ISCO INTERNATIONAL INC
Form 10-Q
August 13, 2004
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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2004.

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

For the transition period from ______ to ______

Commission file number 000-22302

ISCO INTERNATIONAL, INC.

(Name of Registrant as Specified in Its Charter)

Delaware	**36-3688459**
(State or Other Jurisdiction of	**(I.R.S. Employer**

Incorporation or Organization)	**Identification No.)**
451 Kingston Court Mt. Prospect, Illinois **(Address of Principal Executive Offices)**	**60056** **(Zip Code)**

Registrant s Telephone Number, Including Area Code (847) 391-9400

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicated by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	Outstanding at July 1, 2004
Common Stock, par value $0.001 per share	160,428,260
Preferred Stock Purchase Rights	

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

ISCO INTERNATIONAL, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2004	December 31, 2003
	(unaudited)	
Assets:		
Current Assets:		
Cash and cash equivalents	$ 302,032	$ 346,409
Inventories	786,952	678,361
Accounts receivable, net	384,871	1,169,711
Prepaid expenses, settlement receivable, and other	181,941	321,147
Total current assets	1,655,796	2,515,628
Property and equipment:		
Property and equipment	8,905,009	8,957,866
Less: accumulated depreciation and amortization	(8,571,563)	(8,256,489)
Net property and equipment	333,446	701,377
Restricted certificates of deposit	40,527	40,527
Intangible assets, net	14,461,685	14,465,503
Other assets, net		
Total assets	$ 16,491,454	$ 17,723,035
Liabilities and Stockholders Equity:		
Current liabilities:		
Accounts payable	$ 105,267	$ 243,647
Accrued liabilities	1,082,971	1,536,141
Current debt	5,000,000	
Total current liabilities	6,188,238	1,779,788
Other long-term debt, less current portion		5,000,000
Stockholders equity:		
Preferred stock; 300,000 shares authorized; No shares issued and outstanding at June 30, 2004 and December 31, 2003		
Common stock ($.001 par value); 250,000,000 shares authorized; 160,428,260 and 150,149,927 shares issued and outstanding at June 30, 2004 and December 31, 2003, respectively	160,428	150,150
Additional paid-in capital (net of unearned compensation)	163,483,666	160,889,202

Accumulated deficit	(153,340,878)	(150,096,105)
Total stockholders equity	10,303,216	10,943,247
Total liabilities and stockholders equity	$ 16,491,454	$ 17,723,035

NOTE: The condensed consolidated balance sheet as of December 31, 2003 has been derived from the audited financial statements for that date, but does not include all of the information and accompanying notes required by accounting principles generally accepted in the United States of America for complete financial statements.

See the accompanying Notes which are an integral part of the Condensed Consolidated Financial Statements.

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ISCO INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	**2003**	**2004**	**2003**
Net sales	$ 843,300	$ 336,101	$ 1,265,250	$ 1,571,452
Costs and expenses:				
Cost of sales	458,547	332,426	767,142	961,947
Research and development	207,257	234,299	441,246	524,012
Selling and marketing	250,212	225,566	473,751	449,299
General and administrative	1,084,370	1,371,184	2,317,920	4,299,843
Total costs and expenses	2,000,386	2,163,475	4,000,059	6,285,101
Operating loss	(1,157,086)	(1,827,374)	(2,734,809)	(4,713,649)
Other income (expense):				
Interest income	1,416	1,108	3,223	3,164
Non-cash interest expense		(212,516)	(250,297)	(427,393)
Other interest expense	(131,445)	(74,404)	(262,890)	(126,403)
	(130,029)	(285,812)	(509,964)	(550,632)
Net loss	$ (1,287,115)	$ (2,113,186)	$ (3,244,773)	$ (5,264,281)
Basic and diluted loss per share	$ (0.01)	$ (0.02)	$ (0.02)	$ (0.04)
Weighted average number of common shares outstanding	160,424,606	147,974,927	157,198,407	147,965,645

See the accompanying Notes which are an integral part of the Condensed Consolidated Financial Statements.

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ISCO INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

Six Months ended June 30, 2004

(UNAUDITED)

	Common Stock		Additional Paid-In		
	Number of Shares	Amount	Capital	Accumulated Deficit	Total
Balance at December 31, 2003	150,149,927	$ 150,150	$ 160,889,202	$ (150,096,105)	$ 10,943,247
Exercise of Stock Options	278,333	278	41,539		41,817
Exercise of Warrants	10,000,000	10,000	1,990,000		2,000,000
Compensation Expense for Discount on Employee Stock Options / Variable Accounting for Stock Options			312,628		312,628
Non-cash Warrant Expense			250,297		250,297
Net Loss				(3,244,773)	(3,244,773)
Balance at June 30, 2004	160,428,260	$ 160,428	$ 163,483,666	$ (153,340,878)	$ 10,303,216

See the accompanying Notes which are an integral part of the Condensed Consolidated Financial Statements.

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ISCO INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Six Months Ended June 30, 2004	Six Months Ended June 30, 2003
Operating Activities:		
Net loss	$ (3,244,773)	$ (5,264,281)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization, excluding goodwill	420,425	418,343
Non-cash warrant expense	250,297	427,393
Non-cash compensation expense	312,628	617,100
Changes in operating assets and liabilities	223,906	2,937,736
Net cash used in operating activities	(2,037,517)	(863,709)
Investing Activities:		
Decrease in restricted certificates of deposit		23,684
Payment of patent costs	(27,937)	(56,019)
Acquisition of property and equipment, net	(20,740)	(4,857)
Net cash used in investing activities	(48,676)	(37,192)
Financing Activities:		
Exercise of warrants	2,000,000	
Proceeds from credit line		1,000,000
Exercise of stock options	41,816	
Net cash provided by financing activities	2,041,816	1,000,000
(Decrease)/Increase in cash and cash equivalents	(44,377)	99,099
Cash and cash equivalents at beginning of period	346,409	216,119
Cash and cash equivalents at end of period	$ 302,032	$ 315,218

See the accompanying Notes which are an integral part of the Condensed Consolidated Financial Statements.

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ISCO INTERNATIONAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 1 - Basis of Presentation

The condensed consolidated financial statements include the accounts of ISCO International, Inc. and its wholly-owned subsidiaries, Spectral Solutions, Inc. and Illinois Superconductor Canada Corporation (collectively referred to as the Company). All significant intercompany balances and transactions have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America (US GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by US GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of results for the interim periods have been included. These financial statements and notes included herein should be read in conjunction with the Company s audited financial statements and notes for the year ended December 31, 2003 included in the Company s Annual Report on Form 10-K filed with the Securities and Exchange Commission. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for any subsequent quarter of for the entire year ending December 31, 2004. For further information, refer to the financial statements, including the notes thereto, included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2003.

Recent Accounting Pronouncements

In January 2003, the FASB issued FASB Interpretation No. 46 (FIN No. 46), *Consolidation of Variable Interest Entities,* to expand upon existing accounting guidance that addresses when a company should include in its financial statements the assets, liabilities and activities of another entity. In December 2003, the FASB revised FIN No. 46 to provide more clarification. Until now, a company generally has included another entity in its consolidated financial statements only if it controlled the entity through voting interests. FIN No. 46 changes that by requiring a variable interest entity, as defined, to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity s activities or entitled to receive a majority of the entity s residual returns or both. FIN No. 46, as revised, did not have a material impact on the Company s consolidated financial statements.

Note 2. Realization of Assets

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern. However, the Company has sustained substantial losses from operations in recent years, and, although reduced, such losses have continued through the (unaudited) period ended June 30, 2004. In addition, the Company has used, rather than provided, cash in its operations.

In view of the matters described in the preceding paragraph, recoverability of a major portion of the recorded asset amounts shown in the accompanying balance sheet is dependent upon continued operations of the Company, which in turn is dependent upon the Company s ability to meet its operational and financing requirements on a continuing basis, to maintain present financing, and to succeed in its future

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operations. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence.

The Company has incurred, and continues to incur, losses from operations. For the years ended December 31, 2003, 2002, and 2001, the Company incurred net losses of $7,156,075, $13,077,832, and $28,189,603, respectively. The Company incurred an additional net loss of $3,244,773 during the first six months of 2004. During the past few years the Company implemented strategies to reduce its cash used in operating activities. The Company s strategy included the consolidation of its manufacturing and research and development facilities and a targeted reduction of the employee workforce, increasing the efficiency of the Company s processes, focusing development efforts on products with a greater probability of commercial sales, expanding its outsourcing of manufacturing strategy, reducing professional fees and discretionary expenditures, and negotiating favorable payment arrangements with suppliers and service providers.

To date, the Company has financed its operations primarily through public and private equity and debt financings. During July 2004, the Company reported a subsequent event wherein it drew the remaining $1 million of the credit line and increased the available line by $0.5 million, drawing that amount as well. The Company believes that it has sufficient funds to operate its business as identified herein and to meet its obligations through 2004, and into 2005, depending in part on operating results. The Company intends to look into augmenting its existing capital position.

Note 3 - Net Loss Per Share

Basic and diluted net loss per share is computed based on the weighted average number of common shares outstanding. Common shares issuable upon the exercise of options are not included in the per share calculations since the effect of their inclusion would be antidilutive.

Note 4 - Inventories

Inventories consisted of the following:

	June 30, 2004	December 31, 2003
Raw materials	$ 148,000	$ 357,000
Work in process	118,000	67,000
Finished product	521,000	254,000
	$ 787,000	$ 678,000

Cost of product sales for the six months ending June 30, 2004, and the twelve months ending December 31, 2003 include approximately $57,000 and $130,000, respectively, of costs in excess of the net realizable value of inventory.

Note 5 - Stock Options and Equity Transactions

On August 19, 1993, the Board of Directors adopted the 1993 Stock Option Plan (the 1993 Plan) for employees, consultants, and directors who are not also employees of the Company (outside directors). This plan expired during 2003. At the 2003 annual meeting of shareholders held in December 2003, the Company s shareholders approved a new 2003 Equity Incentive Plan (the 2003 Plan) to take the place of the expiring 1993 Plan. Unissued options from the 1993 Plan were used to fund the 2003 Plan. The maximum number of shares issuable under these plans was 14,011,468.

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The 2003 Plan provides for the grant of incentive stock options, non-qualified stock options, restricted stock and stock appreciation rights to employees, directors and consultants. The full Board and the Compensation Committee are authorized to make awards under the 2003 Plan, to determine the terms of those awards and to otherwise administer the 2003 Plan. A more extensive description of the 2003, as well as a copy of the 2003 Plan, are attached to the Company s Proxy Statement filed on November 14, 2003.

On May 10, 1999, the Board of Directors granted to each employee of the Company (other than the executive officers of the Company) (collectively, the Non-Executive Employees) the option to (i) reduce the exercise prices of up to a maximum of 15,000 of the unexercised stock options previously granted to such Non-Executive Employee under the Plan to $.5625 per share (the closing price of the Company s Common Stock on May 10, 1999) and (ii) cause all of such stock options not otherwise scheduled to become fully vested on or before May 10, 2000 to become fully vested on such date. As a result thereof, an aggregate of 279,550 stock options previously granted under the Plan were amended as described in the preceding sentence. In addition, on May 10, 1999 the Board of Directors granted to the executive officers and certain Non-Executive Employees of the Company additional non-statutory stock options to purchase an aggregate of 343,575 shares of the Company s Common Stock under the Plan. Such stock options became fully vested on the first anniversary of the date of grant, with exercise prices of $.5625 per share and expire 10 years from the date of grant.

On July 1, 2000, Financial Accounting Standards Board Interpretation No. 44, Accounting for Certain Transactions involving Stock Compensation, an interpretation of APB Opinion No. 25 (FIN 44) was adopted by the Company. FIN 44 requires that stock options that have been modified to reduce the exercise price be subject to variable accounting. The Company accounts for employee stock options under APB Opinion No. 25 and non-employee stock options under Statement of Financial Accounting Standards No. 123, Accounting for Stock Based Compensation (SFAS No. 123).

On May 10, 1999, as described above, the Company re-priced certain stock options granted to employees and in accordance with US GAAP, at that time, the Company accounted for the re-priced stock options as fixed . As a result of adopting FIN 44, the Company is required to apply variable accounting to these options. If the market price of the Company s common stock increases above the July 1, 2000 market price, the Company will have to recognize additional compensation expense equal to the increase in stock price multiplied by the number of re-priced options. No additional expense will be recognized if the stock does not exceed the July 1, 2000 value. However, the impact cannot be determined as it is dependent on the change in the market price of the common stock from July 1, 2000 until the stock options are exercised, forfeited, or expire unexercised. Because the stock price on June 30, 2004 was below that of July 1, 2000, no expense has been recognized during the period.

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On February 5, 2001, the Company s board of directors authorized the re-pricing of certain out of the money stock options granted to employees during the calendar year of 2000 to the closing share price on such date, or $1.9375 per share. This re-pricing causes these options to be subject to variable accounting as described in FIN 44. Because the stock price on June 30, 2004, was lower than the re-priced strike price no gain or loss was recognized during the period.

On April 1, 2002, the Company s board of directors authorized the re-pricing of certain out of the money stock options granted to employees. A new strike price of $0.81 per share was established, provided the respective employees remain with the Company for at least six months following the re-pricing date. In addition, certain stock options granted to directors were repriced, with a new strike price of $1.00 per share. As the stock price on June 30, 2004 was lower than the re-priced strike price no gain or loss was recognized during the period.

On February 15, 2002, the Company completed a Shareholder Rights Offering. Approximately $20 million was raised from existing shareholders as of the recording date in exchange for the issuance of approximately 40 million shares of the Company s common stock. A portion of the proceeds were then used to repay in full $9.8 million of debt and related accrued interest, as well as the payment of various other accrued expenses.

During July 2003, the Board of Directors cancelled approximately 2.8 million outstanding options held by certain Company employees, including officers.

On October 31, 2003, the Company s board of directors authorized the re-pricing of certain out of the money stock options granted to directors. A new strike price of $0.24 per share was established. This price was based on the closing price of the Company s common stock as reported on the American Stock Exchange on October 1, 2003. The closing price of the Company s common stock on October 31, 2003 was $0.20 per share.

During 2004, the Company s Board of Directors granted 3,800,000 new stock options under the 2003 Plan to the Company s employees, including officers, and Directors. The majority of the grants to employees, including officers, were priced at 25% of the average closing price of the Company s common stock as reported on the American Stock Exchange over ten trading days prior to the date of grant. Due to the resulting discount, $325,000 and $542,000 of compensation expense was recognized during the second quarter and first six months, respectively, of 2004.

Certain options granted prior to 2004 were deemed subject to variable accounting. As such, a charge of $418,000 was recognized during the fourth quarter 2003 to reflect the $0.55 closing price of the Company s common stock as of December 31, 2003. Because the closing price of the Company s common stock on March 31, 2004 was $0.44 per share, $168,000 of this amount was reversed during the first quarter 2004. Due to the closing price of the Company s common stock on June 30, 2004 of $0.40 per share, an additional $61,000 of this amount was reversed during the second quarter 2004.

Note 6 Debt and Financial Position

As of the reporting date, the Company had drawn $5 million of debt financing under a credit line, as described below. During October 2002, the Company entered into an Uncommitted Line of Credit with its two largest shareholders, an affiliate of Elliott Associates, L.P. (Manchester Securities Corporation) and Alexander Finance, L.P. This line provided up to $4 million to the Company. This line was uncommitted, such that each new borrowing under the facility would be subject to the approval of the lenders. Borrowings on this line bore an interest rate of 9.5% and are collateralized by all the assets of the Company. Outstanding loans under this agreement would be required to be repaid on a priority basis should the Company receive new funding from other sources. Additionally, the lenders were entitled to receive warrants to the extent funds were drawn down on the line. The warrants bore a strike price of $0.20 per share of common stock and were to expire on April 15, 2004. The credit line was to mature and be due, including accrued interest thereon, on March 31, 2004. Due to an agreement between the parties that did not provide warrants with respect to the then most recent borrowings, a maximum of 10 million warrants were issued as a result of this transaction. During February 2004, the warrant holders exercised all of their warrants, contributing $2 million to the Company in exchange for 10 million shares of common stock.

According to existing accounting pronouncements and SEC guidelines, the Company allocated the proceeds of these borrowings between their debt and equity components. As a result of these borrowings during 2002, the Company has recorded a non-cash charge of $1.2 million through the outstanding term of the warrants (fully exercised as of March 31, 2004). The final $250,000 of that amount was recorded during the quarter ended March 31, 2004.

As announced during October 2003, the Company entered into an agreement with its lenders to supplement the credit line with an additional $2 million, $1 million of which was drawn immediately and $1 million available to be drawn upon the Company s request and subject to the approval of the lenders. This supplemental facility bore a 14% rate of interest and was due October 31, 2004. Unlike the previous credit line, the supplemental facility did not include any stock warrants. The term of the previous credit line were not affected by this supplement, and as such the $4 million borrowed under that line, plus accrued interest, remained due March 31, 2004.

During February 2004, these credit lines were extended to a due date of April 2005, with interest after the initial periods to be charged at 14%. No warrants or other inducements were issued with respect to these extensions. Additionally, as noted above, the lenders exercised their 10 million warrants during February 2004, agreeing to let the Company use the funds for general purposes as opposed to repaying debt.

During July 2004, and subsequent to the reporting period, the Company and its lenders agreed to increase the amount available under the credit line by $0.5 million, and for the Company to draw the remaining $1.5 million available under the credit line.

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Note 7 Stock Based Compensation

The Company has a stock-based employee compensation plan, which is more fully described in Note 5. The Company accounts for its stock-based compensation plan under Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation,* as amended by SFAS No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure,* which allows companies to apply the provisions of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees,* and provide pro forma net income and net income per share disclosures for employee stock option grants as if the fair value method defined in SFAS No. 123 had been applied. The Company applies the intrinsic value method for accounting for stock-based compensation as outlined in APB Opinion No. 25.

Stock expense for the first six months of 2004 and 2003, respectively, includes the result of options issued with an exercise price below the underlying stock s market price. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of FASB Statement 123, Accounting for Stock-Based Compensation as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure an amendment of FASB Statement No. 123, using the assumptions described in Note 5, to its stock-based employee plans:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	**2003**	**2004**	**2003**
Net loss, as reported	$ 1,287	$ 2,113	$ 3,245	$ 5,264
Add: Stock-based employee compensation expense included in reported net loss, net of related tax effects	264	210	313	623
Less: Total stock-based employee compensation determined under fair value based method for awards granted, modified, or settled, net of related tax effects	385	595	528	1,494
Pro forma net loss	$ 1,408	$ 2,498	$ 3,460	$ 6,135
Loss per share:				
Basic as reported	$ 0.01	$ 0.02	$ 0.02	$ 0.04
Basic pro forma	$ 0.01	$ 0.02	$ 0.02	$ 0.04
Diluted as reported	$ 0.01	$ 0.02	$ 0.02	$ 0.04
Diluted pro forma	$ 0.01	$ 0.02	$ 0.02	$ 0.04

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

General

The following is a discussion and analysis of the historical results of operations and financial condition of the Company and factors affecting the Company s financial resources. This discussion should be read in conjunction with the financial statements, including the notes thereto, set forth herein under Part I. - Financial Information and Item 1. Financial Statements and in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2003. This discussion contains forward-looking statements which involve certain risks, uncertainties and contingencies which could cause the Company s actual results, performance or achievements to differ materially from those expressed, or implied, by such forward-looking statements. Such factors include those described in Risk Factors included in the Company s Annual Report on Form 10-K. The forward-looking statements included in this report may prove to be inaccurate. In light of the significant uncertainties inherent in these forward-looking statements, you should not consider this information to be a guarantee by the Company or any other person that our objectives and plans will be achieved.

The Company provides a wide array of solutions to optimize the reverse link for the wireless telecommunications industry. Reverse link is the signal from the mobile device to the base station. Reverse link problems often lead to dropped calls, ineffective attempts, high mobile transmit power, capacity reduction and coverage dead zone areas. The Company solves these problems utilizing its adaptive notch filter (ANF) technology, its value-leading Reverse link Radio Frequency Fidelity (RF²) technology, and a variety of other products and services.

The continuing development of and expansion in sales of the Company s RF product lines, as well as the continued defense of its intellectual property, may require a commitment of funds to undertake product line development and potentially the expansion of manufacturing capabilities and to market and sell its RF front-end products. The actual amount of the Company s future funding requirements will depend on many factors, including: the amount and timing of future revenues, the level of product marketing and sales efforts to support the Company s commercialization plans, the magnitude of its research and product development programs, the ability of the Company to improve or maintain product margins, the potential cost of additional plant and equipment for manufacturing and the costs involved in protecting the Company s patents or other intellectual property.

The Company was founded in 1989 by ARCH Development Corporation, an affiliate of the University of Chicago, to commercialize superconductor technologies initially developed by Argonne National Laboratory. The Company was incorporated in Illinois on October 18, 1989 and reincorporated in Delaware on September 24, 1993. Its facilities and principal executive offices are located at 451 Kingston Court, Mt. Prospect, Illinois 60056 and telephone number is (847) 391-9400.

Overview

The Company has shifted from manufacturing in-house to an outsourced manufacturing model. Its products are designed for efficient production in this manner, emphasizing solid-state electronics over mechanical devices with moving parts. The decrease in cost associated with these developments, coupled with enhanced product functionality, has allowed the Company to realize improved margins. Extensions of developed technology, based on substantial input from customers, have allowed the Company to launch the RF² product and consider additional solutions while controlling total R&D cost. The Company announced during the first six months of 2004 the resolution of the Laves litigation, the receipt of $2 million from the exercise of all outstanding warrants (which were related to the credit line), and the expansion of that credit line including the extension of its credit line debt maturity date from March and October 2004 to April 2005. Despite these improvements, the wireless telecommunications industry is highly competitive and subject to risks beyond the Company s control that can negatively impact customer capital spending budgets and/or spending patterns. Despite cultivating more business opportunities during the first six months of 2004 than in the past and some improvement in the second quarter over the first quarter, total revenue from closed and shipped business was less than expected during the period. While the Company views the varied reasons for this difficulty to be temporary in nature, nonetheless, for these and other reasons the Company s financial statements have been prepared assuming the Company will continue as a going concern.

Results of Operations

Three Months Ended June 30, 2004 and 2003

The Company s net sales increased $507,000, or 151%, to $843,000 for the three months ended June 30, 2004 from $336,000 for the same period in 2003. This increase was due to the shipment of more ANF products during the second quarter of 2004 relative to the second quarter of 2003. The Company anticipates its unit volume and related revenue to increase during the third quarter of 2004 as compared to the third quarter of 2003, due to existing and/or anticipated customer orders.

Cost of sales increased by $127,000, or 38%, to $459,000 for the three months ended June 30, 2004 from $332,000 for the same period in 2003. The increase in cost of sales was due to the increase in sales volume, however, cost of sales as a percentage of revenue declined as a result of the more efficient allocation of fixed expenses and other efficiencies.

The Company s research and development expenses decreased by $27,000, or 12%, to $207,000 for the three months ended June 30, 2004, from $234,000 for the same period in 2003. The Company has recently added personnel in this area and thus expects a modest increase in R&D expenses beginning in the third quarter 2004.

Selling and marketing expenses increased by $24,000, or 11%, to $250,000 for the three months ended June 30, 2004, from $226,000 for the same period in 2003. The Company has recently added personnel in this area as well and thus expects a modest increase in selling and marketing expenses in future periods.

General and administrative expenses decreased by $287,000, or 21%, to $1,084,000 for the three months ended June 30, 2004, from $1,371,000 for the same period in 2003. This decrease was attributable to an overall decrease in legal expenses incurred in the ongoing patent litigation as well as other cost control measures. This reduced litigation cost represents approximately $260,000 of the $287,000 decrease between these respective periods.

Six Months Ended June 30, 2004 and 2003

The Company s net sales decreased $306,000, or 19%, to $1,265,000 for the six months ended June 30, 2004 from $1,571,000 for the same period in 2003. This decrease was due to relatively slower conversion of customer-requested quotations to shipped purchase orders to date in 2004. The Company anticipates its unit volume and related revenue during the full year 2004 to exceed related figures during 2003 due to existing and/or anticipated customer orders.

Cost of sales decreased by $195,000, or 20%, to $767,000 for the six months ended June 30, 2004 from $962,000 for the same period in 2003. The decrease in cost of sales was due to the decrease in sales volume.

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The Company s research and development expenses decreased by $83,000, or 16%, to $441,000 for the six months ended June 30, 2004, from $524,000 for the same period in 2003. The implementation of a number of cost control measures were the primary reasons for this reduction. R&D expenses for the remainder of 2004 are expected to increase slightly due to the addition of personnel in this area.

Selling and marketing expenses decreased by $25,000, or 5%, to $474,000 for the six months ended June 30, 2004, from $499,000 for the same period in 2003. It is expected that future costs for the remainder of 2004 will be higher than related periods of 2003 due to an increase in activities and the addition of personnel.

General and administrative expenses decreased by $1,982,000, or 46%, to $2,318,000 for the six months ended June 30, 2004, from $4,300,000 for the same period in 2003. This decrease was attributable to an overall decrease in legal expenses incurred in the ongoing patent litigation as well as other cost control measures. This reduced litigation cost represents approximately $1.5 million of the $2 million decrease between these respective periods.

Liquidity and Capital Resources

At June 30, 2004, the Company s cash and cash equivalents were $302,000, a decrease of $44,000 from the balance at December 31, 2003 of $346,000.

The continuing development of, and expansion in, sales of the Company s interference management solutions product lines will require a commitment of additional funds. The actual amount of the Company s future funding requirements will depend on many factors, including: the amount and timing of future revenues, the level of product marketing and sales efforts to support the Company s commercialization plans, the magnitude of the Company s research and product development programs, the ability of the Company to improve product margins, the cost of additional plant and equipment for manufacturing and the costs involved in protecting the Company s patents or other intellectual property.

To date, the Company has financed its operations primarily through public and private equity and debt financings. During July 2004, the Company reported a subsequent event wherein it drew the remaining $1 million of the credit line and increased the available line by $0.5 million, drawing that amount as well. The Company believes that it has sufficient funds to operate its business as identified herein and to meet its obligations through 2004, and into 2005, depending in part on operating results. The Company intends to look into augmenting its existing capital position.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

The Company does not have any material market risk sensitive instruments.

Item 4. Controls and Procedures.

(a) An evaluation was performed under the supervision and with the participation of the Company s management, including its Chief Executive Officer, or CEO, and Chief Financial Officer, or CFO, of the effectiveness of the Company s disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act) as of June 30, 2004. Based on that evaluation, the Company s management, including the CEO and CFO, concluded that the Company s disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act, is recorded, processed, summarized and reported as specified in Securities and Exchange Commission rules and forms.

(b) There were no significant changes in the Company s internal control over financial reporting that occurred during the Company s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

Patent Litigation

In July 2001, the Company filed suit in the United States District Court for the District of Delaware against Conductus, Inc. and Superconductor Technologies, Inc. alleging infringement of U.S. Patent No. 6,263,215, entitled Cryoelectronically Cooled Receiver Front End for Mobile Radio Systems (the 215 patent). This suit alleges that Conductus and Superconductor Technologies base station front-end systems containing cryogenically cooled superconducting filters infringe this patent. The Company seeks a permanent injunction enjoining Conductus and Superconductor Technologies from marketing, selling or manufacturing these products, as well as triple damages and attorneys fees. Conductus and Superconductor Technologies denied these allegations and asked the court to enter a judgment that the patent is invalid and not infringed. Conductus and Superconductor Technologies also asserted the defense of inequitable conduct and a counterclaim for a declaration that the patent is unenforceable as well as federal and state law counterclaims, including claims of unfair competition. Conductus and Superconductor Technologies sought both compensatory and punitive damages as well as attorneys fees and costs.

On March 26, 2002, the Company replied to Conductus and Superconductor Technologies Second Amended Answer and Counterclaims and filed counterclaims alleging that Conductus and Superconductor Technologies also infringe U.S. Patent No. 6,104,934 entitled Cryoelectronic Receiver Front End and U.S. Patent No. 6,205,340 B1 entitled Cryoelectronic Receiver Front End For Mobile Radio Systems . On April 17, 2002, the court dismissed these (the Company s) counterclaims without prejudice to the Company s right to assert these counterclaims in a separate action.

On February 10, 2003, the court disposed of various motions for summary judgment filed by each party. The court denied Superconductor Technologies motion for summary judgment of invalidity of the 215 patent as well as Conductus motion for summary judgment limiting computation of damages to a reasonable royalty for sales to Dobson Communications, Inc. On Superconductor Technologies motion for summary judgment of non-infringement, the court granted the motion with respect to claim 13 of the 215 patent and otherwise denied the motion with respect to each of the other asserted claims. With regard to Conductus motion for summary judgment of non-infringement, the court granted the motion with respect to claim 13 of the 215 patent and otherwise denied the motion with respect to each of the other asserted claims. In addition, the court denied Conductus motion for summary judgment of invalidity of all asserted claims for causes of action existing prior to the date of issuance of the certificate of correction and of invalidity of claim 13. The court also denied the Company s motions for summary judgment that Superconductor Technologies internal projects are not prior art to the 215 patent and to dismiss the defendants counterclaims alleging unfair competition and interference with business relations.

On April 3, 2003, the jury returned with its verdict. The jury rejected the Company s positions and determined its patent to be invalid. Additionally, the jury determined that inequitable conduct had occurred and subsequently awarded defendants $3.87 million in damages from the Company. The Company was severely disappointed by this verdict and it engaged in the post-trial motion process to overturn it. On August 21, 2003, the court issued its ruling on the post-trial motions. The court overturned the jury s determination of unfair competition on the part of the Company and denied all requests for damages, including the $3.87 million jury award cited above. The court did not, however, overturn the jury determinations of patent invalidity and unenforceability based on inequitable conduct and denied ISCO s motion for a new trial.

During September 2003, the Company filed an appeal of this verdict requesting the reinstatement of its patent and the rights inherent within that patent, and Superconductor Technologies, Inc. filed a cross-appeal requesting reinstatement of the jury award and attorney s fees. This process is ongoing. As of the date of this filing each party has filed briefs with the court and additional filings and an appearance in front of a three-judge panel are scheduled.

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The Company intends to continue to prosecute its claims vigorously on appeal and continue to defend against defendants counterclaims. The Company believes the patent to be valid, the counterclaims asserted against the Company to be without merit, and that it is in the best interests of the Company and its shareholders to pursue this matter vigorously.

In November 2001, the Company filed suit against Dobson Communications, Inc. for allegedly infringing this patent. The action has been stayed, per agreement between the parties, until resolution of the matter between the Company and Conductus and Superconductor Technologies. The parties have agreed that Dobson Communications will be bound by any and all final, non-appealable determinations, holdings or findings with respect to all liability issues in the Company s case against Conductus.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits: A list of exhibits is set forth in the Exhibit Index found on page 12 of this report.

(b) Reports on Form 8-K:

On July 23, 2004, the Company announced an increase in the amount of available funds under its credit facility by $500,000 and that the Company drew all of the remaining $1,500,000 financing.

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Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on the 13th day of August 2004.

ISCO International, Inc.

By: /s/ Amr Abdelmonem

Dr. Amr Abdelmonem
Chief Executive Officer (Principal

Executive Officer)

By: /s/ Frank Cesario

Frank Cesario
Chief Financial Officer (Principal

Financial and Accounting Officer)

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EXHIBIT INDEX

Exhibit Number	Description of Exhibit
10.1	Second Amended and Restated Loan Agreement dated July 23, 2004 by and among Manchester Securities Corporation, Alexander Finance, L.P., and ISCO International, Inc., incorporated by reference to Exhibit 10.1 of the Company s Current Report on Form 8-K filed July 28, 2004.
10.2	Second Amended and Restated Security Agreement dated July 23, 2004 by and among ISCO International, Inc., Spectral Solutions, Inc., Illinois Superconductor Canada Corporation, Manchester Securities Corporation and Alexander Finance, L.P., incorporated by reference to Exhibit 10.2 of the Company s Current Report on Form 8-K filed July 28, 2004.
10.3	Secured 14% Grid Note dated July 23, 2004 between ISCO International, Inc. and Alexander Finance, L.P. in the principal amount of $386,900, incorporated by reference to Exhibit 10.3 of the Company s Current Report on Form 8-K filed July 28, 2004.
10.4	Secured 14% Grid Note dated July 23, 2004 between ISCO International, Inc. and Manchester Securities Corporation in the principal amount of $118,100, incorporated by reference to Exhibit 10.4 of the Company s Current Report on Form 8-K filed July 28, 2004.
10.5	Second Amended and Restated Guaranty of Spectral Solutions, Inc. dated July 23, 2004, incorporated by reference to Exhibit 10.5 of the Company s Current Report on Form 8-K filed July 28, 2004.
10.6	Second Amended and Restated Guaranty of Illinois Superconductor Canada Corporation, Inc. dated July 23, 2004, incorporated by reference to Exhibit 10.6 of the Company s Current Report on Form 8-K filed July 28, 2004.
31.1	Certification by Chief Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by Chief Financial Officer pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002