMW Inspection Technology

The Company has developed two basic EMW inspection techniques, namely, Dual Pulse or Pulse Propagation Analyzer and Single-Pulse or Calibration Mark Z. For above-grade piping, the Company uses both the Dual-Pulse and CMZ to determine the condition of a given pipe segment in the open field as well as in a refinery, chemical plant or power plant. For below-grade piping under streets and road crossings, the Company uses only the Dual Pulse technique. The results of our two basic techniques provide an assessment of the overall integrity of the pipe in question and the location and classification of electromagnetic anomalies which, in most instances, are related to external corrosion.

The Single-Pulse Technique

The Single-Pulse technique requires fixing the source location on one end of the pipe segment in question and adjusting the signal receiver generally at an equal incremental distance from the source across the length of pipe segment. From the characteristics of the electromagnetic waves as a result of wave propagation, attenuation, and dispersion, we determine whether electromagnetic anomalies exist, as in the case of the Dual-Pulse techniques.

As simple as these concepts may appear, the Company believes that the EMW process is not intuitively obvious. The petroleum industry has spent significant funds trying to solve the problem of finding corrosion under insulation. Correlating pipeline corrosion information using the Company's technology requires a combination of state-of-the-art instrumentation plus an understanding of the physical phenomena that are being measured. Although the principles of the EMW process are simple to explain, management believes that the EMW measurement and analysis are on the leading edge of inspection technology.

The Company believes that its technology has at least two significant competitive advantages. First, its technology can inspect certain pipelines that are inaccessible to other testing methods. Second, with respect to insulated, coated, encased or buried facilities that are accessible to other inspection technologies, because the Company's technology does not require the removal of such insulation, coatings or encasements or pipeline excavation as a prerequisite to testing, it has a much lower cost of site preparation and, therefore, a significant cost advantage over other technologies. Research and

development efforts will continue in the development of new applications for the Company's technology and to develop new products for the petroleum industry and

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other industries.

The Dual-Pulse Technique

The Dual-Pulse process extracts corrosion related information from segments of both accessible and inaccessible pipelines underneath the entire insulation barrier by analyzing the intersection of two electrical current pulses traveling in opposite directions along the pipeline. This corrosion related information is extracted without the need for removing the insulation protecting the pipeline. Through laboratory and field testing the Company established that the electrical response, called characteristic transfer function ("CTF"), of two intersecting pulses traveling along the pipeline is uniquely defined with location specific information that relates to the integrity of the pipeline at the point of intersection. Constructive interference occurs when the two current impulses run into and interfere with each other at the point of intersection on a pipeline. The CTF is determined, not only by the nature and characteristics of the original pulses, but by the physical characteristics of the pipeline segment in its environment at the point of intersection.

The EMW process was developed to evaluate the condition and integrity of pipelines. Electro-magnetic pulses are applied at both ends of the pipe segment being tested. Under computer control, the timing of the pulses is controlled so that the intersection point of the two pulses moves sequentially from one end of the pipe to the other end. A unique CTF is obtained for each intersection point of the pipeline segment being tested on some predetermined interval, such as, in one foot intervals. When this data is geophysically displayed, it provides a visual display of data related to the physical condition of the pipe at each point of intersection. Information can also be derived using the EMW process to determine the condition of the coating and the effectiveness of the existing corrosion protection system that is being used to protect each point of intersection. Where there are indications of problems, closer interval inspection can be performed and/or one of the other location specific processes used in the industry may be utilized before the insulation is removed to inspect the pipe condition.

Revenues

The Company derives revenue solely from the sale of the EMW inspection technology service. The Company relies solely upon several employees, including the Chief Executive Officer and the Chief Operating Officer to conduct the Company's sales activities.

The Company did not have revenues during the three months ended September 30, 2005 and 2004, respectively.

Sales and Marketing

The Company's sales and marketing strategy has been to position the Company's EMW inspection process as the method of choice to detect pipeline corrosion where the pipelines are either inaccessible to other inspection tools or much more costly to inspect with tools other than the Company's EMW technology. Pipelines are commonly found in refinery and chemical plants (such as insulated, overhead pipes), natural gas distribution systems (such as pipes buried in city streets), and natural gas transmission systems (such as road, bridge and stream crossings and concrete-encased pipes).

As described above, the Company has fabricated new buried pipe inspection hardware and is actively seeking industry and other financing sources in order to rigorously and scientifically test that hardware. In order to obtain additional revenue generating contracts, the Company intends to emphasize the reliability of its buried pipeline testing method, the flexibility of the

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method's application, and its cost effectiveness as compared to other methods. The Company intends to concentrate its fiscal year 2006 marketing efforts on the pipeline and utility buried pipe inspection markets in the lower-48 states, particularly in "high consequence areas" as defined in the federal Department of Transportation's regulations ("HCAs"). However, there can be no assurance that the Company will be successful in concentrating its marketing efforts for the EMW technology on natural gas utility and pipeline markets.

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Results of Operations

The Company's operating results depend exclusively on its ability to market its EMW inspection technology services. If the Company is not able to automate completely the EMW inspection process and fully implement its new technology, the Company may not be able to obtain future contracts to sell or license its EMW technology. Since the Company's revenues are derived solely from sales of its EMW technology, any failure to obtain future contracts will have a material adverse effect on the business and financial condition of the Company.

The Company did not generate any revenues during the three months ended September 30, 2005 and 2004, respectively, as the Company was engaged solely in the redevelopment and improvement of its testing hardware and software.

The Company did not have any cost of revenues for the three months ended September 30, 2005 and 2004, respectively. The Company did not have any employees working in the field because the Company did not have any revenue generating contracts during these periods.

Research and development expenses for the three months ended September 30, 2005 and 2004 were \$57,100 and \$22,870, respectively. The increase of \$34,230 for the three months ended September 30, 2005 as compared to the three months ended September 30, 2004 is substantially the result of the Company retaining the services of a consultant and scientist to focus increased efforts on the design, fabrication, and testing of the Company's new hardware.

General and administrative expenses for the three months ended September 30, 2005 and 2004 were \$160,306 and \$180,602, respectively. The decrease of \$20,296 for the three months ended September 30, 2005 as compared to the three months ended September 30, 2004 is the result of a general reduction of operating expenditures as the Company continues to focus on reducing its overall burn rate. There were significant decreases in professional fees of approximately \$12,300 and insurance premiums of approximately \$2,300 for the three months ended September 30, 2005 as compared to the three months ended September 30, 2004.

Loss from operations for the three months ended September 30, 2005 and 2004 was \$217,406 and \$203,472, respectively. In general, loss from operations increased for the three months ended September 30, 2005 as compared to the three months ended September 30, 2004 as a result of an increase in research and development activities, offset by reductions in professional fees and other operating expenses as discussed above.

Interest expense for the three months ended September 30, 2005 and 2004 was \$194,657 and \$105,763, respectively. The increase of \$88,894 for the three months ended September 30, 2005 as compared to the three months ended September 30, 2004 is substantially the impact of investors exercising their conversion right in accordance with the terms of the Convertible Debentures. Accordingly, during the three months ended September 30, 2005, approximately \$170,000 of

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unamortized discount was recognized as interest expense upon conversion as compared to approximately \$85,000 during the three months ended September 30, 2004.

Liquidity and Capital Resources

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. The Company incurred cumulative losses of \$12,017,202 through September 30, 2005 and had negative working capital of \$1,597,630 as of September 30, 2005. Additionally, the Company has expended a significant amount of cash in developing its technology and patented processes. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management recognizes that in order to meet the Company's capital requirements, and continue to operate, additional financing, including seeking industry-partner investment through joint ventures or other possible arrangements, will be necessary. The Company is evaluating alternative sources of financing to improve its cash position and is undertaking efforts to raise capital. If the Company is unable to raise additional capital or secure additional revenue contracts and generate positive cash flow, it is unlikely that the Company will be able to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

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Deferred Wages and Accrued Professional Fees

To reduce cash outflows, certain of the Company's employees, officers, consultants, and directors have agreed to defer a portion of their salaries and professional fees until the Company has sufficient resources to pay the amounts owed or to exchange such amounts into options as described below. At September 30, 2005, the Company has accrued \$835,860 related to the deferred payment of salaries and professional fees of which \$661,710 is included under deferred wages and \$174,150 in accrued professional fees. On March 18, 2002, the Board approved a conversion right on all deferred wages and accrued professional fees deferred as of March 18, 2002. Pursuant to this conversion right, employees, officers, consultants, and directors may elect to convert \$1.00 of fees owed to them as of March 18, 2002 for an option to purchase two shares of the Company's common stock, at an exercise price of \$1.00 per share for a term of five years. Deferred salaries and fees as of March 18, 2002 were \$111,500, resulting in the potential issuance of 223,000 options under the terms mentioned above. No conversions have occurred to date. At March 18, 2002, there was no intrinsic value associated with these exchange rights. As such, no additional compensation cost was recorded.

Long-Term Convertible Debt

On June 19, 2003, the Board of Directors approved the offering (the "2003 Offering") of \$1,000,000 in convertible debentures (the "Debentures"). The Debentures are convertible into that number of shares of the Company's common stock equal to the amount of the converted indebtedness divided by \$0.50 per share. The Debentures bear interest at a rate of 5% per annum, payable quarterly. Delinquent interest payments bear interest at a rate of 12% per annum. The Company is required to redeem each Debenture on the 5th anniversary of the date of the Debenture. The Company may, in its discretion, redeem any Debenture at any time prior to the mandatory redemption date of the Debenture by providing no less than 60 days' prior written notice to the holder of the

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Debenture. Certain events of default will result in the Debentures being redeemable by the Company upon demand of the holder.

Upon the purchase of, and for each \$0.50 of the Debenture's principal amount, the Company issued to each investor a warrant (the "Warrant") to purchase one (1) share of the Company's common stock at an exercise price of \$0.75 per share. The Warrants are exercisable at any time prior to the 5th anniversary date of the redemption of the Debenture.

Warrants issued in connection with the 2003 Offering were recorded based on their relative fair value as compared to the fair value of the debt at issuance. The relative fair value of the warrants were recorded as paid-in capital, estimated at \$0 and \$37,815 for the three months ended September 30, 2005 and 2004, respectively. The fair value of the warrants issued during the three months ended September 30, 2004, were determined based on an option pricing model with the following assumptions: warrant lives of 10 years, risk free interest rates ranging from 4.24% to 4.30%, volatility of 120%, and a zero dividend yield. The intrinsic value of the Debentures results in a beneficial conversion feature that reduces the book value of the convertible debt to not less than zero. Accordingly, the Company recorded a discount of \$0 and \$32,185 during the three months ended September 30, 2005 and 2004, respectively on the convertible debt issued under the 2003 Offering. The Company amortizes the discount using the effective interest method over the five-year life of the Debentures.

During the quarter ended March 31, 2005, the Board of Directors terminated the 2003 Offering. As of the closing date of the 2003 Offering, the Company had raised \$503,000 from the 2003 Offering.

During the three months ended September 30, 2005, four investors exercised their conversion right under the terms of the Debentures. Accordingly, the carrying value of the convertible debt was reclassified as equity upon conversion. Since the convertible debt instruments include a beneficial conversion feature, the remaining unamortized discount of approximately \$170,000 at the conversion date was recognized as interest expense.

During the three months ended September 30, 2004, four investors exercised their conversion right under the terms of the Debentures. Accordingly, the carrying value of the convertible debt was reclassified as equity upon conversion. Since the convertible debt instruments include a beneficial conversion feature, the remaining unamortized discount of approximately \$85,000 at the conversion date was recognized as interest expense.

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As of September 30, 2005, accrued interest on the Debentures was \$3,245. The Company recorded interest expense related to the accretion of the discount on the Debentures and amortization of the convertible debt discount of \$169,985 and \$85,000 for the three months ended September 30, 2005 and 2004, respectively. As of September 30, 2005 the carrying value of the long-term debt debenture was \$46, net of unamortized debt discount of \$95,454.

Common Stock

On January 19, 2005, the Board of Directors approved the offering (the "2005 Offering") of 2,000,000 units (the "Units") for a total offering price of \$1,000,000, consisting of shares of common stock and attached warrants. The purchase price of one Unit is \$0.50. Each Unit consists of one share of common stock and a warrant to purchase one share of common stock at an exercise price

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of \$0.75 per share. The warrants are exercisable at any time prior to the fifth anniversary from the date of grant.

During the three months ended September 30, 2005, the Company raised \$548,500 under the terms of the 2005 Offering. Accordingly, the Company issued 1,097,000 shares of common stock and warrants to purchase up to 1,097,000 shares of common stock at an exercise price of \$0.75 per share.

The Company engaged a brokerage firm to help in the fund raising efforts of the 2005 Offering. Pursuant to the terms of the agreement with the brokerage firm, the Company will pay the brokerage firm a ten percent cash commission on all funds that the brokerage firm helps raise. Additionally, the Company will issue warrants to purchase shares of common stock at \$0.75 per share equal to ten percent of the total warrants issued in connection with the 2005 Offering. The warrants may be exercised up to five years from the date of issuance, which is the date the proceeds are received under the 2005 Offering. During the three months ended September 30, 2005, the Company incurred \$51,650 of fees to be paid in cash to the brokerage firm and issued warrants to purchase 103,300 shares of common stock. The Company recorded \$68,178 as a reduction to paid-in capital for the fair value of the warrant grants. The fair value of the warrant grants were estimated using the Black-Scholes option pricing model with the following weighted average assumptions: expected volatility of 168%, risk-free interest rate of 4.14%, expected life of five years, and a 0% dividend yield.

Other Commitments

The Company's other contractual obligations consist of commitments under an operating lease and repayment of loans payable to certain officers, directors and stockholders.

As of to September 30, 2005, the Company had outstanding loans payable to certain officers, directors and stockholders with principal amounts, in the aggregate, equal to \$653,990. The terms of the various notes are described above under "Note 6: Notes Payable - Stockholders."

As of to September 30, 2005, the Company has future minimum lease payments of approximately \$6,078 under its operating lease.

Capital will be expended to support operations until the Company can generate sufficient cash flows from operations. In order for the Company to generate cash flows from operations, the Company must generate additional revenue generating contracts. Management is currently directing the Company's activities towards obtaining additional service contracts, which, if obtained, will necessitate the Company attracting, hiring, training and outfitting qualified technicians. If additional service contracts are obtained, it will also necessitate additional field test equipment purchases in order to provide the services. The Company's intention is to purchase such equipment for its field crews for the foreseeable future, until such time as the scope of operations may require alternate sources of financing equipment. The Company expects that if additional contracts are secured, and revenues increase, working capital requirements will increase. There can be no assurance that the Company's process will gain widespread commercial acceptance within any particular time frame, or at all. The Company will incur additional expenses as it hires and trains field crews and support personnel related to the successful receipt of commercial contracts. Additionally, the Company anticipates that cash will be

used to meet capital expenditure requirements necessary to develop

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infrastructure to support future growth. There can be no assurance that the Company will be able to secure additional revenue generating contracts to provide sufficient cash.

Pending the deployment of the Company's new hardware (as discussed in the "General" section) and the receipt of new contracts, and in an effort to reduce its out-of-pocket expenses to the lowest practicable level, the Company has furloughed all of its field crews. If and when revenue-generating contracts are obtained, the Company will re-hire former crew personnel or may hire and train new crews. The Company was not obligated to make any severance payments for salaries, health benefits or accrued vacation and sick time related to the termination of any of its employees.

Off Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-QSB contains "forward-looking statements." These forward-looking statements can generally be identified as such because the context of the statement will include words such as the Company "believes," "anticipates," "expects" or words of similar import. Similarly, statements that describe the Company's projected future results, future plans, objectives or goals or future conditions or events are also forward looking statements. Actual results are inherently difficult to predict. Any such forward-looking statements are subject to the risks and uncertainties that could cause actual results of operations, financial condition, acquisitions, financing transactions, operations, expenditures, expansion and other events to differ materially from those expressed or implied in such forward-looking statements. Any such forward-looking statements would be subject to a number of assumptions regarding, among other things, future economic, competitive and market conditions generally. Such assumptions would be based on facts and conditions as they exist at the time such statements are made as well as predictions as to future facts and conditions, the accurate prediction of which may be difficult and involve the assessment of events beyond the Company's control.

The forward-looking statements contained in this report are based on current expectations that involve a number of risks and uncertainties. Such forward-looking statements are based on assumptions that the Company will obtain or have access to adequate financing to continue its operations, that the Company will market and provide products and services on a timely basis, that there will be no material adverse competitive or technological change with respect to the Company's business, demand for the Company's products and services will significantly increase, that the Company will be able to secure additional fee-for-services or licensing contracts, that the Company's executive officers will remain employed as such by the Company, that the Company's forecast accurately anticipate market demand, and that there will be no material adverse change in the Company's operations, business or governmental regulation affecting the Company or its customers. The foregoing assumptions are based on judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond the Company's control. Although the Company believes the expectations reflected in the forward-looking statements are reasonable, the Company cannot guarantee future results, levels of activity, performance or achievements.

Item 3. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

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The term "disclosure controls and procedures" is defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). This term refers to the controls and procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized, and reported within the required time periods. Our Chief Executive Officer and our Chief Financial Officer have evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. They have concluded that, as

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of that date, our disclosure controls and procedures were effective at ensuring that required information will be disclosed on a timely basis in our reports filed under the Exchange Act.

(b) Changes in Internal Control over Financial Reporting

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II -- OTHER INFORMATION

Item 1. Legal Proceedings.

The Company is not aware of any legal proceedings contemplated by any governmental authority or any other party involving the Company or its properties. As of the date of this report, no director, officer or affiliate is a party adverse to the Company in any legal proceeding or has an adverse interest to the Company in any legal proceedings. The Company is not aware of any other legal proceedings pending or that have been threatened against the Company or its properties.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

On January 19, 2005, the Board of Directors approved the offering (the "2005 Offering") of 2,000,000 units (the "Units") for a total offering price of \$1,000,000 to accredited investors, consisting of shares of common stock and attached warrants. The purchase price of one Unit is \$0.50. Each Unit consists of one share of common stock and a warrant to purchase one share of common stock at an exercise price of \$0.75. The warrants are exercisable at any time prior to the fifth anniversary from the date of grant. The 2005 Offering is exempt from registration under Section 4(2) of the Securities Act.

During the quarter ended September 30, 2005, the Company raised \$548,500 and issued 1,097,000 shares of common stock and warrants to purchase up to 1,097,000 shares of stock in accordance with the terms of the 2005 Offering.

Item 3. Defaults Upon Senior Securities.

As of to September 30, 2005, the outstanding principal balance of the Amended Evans Loan (see "Note 6. Notes Payable - Stockholders" in the "Notes to Financial Statements") was equal to \$596,490. The Company has not made the

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interest payments in the amounts of \$13,062, \$17,692, \$20,043, \$21,896 and \$25,636, which were due and payable to Mr. Evans on June 30, 2003, December 31, 2003, June 30, 2004, December 31, 2004, and June 30, 2005, respectively. As of to September 30, 2005, the Company's total arrearage under the Amended Evans Loan with respect to accrued interest payments was equal to \$107,063. Mr. Evans has not made any demand for payment, or exercised any of his remedies, under the Amended Evans Loan.

Item 4. Submission of Matters to a Vote of Shareholders.

No matters were submitted to a vote of the Company's security holders during the quarter ended September 30, 2005.

Item 5. Exhibits.

The following exhibits are filed with or incorporated by reference into this report as required by Item 601 of Regulation S-B:

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| Exhibit No. ----- | Description of Exhibit ----- |
|----------------------|--|
| Exhibit 3.1 | Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Statement on Form SB-2 filed with the Commission on May 10, 1996). |
| Exhibit 3.2 | Bylaws of the Company (incorporated by reference to Exhibit 3.3 to the Company's Statement on Form SB-2 filed with the Commission on May 10, 1996). |
| Exhibit 3.3 | Amendment to Certificate of Incorporation (incorporated by reference to Exhibit 3.4 to the Company's Definitive Proxy Statement filed with the Commission on October 28, 2003). |
| Exhibit 10.1 | Loan Agreement dated May 9, 2002, by and between the Company and Mr. Evans (incorporated by reference to Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q filed with the Commission on May 15, 2002). |
| Exhibit 10.2 | Loan Amendment and Promissory Note dated March 6, 2003, by and between the Company and Mr. Evans (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed with the Commission on May 20, 2003). |
| Exhibit 10.3 | Lease Agreement dated January 26, 2001 by and between the Company and Mr. Evans (incorporated by reference to Exhibit 10.4 to the Company's Annual Report on Form 10-K filed with the Commission on October 12, 2004). |
| Exhibit 10.4 | Lease Extension dated February 26, 2003 by and between the Company and Mr. Evans (incorporated by reference to Exhibit 10.5 to the Company's Annual Report on Form 10-K filed with the Commission on October 12, 2004). |
| Exhibit 10.5 | Royalty Agreement (incorporated by reference to Exhibit 10.1 to the Company's Statement on Form SB-2 filed with the Commission on May 10, 1996). |
| Exhibit 10.6 | Assignment of Patent Rights (incorporated by reference to Exhibit 10.1 to the Company's Registration Statement on Form SB-2 filed with the Commission on May 10, 1996). |

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Exhibit 10.7 1999 Stock Option Plan (incorporated by reference to Exhibit 10.9 to the Company's Form 10-KSB filed with the Commission on October 12, 2004).

Exhibit 14 Code of Ethics (incorporated by reference to Exhibit 14 to the Company's Form 10-KSB filed with the Commission on October 12, 2004).

Exhibit 31.1 Rule 13a-14(a)/15d-14(a) Certification of Henry E. Gemino, as Chief Financial Officer of the Company.

Exhibit 31.2 Rule 13a-14(a)/15d-14(a) Certification of Philip L. Jones, as Chief Executive Vice President of the Company.

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Exhibit 32.1 Certification under Section 906 of the Sarbanes-Oxley Act of 2002 by Executive Officer and Chief Financial Officer of the Company.

Exhibit 32.2 Certification under Section 906 of the Sarbanes-Oxley Act of 2002 by Operating Officer and Executive Vice President of the Company.

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SIGNATURES

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

PROFILE TECHNOLOGIES, INC.

(Registrant)

Date: November 11, 2005

(
/s/ Henry E. Gemino

Henry E. Gemino
Chief Executive Officer and
Chief Financial Officer

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