

Convergence Ethanol, Inc.  
Form 10QSB/A  
August 21, 2007

---

---

**U.S. SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

FORM 10-QSB/A  
(Amendment No. 1)

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

For the quarterly period ended June 30, 2007

Commission file number 0-4846-3

**CONVERGENCE ETHANOL, INC.**  
(Name of small business issuer in its charter)

Nevada  
(State or other jurisdiction of  
incorporation or organization)

82-0288840  
(I.R.S. employer  
identification no.)

5701 Lindero Canyon Road, Suite 2-100  
Westlake Village, California  
(Address of principal executive offices)

91362  
(Zip code)

**Issuer's telephone number, including area code (818) 735-4750**

Check whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)

Yes  No

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

Common Stock Outstanding as of August 15, 2007 was 21,050,790.

Transitional Small Business Disclosure Format: Yes  No

**Documents incorporated by reference:**

**None**

---

**PART I  
FINANCIAL INFORMATION**

	<b>Page</b>
Item 1. Financial Statements	
Consolidated Balance Sheet as of June 30, 2007 (Unaudited)	F-2
Consolidated Statements of Operations for the Three Month and Nine Month Periods Ended June 30, 2007 and 2006 (unaudited)	F-3
Consolidated Statements of Cash Flows for the Nine Month Periods Ended June 30, 2007 and 2006 (Unaudited)	F-4
Notes to Consolidated Financial Statements (Unaudited)	F-5
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	2
Item 3. Controls and Procedures	6

**PART II  
OTHER INFORMATION**

Item 1. Legal Proceedings	6
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	7
Item 3. Defaults Upon Senior Securities	8
Item 4. Submission of Matters to a Vote of Security Holders	8
Item 5. Other Information	8
Item 6. Exhibits	8
Signatures	9

**ITEM 1. FINANCIAL STATEMENTS**

**CONVERGENCE ETHANOL, INC. (fka MemS USA, Inc.)**  
**Consolidated Balance Sheet**

ASSETS	Unaudited June 30, 2007
Current assets:	
Cash and cash equivalent	\$ 168,764
Accounts receivable, net allowance for uncollectible of \$154,331	718,261
Inventories, net of provision for obsolete items	1,245,291
Other current assets	345,983
Total current assets	2,478,299
Plant, property and equipment, net	2,435,477
Other assets	244,136
Total assets	\$ 5,157,912
LIABILITIES AND STOCKHOLDERS' DEFICIT	
Current liabilities:	
Accounts payable and accrued expenses	\$ 2,549,393
Liquidation Damages	561,270
Current portion of long-term debt	17,412
Loans from shareholders	110,738
Liability to be satisfied through the issuance of shares	561,300
Convertible loan payable	3,530,000
Derivative liability	3,016,839
Total current liabilities	10,346,951
Long-term liabilities	3,672
Total liabilities	10,350,623
Minority interests	103,930
Stockholders' equity	
Common stock, \$0.001 par value; 100,000,000 shares authorized; 21,395,178 shares issued and outstanding	21,395
Additional paid in capital	21,024,305
Accumulated deficit	(22,417,783)
Prepaid Expenses in Stock	(125,000)
Treasury stock (2,710,436 shares)	(3,799,558)
Total stockholders' deficit	(5,296,640)
Total liabilities and stockholders' deficit	\$ 5,157,912

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

**CONVERGENCE ETHANOL, INC. (fka MemS USA, Inc.)**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**FOR THE THREE AND NINE MONTH PERIODS ENDED JUNE 30, 2007 AND 2006**  
**(Unaudited)**

	Three month periods ended June 30,		Nine month periods ended June 30,	
	2007	2006	2007	2006
Net revenues	\$ 924,930	\$ 2,029,431	\$ 6,380,115	\$ 7,171,362
Cost of revenues	738,313	1,554,914	5,374,408	5,585,009
<b>Gross profit</b>	<b>186,617</b>	<b>474,517</b>	<b>1,005,707</b>	<b>1,586,353</b>
Operating Expenses				
Selling, general and administrative expenses	1,227,701	1,161,641	4,023,267	3,837,378
<b>Loss from operations</b>	<b>(1,041,085)</b>	<b>(687,124)</b>	<b>(3,017,560)</b>	<b>(2,251,025)</b>
Other income (expenses)				
Gain from change in derivative liability	841,674	-	1,479,967	-
Liquidation damage - convertible note	(373,003)	-	(561,270)	-
Income due to legal settlement	-	-	-	3,703,634
Interest expense	(3,281,146)	-	(3,843,522)	-
Other income (expense)	61,378	(18,385)	(2,651)	(52,888)
Total other Income (expenses)	(2,751,097)	(18,385)	(2,927,475)	3,650,746
<b>Income (loss) before minority interest</b>	<b>(3,792,182)</b>	<b>(705,509)</b>	<b>(5,945,035)</b>	<b>1,399,721</b>
Loss attributable to minority interest	-	3,133	3,283	3,133
<b>Net income (loss)</b>	<b>\$ (3,792,182)</b>	<b>\$ (702,376)</b>	<b>\$ (5,941,752)</b>	<b>\$ 1,402,854</b>
<b>Net income (loss) per share, basic and diluted:</b>				
Weighted average number of shares outstanding, basic	20,622,414	19,849,572	20,390,298	19,026,161
Net income (loss) per share, basic	\$ (0.18)	\$ (0.04)	\$ (0.29)	\$ 0.07
Weighted average number of shares outstanding, diluted	20,622,414	19,849,572	20,390,298	20,700,202
Net income (loss) per share, diluted	\$ (0.18)	\$ (0.04)	\$ (0.29)	\$ 0.07

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

**CONVERGENCE ETHANOL, INC. (fka Mems USA, Inc.)**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE NINE MONTHS ENDED JUNE 30, 2007 AND 2006**  
**(Unaudited)**

	2007	2006
Cash flows used for operating activities:		
Net income (loss)	\$ (5,941,752)	\$ 1,402,854
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Income due to legal settlement	-	(3,703,634)
Depreciation and amortization	164,759	173,855
Gain on sale of asset	(5,629)	-
Stock base compensation, director and employee	213,740	-
Warrant issued to outsiders	203,115	-
Amortization of discount on convertible debenture	2,821,081	-
Gain from derivative liability	(1,479,968)	-
Common stock issued for services	48,279	319,677
Loss attributable to minority interest	(3,283)	(3,133)
Change in assets and liabilities:		
Accounts receivable	563,737	(405,333)
Inventories	794,397	(458,807)
Other current assets	259,362	(546,787)
Change in other assets :-		
Accounts payable and accrued expenses	(461,517)	1,747,962
Other current liabilities	-	159,390
Liquidation Damages Payable	561,270	-
Total adjustments	3,679,342	(2,716,810)
Net cash used for operating activities	<b>(2,262,410)</b>	<b>(1,313,956)</b>
Cash flows from investing activities:		
Acquisition of property and equipment	-	(122,691)
Disposal of property and equipment	18,920	-
Other assets	-	(82,878)
Net cash provided by (used for) investing activities	<b>18,920</b>	<b>(205,569)</b>
Cash flows from financing activities:		
Proceeds from convertible debenture	3,530,000	-
Lines of credit	(325,114)	(35,506)
Promissory notes payable	(343,302)	(25,673)
Notes payable	(66,211)	63,579
Liability to be satisfied through the issuance of shares	-	2,776
Payment on long term liabilities	-	(20,163)
Convertible loan	(150,000)	-
Loan from shareholders	(56,670)	(40,527)
Purchase of shares pursuant to acquisition of subsidiaries	-	(20,000)
Liability due to legal settlement	(307,000)	-
Underwriting related to issuance of shares	-	(97,316)
Common stock issued for cash	-	1,652,878
Net cash provided (used) by financing activities	<b>2,281,703</b>	<b>1,480,048</b>
Net increase in cash and cash equivalents	38,213	(39,477)

Cash and cash equivalents, beginning of period		130,550		828,153
Cash and cash equivalents, end of period	\$	<b>168,763</b>	\$	<b>788,676</b>
<b>Supplemental disclosure of cash flow information:</b>				
Interest paid	\$	353,000	\$	137,332
Income taxes paid	\$	-	\$	29,354
<b>Supplemental disclosure of non-cash financing activities:</b>				
Common stock issued for finder's fees for HEO property	\$	38,500	\$	-
Common stock (including \$1,400,000 of shares subject to mandatory redemption factor) issued for acquisition of Bott and Gulfgate	\$	-	\$	809,966
Common issued for prepayment of retainer	\$	125,000	\$	-
Common stock issued for Accounts payable settlement	\$	449,162	\$	-
Assets acquired by HEO through issuance of shares	\$	-	\$	11,797,096

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

**CONVERGENCE ETHANOL, INC.** (fka Mems USA, INC.)  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**1) Organization and Summary of Significant Accounting Policies:**

**Organization**

Convergence Ethanol, Inc. formerly known as MEMS USA, Inc. (the “Company” or “we”) has been incorporated in November, 2002; The Company changed its name to Convergence Ethanol, Inc. in November 2006. The Company's mission is to support the energy industry in producing cleaner burning fuels. Each of our subsidiaries has a specific eco-energy focus: (1) development of a woodwaste to bio-renewable fuel-grade alcohol/ethanol project (HEO); (2) selling engineered products (Bott); (3) engineering, fabrication and sale of eco-focused energy systems (Gulfgate); and (4) intelligent filtration systems (CA MEMS).

**Subsidiaries:**

The Company is comprised of three wholly owned subsidiaries, California MEMS USA, Inc., a California Corporation (“CA MEMS”), Bott Equipment Company, Inc. (“Bott”), a Texas Corporation, and Gulfgate Equipment, Inc. (“Gulfgate”) a Texas Corporation, and a majority interest (87%) of Hearst Ethanol One, Inc., a Federal Canadian Corporation (“HEO”).

**CA Mems**

CA MEMS engineers, designs and oversees the construction of “intelligent filtration systems” (“IFS”) for the gas and oil industry. The Company's IFS systems are fully integrated and are composed of a “Smart Backflush Filtration System” with an integral electronic decanting system, a carbon bed filter and an ion-exchange resin bed system.

**Bott**

Bott is a stocking distributor for premier lines of industrial pumps, valves and instrumentation. Bott specializes in the selling of aviation refueling systems for helicopter refueling on oil rigs throughout the world. Bott and Gulfgate have a combined direct sales force as well as commissioned sales representatives that sell their products.

**Gulfgate**

Gulfgate engineers, designs, fabricates and commissions eco-focused energy systems including aviation refueling systems, particulate filtration equipment for the oil and power industries. Gulfgate also makes and sells on-site oil recycling systems that recycle hydrocarbon oils. Gulfgate maintains and operates a rental fleet of such systems.

**HEO - Hearst Ethanol One**

In April 10, 2006, the Company incorporated Hearst Ethanol One, Inc., a Federal Canadian Corporation (“HEO”). Since that time, HEO has acquired 720 acres in Hearst, Ontario, Canada together with approximately 1.3 million cubic meters of woodwaste. The property was purchased to provide the site and the biomass material to produce bio-renewable fuel-grade alcohol/ethanol from woodwaste. HEO has obtained construction and zoning permits. The Company currently owns 87% of HEO.

**Fair Value of Financial Instruments:**



The Company measures its financial assets and liabilities in accordance with accounting principles generally accepted in the United States of America. For certain of the Company's financial instruments, including accounts receivable (trade and related party), notes receivable and accounts payable (trade and related party), and accrued expenses, the carrying amounts approximate fair value due to their short maturities.

**Use of Estimates:**

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

F-5

---

**CONVERGENCE ETHANOL, INC.** (fka Mems USA, INC.)  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**Revenue Recognition:**

The Company's revenue recognition policies are in compliance with Staff accounting bulletin (SAB) 104. Sales revenue is recognized at the date of shipment to customers when a formal arrangement exists, the price is fixed or determinable, the delivery is completed, no other significant obligations of the Company exist and collectibility is reasonably assured. Payments received before all of the relevant criteria for revenue recognition are satisfied are recorded as unearned revenue.

**Earnings Per Share:**

Basic earnings (loss) per share are computed by dividing net income (loss) attributable to common stockholders by the weighted average number of common shares outstanding. Diluted earnings (loss) per share is computed similar to basic earnings (loss) per share except that the denominator is increased to include the number of additional shares of common stock that would have been outstanding if the potential shares of common stock equivalents had been exercised and issued and if the additional common shares were dilutive. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company. There were 87,919 shares of common stock equivalents for the nine month period ended June 30, 2007 which were excluded because they are not dilutive. Common stock equivalents includes, but is not limited to warrants, stock options, convertible notes, etc.

**Interim Financial Statements:**

The accompanying unaudited consolidated financial statements for the nine month periods ended June 30, 2007 include all adjustments (consisting of only normal recurring accruals), which, in the opinion of management, are necessary for a fair presentation of the results of operations for the periods presented. Interim results are not necessarily indicative of the results to be expected for a full year. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended September 30, 2006 included in the Company's 2006 Annual Report.

**Going Concern and Impending Bankruptcy:**

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplates the Company as a going concern. However, the Company has sustained net losses of \$22,417,783 which included non-cash net asset impairment charges of \$10,900,000 and gains from a change in derivative liability of \$1,479,967 and has used substantial amounts of working capital in its operations. Realization of a major portion of the assets reflected on 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 financing requirements and succeed in its future operations.

The Company is investigating the options of either selling its two Texas subsidiaries (Bott & Gulfgate) or electing to consent to a voluntary Chapter 11 proceeding, (re-organization), which would allow the Company to continue operating under supervision of the bankruptcy court. The breathing room provided under Chapter 11 would allow the Company to attempt to raise equity or debt financing to provide the necessary capital to reorganize its affairs. There is no guarantee that the Company will be permitted to proceed under Chapter 11 and, further, there is no guarantee that the Company will be successful in raising equity and/or debt financing sufficient to reorganize its affairs. However,

as of the date of this report, no firm decision has been made by the Management. As of the date of this report, no orders have been entered by this court, no receivers or other similar officers have been appointed, nor has the court assumed jurisdiction over the Company's business.

These conditions raise substantial doubt as to the Company's ability to continue as a going concern. These consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty. These consolidated 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 as a going concern.

### **Reclassifications**

Certain reclassifications have been made to prior year amounts to conform to the current year presentation. These changes had no effect on reported financial positions or results of operations.

F-6

---

**CONVERGENCE ETHANOL, INC. (fka Memms USA, INC.)**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**Recent Accounting Pronouncements:**

In September 2006, FASB issued SFAS 158 Employers Accounting for Defined Benefit Pension and Other Postretirement Plans--an amendment of FASB Statements No. 87, 88, 106, and 132(R). This Statement improves financial reporting by requiring an employer to recognize the over-funded or under-funded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity or changes in unrestricted net assets of a not-for-profit organization. This Statement also improves financial reporting by requiring an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions. An employer with publicly traded equity securities is required to initially recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after December 15, 2006. An employer without publicly traded equity securities is required to recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after June 15, 2007. However, an employer without publicly traded equity securities is required to disclose the following information in the notes to financial statements for a fiscal year ending after December 15, 2006, but before June 16, 2007, unless it has applied the recognition provisions of this Statement in preparing those financial statements. The disclosures include a brief description of the provisions of this Statement; the date that adoption is required; and the date the employer plans to adopt the recognition provisions of this Statement, if earlier.

This statement is effective for fiscal year ending after December 15, 2008. Management has not determined the effect if any, the adoption of this statement will have on the financial statements.

In February of 2007 the FASB issued SFAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities--Including an amendment of FASB Statement No. 115." The statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007.

The effect of this pronouncement on our financial statements has been significant.

**(2) Investments in Hearst Ethanol One, Inc.:**

**Hearst Ethanol One Inc. Agreement:**

On April 10, 2006, the Company incorporated Hearst Ethanol One, Inc., a Federal Canadian Corporation ("HEO"). On April 21, 2006 the Company completed the acquisition of 720 acres of real property, together with all biomass material located thereon. The site is located in the Township of Kendall, District of Cochrane, Canada, The property was purchased from C. Villeneuve Construction Co. LTD., a Canadian Corporation to provide the site and the biomass material for the construction and operation of bio-renewable woodwaste-to-fuel-grade alcohol/ethanol refinery to be owned by HEO.

Pursuant to the provisions of the Agreement, HEO issued ten point five percent (10.5%) of HEO's common shares to Villeneuve as consideration for the transfer of the Property. At the close of the transaction, the Company owned 87% of the common stock of HEO.

Pursuant to a Memorandum of Understanding entered into on April 20, 2006 between HEO and Villeneuve to clarify the Agreement, Villeneuve shall be entitled to appoint one member of HEO's board of directors for so long as Villeneuve is at least a ten percent (10%) stockholder of HEO.

**Hearst Ethanol One Inc. Valuation:**

The valuation based on the residual property valuation of the land is \$253,070, building \$88,574, raw material (mature timber) of \$647,953 and Forest Waste Disposal license Bond \$67,780. Also included in the valuation was the residual value of the biomass on the HEO site of US\$11,461,362.

The other tangible and intangible assets owned by HEO include: a small rock quarry (and associated mineral rights) on the property, as well as a landfill license and permits as issued by the Government of Ontario Ministry of the Environment ("MOE").

**Writing off Inventory:**

During the fourth quarter of last year the company wrote off the value of HEO's inventory to a nominal amount. After conducting an asset evaluation review it was determined that no known market for the materials other than utilization in the Company's planned manufacturing facility currently exists.

At September 30, 2006, HEO's inventory with a gross value of US \$11,461,362 was fully written off.

**CONVERGENCE ETHANOL, INC. (fka Memms USA, INC.)**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**(3) Business Acquisition:**

On October 26, 2004 ("Closing Date"), effective October 1, 2004, the Company purchased 100% of the outstanding shares of two Texas corporations, Bott Equipment Company, Inc. ("Bott") and Gulfgate Equipment, Inc. ("Gulfgate") from their president and sole stockholder, Mr. Mark Trumble.

Under the terms of the stock purchase agreement, the Company acquired 100% of the shares of Bott and Gulfgate from Mr. Trumble for \$50,000 in cash and 1,309,677 shares of the Company's newly issued common stock.

The Company also agreed, to raise \$2,000,000 in gross equity funding within 120 days of the Closing Date. The Company failed to achieve this milestone and issued Trumble an additional 123,659 shares of its restricted stock

During the first quarter of fiscal year 2005, the Company, in order to avoid the issuance of 61,829 penalty shares, paid \$75,000 directly to Mr. Trumble. As of the date of this report the Company has received approximately \$39,000 of the \$75,000 from Mr. Weisdorn Sr. The Company has recorded this payment as a reduction to additional paid-in capital.

On December 15, 2005, the Company assumed Weisdorn Sr.'s obligation to purchase 165,054 shares from Mr. Trumble at \$1.86 per share. This obligation was satisfied on October 31, 2006.

**First amended stock purchase agreement with Mark Trumble**

Effective May 8, 2006, the Company and its officers entered into a First Amended Stock Purchase Agreement and Release ("Agreement") with Mark Trumble, amending that certain Stock Purchase Agreement dated September 1, 2004 (the "SPA"), pursuant to which the parties agreed to, among other things, Trumble agreed to release the Company from its obligations under the put, including any obligation to make the interest payment or to pay interest on any sum whatsoever, and release any security interest he claims in the real estate owned by Gulfgate and/or Bott, and the Company, within 60 days, shall secure a funding commitment in which Trumble shall be paid the sum of \$307,000 at the time of the closing of the funding. This sum shall be used to purchase 165,053 shares of the common stock of the Company from Trumble at the price of \$1.86 per share. The Company shall also pay from the funding all amounts of bank or other indebtedness owed by the Company, Bott or Gulfgate, which is personally guaranteed by Trumble. The Company shall issue Trumble, upon closing of the funding, 60,000 shares of the Company's common stock. This additional issuance of shares of the common stock of the Company shall be in full and final satisfaction of all claims that Trumble has or may have to additional shares of the Company's common stock as a result of any breach of, or failure to meet a milestone under, the SPA. The Company has met all of its obligations to Mr. Trumble. As of the date of this report Mr. Trumble owes the Company 45,000 shares of stock.

**(4) Accounts Receivable:**

Accounts receivable has been reduced by an allowance for amounts that may become uncollectible. This estimated allowance is based primarily on Management's evaluation of the financial condition of the customer and historical bad debt experience. The Company has provided reserves for doubtful accounts as of June 30, 2007 in the amount of \$154,331 which the Company believes are adequate.

**(5) Factoring Payable:**

The Company entered into an agreement with BLX Funding LLC (“the Factor”) whereby the Factor will purchase the Company's accounts receivable in factoring transactions with recourse.

Pursuant to the agreement, the Factor will purchase accounts receivables from the Company at varying discounts from the face value of the individual accounts receivable dependent upon the age of the receivable. The discounts range from 2.5% for receivables 30 days or less to 15% for receivables that are older than 90 days. The Factor will advance to the Company 75% of the face amount of each of the accounts receivable it elects to purchase. The Company agreed to sell a minimum of \$200,000 of qualified accounts receivables for both Bott and Gulfgate in any given month. The term of the agreement was from November 22, 2006 to November 21, 2008.

At June 30, 2007, the Company had a factoring payable balance of \$154,244 associated with this factor.

**(6) Inventories:**

Inventories consist of finished goods of \$281,357, raw material of mature timber of \$647,953, and work in process in the amount of \$353,778 at June 30, 2007. The inventory reserves included in the books are \$38,107.

F-8

---

**CONVERGENCE ETHANOL, INC. (fka Mems USA, INC.)**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**(7) Other Assets :**

The other assets at June 30, 2007 comprises of the following:

Deferred compensation to Directors	156,601
Prepaid Expenses	120,513
Advance to vendors	154,791
Deposits	58,191
Certificate of Deposit due in September, 2009	27,791
Collateralized CDs	67,780
Other assets	7,453
<b>Total Other Assets</b>	<b>590,119</b>
Less : current portion of other assets	(345,983)
 Long-term other assets	 \$ 244,136

**(8) Plant, Property and Equipment:**

A summary at June 30, 2007 are as follows:

Land	\$ 848,608
Buildings and improvements	1,244,453
Furniture, Machinery and equipment	980,623
Automobiles and trucks	47,508
	3,121,192
Less accumulated depreciation	(685,715)
	<b>\$ 2,435,477</b>



Depreciation expense charged to operations totaled \$164,759 and \$173,855 respectively, for the nine months ended June 30, 2007 and 2006.

**(9) Accounts Payable and Accrued Expenses:**

As at June 30, 2007, the accounts payable and accrued expenses comprises of the following:

Accounts Payable	\$ 1,466,898
Accrued Expenses	317,407
Factor Payable (Refer Note 2)	154,244
Payroll and Sales Taxes	163,753
Customer Advances	388,235
Other current liabilities	58,858
Total	\$ 2,549,393

**(10) Business Lines of Credits - Bott:**

Bott previously maintained three lines of credits with a bank in Houston, Texas. The credit lines were evidenced by three promissory notes, a Business Loan Agreement and certain commercial guarantees issued in favor of the bank.

In May 2004, Bott entered into a promissory note with a bank whereby Bott could borrow up to \$250,000 over a three year term. The note required monthly payments of one thirty-sixth (1/36) of the outstanding principal balance plus accrued interest at the Bank's prime rate plus 1.0 percent.

In June 2004, Bott executed a promissory note ("Note") with a bank whereby Bott could borrow up to \$600,000, at an interest rate equal to the bank's prime rate. The Note provided for monthly payments of all accrued unpaid interest due as of the date of each payment. The Note further provided for a balloon payment of all principal and interest outstanding on the Note's one year anniversary. The Company informed the bank that it would not renew the line of credit and negotiated a long-term promissory note.

This replacement promissory note was finalized in December 2005, for \$372,012 at a variable interest rate equal to the bank's prime rate. The note provides for five monthly principal payments of \$3,092 and a final payment of the remaining principal and interest in June 2006.

**CONVERGENCE ETHANOL, INC. (fka Memms USA, INC.)**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

The Agreements and Notes are secured by the inventory, chattel paper, accounts receivable and general intangibles. The Agreements and Notes are also secured by the personal performance guarantees of certain executives of the Company (Commercial Guarantees). All amounts related to Bott's outstanding promissory notes totaled \$496,877 on September 30, 2006 and were paid in full on October 31, 2006.

**(11) Business Line of Credit - Gulfgate:**

In June 2002, Gulfgate executed a promissory note ("Note") with a bank that allowed Gulfgate to borrow up to \$200,000 at an interest rate equal to the bank's prime rate, or a minimum interest rate of 5.00% per annum, whichever was greater. The Note provided for monthly payments of all accrued unpaid interest due as of the date of each payment. The Note remains in force and effect until the bank provides notice to Gulfgate that no additional withdrawals are permitted (Final Availability Date). Thereafter, payments equal to either \$250 or the outstanding interest plus one percent of the outstanding principal as of the Final Availability Date are due monthly until the Note is repaid in full. The Note allows for prepayment of all or part of the outstanding principal or interest without penalty. The Note is secured by Gulfgate's accounts with the bank, and by Gulfgate's inventory, chattel paper, accounts receivable, and general intangibles. The Agreement is also secured by the performance guarantees of Mr. Mark Trumble, Mr. Lawrence Weisdorn and the Company. Amounts outstanding at September 30, 2006 totaled \$171,539 and were paid in full on October 31, 2006.

**(12) Loan from Shareholders:**

In September 2005, Daniel K. Moscaritolo, then COO and Director, and James A. Latty, CEO and Chairman, ("Lenders") each loaned the Company, \$95,800 (collectively, \$191,600).

The transactions are evidenced by two notes dated November 1, 2005 (hereinafter, "Notes"). The terms of the Notes require repayment of the principal and interest, which accrues at a rate of ten percent (10%) per annum on May 1, 2006. The Notes are accompanied by Security Agreements that grant the Lenders a security interest in all personal property belonging to the Company, as well as granting an undivided ½ security interest in all of the Company's right title and interest to any trademarks, trade names, contract rights, and leasehold interests.

On October 31, 2006 the Company paid Mr. Daniel Moscaritolo a sum of \$54,358 of which \$8,558 was for accrued interest. As of October 31, 2006 Mr. Moscaritolo's loan was paid in full.

At June 30, 2007 the Company owes James A. Latty, President, CEO and Chairman, the sum of \$110,738 in loan and accrued interest and expense reimbursement.

**(13) Liability to be satisfied through the issuance of shares:**

As of June 30, 2007, the Company incurred a liability for stock subscribed in the amount of \$561,300.

On June 26, 2007 the Company authorized the issuance to Richardson & Patel LLP, or its designees, of an aggregate of 1,800,000 shares (\$0.24 per share) of the Company's common stock registered on a registration statement on Form S-8 and an aggregate of 500,000 restricted shares (\$0.25 per share) of common stock, in lieu of cash, for legal services rendered (non-capital raising transaction) valued at \$561,300.

**(14) Convertible Loan Payable:**

On October 31, 2006, the Company closed its Securities Purchase Agreement (the “Agreement”) with CGA Strategic Investment Fund Limited (“Purchaser”). The Company issued a \$3,530,000 Convertible Note due October 31, 2009 (the “Note”), and the purchase price of the Note was \$3,177,000 (ninety per cent of the principal amount of the Note). The Note does not bear interest except upon an event of default, at which time interest shall accrue at the rate of 18% per annum.

Security: The Note is secured by a first security position in all assets of the Company and its subsidiaries, Bott Equipment Company, Inc., a Texas corporation, and Gulfgate Equipment, Inc., in their inventory, equipment, furniture and fixtures, rental fleet equipment and any other of their assets wherever located except accounts receivable and assets solely attributable to their alternative fuel projects.

F-10

---

**CONVERGENCE ETHANOL, INC. (fka Mems USA, INC.)**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**Registration Rights:** As per the agreement, if the registration statement is not timely filed, the Company owes Purchaser liquidated damages in the amount of 1% of the principal amount of the then outstanding balance due under the Note for each 60-day period, prorated, until the registration statement is filed. If the registration statement is not declared effective within such 90 day period, the Company will owe Purchaser liquidated damages in the amount of 2% of the principal amount of the then outstanding balance of the Note for each 30-day period, prorated, until the registration statement is declared effective. The Company filed a Registration Statement on June 13, 2007. As of June 30, 2007 liquidation damages of \$561,270 were accrued.

**Conversion Price:** The Note may be converted into Company's common shares. The conversion price will be 85% of the trading volume weighted average price, as reported by Bloomberg LP (the "VWAP"), for the five trading days immediately prior to the date of notice of conversion. During the first 30 days after the registration statement is effective registration the conversion price will not be less than \$0.47 (the "Floor Conversion Price"), nor greater than \$0.61 (the "Ceiling Conversion Price"). For the ninety (90) day period following the Initial Pricing Period and each successive ninety (90) day period thereafter (each a "Reset Period"), the Floor Conversion Price shall be reduced by an amount equal to 40% of the lesser of (i) the Floor Conversion Price or (ii) the Closing Bid Price as reported by Bloomberg on the trading day immediately following the Initial Pricing Period or Reset Period, as the case may be, and the Ceiling Conversion Price shall be increased by an amount equal to 40% of the lesser of (y) the current Ceiling Conversion Price or (z) the closing bid price as reported by Bloomberg on the trading day immediately following the Initial Pricing Period or Reset Period as the case may be.

**Prepayment:** For so long as Company is not in default and Company is not in receipt of a notice of conversion from the holder of the Note, Company may, at its option, prepay, in whole or in part, this Convertible Note for a pre-payment price (the "Prepayment Price") equal to the greater of (i) 110% of the outstanding principal amount of the Note plus all accrued and unpaid interest if any, and any outstanding liquidated damages, if any, or (ii) (x) the number of Company's common shares into which the Notes is then convertible, times (y) the average VWAP of Company's common shares for the five (5) trading days immediately prior to the date that the Note is called for redemption, plus accrued and unpaid interest.

**Redemption:** The Company may be required under certain circumstances to redeem any outstanding balance of the Note and the warrants. The redemption price under these circumstances of the outstanding balance due under the Note is equal to the greater of: (i) the Prepayment Price or (ii) (x) the number of Company's common shares into which the unpaid balance due under the Note is then convertible, times (y) the five (5) day VWAP price of Company's common shares for the five trading days immediately prior to the date that the unpaid balance due under the Note is called for redemption, plus accrued and unpaid interest, if any.

**Warrant:** The Company issued warrants to purchase 1,000,000 shares of its common stock. These warrants are callable if the common stock trades at a price equal to 200% of the strike price of the warrants based on any consecutive five day trading average VWAP value. The warrants have a term of five years and an exercise price of \$0.66 (120% of the average five day VWAP price for Company's common stock for the five trading days immediately prior to October 31, 2006).

The Company paid an application fee to Global Capital Advisors, LLC ("Adviser"), Purchaser's adviser, from the proceeds of the funding in an amount equal to one percent of the funding, excluding warrants. Additionally, Company issued to Adviser on warrant to purchase 500,000 shares of Company's common stock. These warrants have a term of five years and have an initial fixed exercise price of \$0.66 (120% of the five day VWAP for the five trading days immediately prior to October 31, 2006).

Per EITF 00-19, paragraph 4, these convertible notes do not meet the definition of a “conventional convertible debt instrument” since the debt is not convertible into a fixed number of shares. The debt can be converted into common stock at a conversions price that is a percentage of the market price; therefore the number of shares that could be required to be delivered upon “net-share settlement” is essentially indeterminate. Therefore, the convertible note is considered “non-conventional,” which means that the conversion feature must be bifurcated from the debt and shown as a separate derivative liability. This beneficial conversion liability has been calculated to be \$2,078,431 at June 30, 2007. In addition, since the convertible note is convertible into an indeterminate number of shares of common stock, it is assumed that the Company could never have enough authorized and unissued shares to settle the conversion of the warrants into common stock. Therefore, the warrants issued in connection with this transaction and all other non-employee options and warrants have been reported as a liability at June 30, 2007 in the accompanying balance sheet with a fair value of \$315,467. The value of the warrant was calculated using the Black-Scholes model using the following assumptions: Discount rate of 4.64%, volatility of 93.54% and expected term of five year. The redemption liability was \$622,941 as at June 30, 2007. The fair value of the beneficial conversion feature, redemption liability and the warrant liability will be adjusted to fair value each balance sheet date with the change being shown as a component of net income.

F-11

---

**CONVERGENCE ETHANOL, INC. (fka Memms USA, INC.)**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

The fair value of the beneficial conversion feature and the warrants at the inception of these convertible notes were \$2,414,852 and \$406,229, respectively. \$2,821,081 has been recorded as a discount to the convertible notes which will be amortized over the term of the notes. As of June 30, 2007 the entire amount of unamortized discount has been amortized on receiving demand notice from GCA.

In June 2007, the Company received a default and demand notice from GCA due to which the debt is considered as current liability. All unamortized discounts and prepaid debt issuance costs have been amortized as of June 30, 2007

Principal payments on these convertible notes are as follows:

Year ending September 30,	
2007	\$ 3,530,000
	\$ 3,530,000

**(15) Long-Term Debts:**

**Promissory Notes:**

In May 2003, Bott executed a promissory note with a bank in the amount of \$26,398 at an interest rate equals to four point fifty five percent (4.55%) for a vehicle purchase. The term of the note is for fifty-nine (59) months at \$494 per month. Balance outstanding at September 30, 2006 was \$10,143 and was paid in full on October 31, 2006.

**Mortgage:**

On May 31, 2002, Gulfgate entered into a \$140,000 promissory note ("Note") with a bank in connection with the refinancing of Gulfgate's real estate. The Note bears a fixed interest rate of seven percent (7.00%) per annum. The Loan provided for fifty-nine monthly payments of \$1,267 due beginning July 2002 and ending June 2007. The Note may be prepaid without fee or penalty and is secured by a deed of trust on Gulfgate's realty. Balance outstanding at September 30, 2006 was \$19,724 and was fully paid for on October 31, 2006.

**Convertible Loan Payable:**

**A. Securities Purchase Agreement with an Individual Investor:**

In September 2004, the Company entered into a convertible loan with an investor. The principal amount of the convertible loan payable is \$150,000 at an interest rate of 8% per annum paid quarterly. The loan is convertible into common stock at any time within two (2) years (24 months) starting September 3, 2004 at the conversion price of \$2.20 or 68,182 shares. Each share converted entitles the holder to purchase one additional share of stock at an exercise price of \$3.30 within the ensuing 12 months.

The loan plus accrued interest was paid in full on October 31, 2006.

**(16) Warrants:**

Warrants outstanding as of June 30, 2007 are as follows:

	Outstanding Warrants	Wt Avg Exercise Price	Aggregate Intrinsic value
Outstanding as of October 1, 2006	822,000	\$ 2.61	\$ 0
Granted	2,458,991	0.60	
Exercised	-	-	
Forfeited	-	-	
Outstanding as of June 30, 2007	3,280,991	\$ 1.53	\$ 0

  

Price range: Warrants	Outstanding Weighted	Weighted Price	Life	Exercisable Weighted	Weighted Price	Weighted Life
\$0.61-\$3.75	3,280,991	1.53	3.45	3,280,991	1.53	3.45
Total	3,280,991	1.53	3.45	3,280,991	1.53	3.45

All of the Company's warrants were fully vested as of October 1, 2006.

**CONVERGENCE ETHANOL, INC. (fka Memms USA, INC.)**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**(17) Stock-based Compensation:**

Following is the Company's stock option activity during the nine months ended June 30, 2007:

On October 18, 2006, the Company issued options to purchase 300,000 shares of common stock to a director. The options vested upon issuance, have an exercise price of \$0.51 per share, and expire in 5 years. The fair value of these options on the date of grant amounted to \$86,829, was recorded as deferred director compensation, and is being amortized over two years on the straight-line method. Amortization of this deferred director compensation amounted to \$30,752 during the nine months ended June 30, 2007. The unamortized deferred director compensation amounted to \$56,077 at June 30, 2007.

On November 1, 2006, the Company issued options to purchase 300,000 shares of common stock to an officer. The options vest over 3 years, have an exercise price of \$0.45 per share, expire in 10 years, and also vest the day before any merger or acquisition of more than 50% of the Company's capital stock, or the purchase of substantially all of the Company's assets, by a third-party. The fair value of these options on the date of grant amounted to \$104,792 and is being recognized on a straight-line basis over the requisite service period.

On February 1, 2007, the Company issued options to purchase 300,000 shares of common stock to a director. The options vested upon issuance, have an exercise price of \$0.60 per share, and expire in 5 years. The fair value of these options on the date of grant amounted to \$126,979, was recorded as deferred director compensation, and is being amortized over two years on the straight-line method. Amortization of this deferred director compensation amounted to \$26,454 during the nine months ended June 30, 2007. The unamortized deferred director compensation amounted to \$100,525 at June 30, 2007.

Prior to October 1, 2006, the Company accounted for its stock options in accordance with the intrinsic value provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). Under APB 25, the difference between the quoted market price as of the date of grant and the contractual purchase price of shares was recognized as compensation expense over the vesting period on a straight-line basis. The Company did not recognize compensation expense in its consolidated financial statements for stock options as the exercise price was not less than 100% of the fair value of the underlying common stock on the date of grant.

The following table illustrates the effect on net income and net income per share had the Company recognized compensation expense consistent with the fair value provisions of SFAS No. 123 "Accounting for Stock-Based Compensation", as amended by SFAS 148 "Accounting for Stock-Based Compensation Transaction and Disclosure - An Amendment to SFAS 123, prior to the adoption of SFAS 123R:

	Three Months Ended June 30, 2006
Net income, as reported	\$ 1,402,854
Deduct: Total stock-based employee compensation expenses determined under the fair value Black-Scholes method with a 128% volatility at December 31, 2005 and a 6% risk free rate of return	(29,911)



assumption	
Pro forma net income	\$ 1,372,943
Income per share:	
Weighted average shares, basic	19,026,161
Basic, pro forma, per share	\$ 0.07

A summary of option activity relating to employee and director compensation as of June 30, 2007, and changes during the three months then ended is presented below:

Options	Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at October 1, 2006	1,884,358	\$ 1.85	7.35	\$ -
Granted	1,050,000	0.53	2.75	-
Exercised	-	-	-	-
Forfeited	(465,874)	1.48	-	-
Converted	-	-	-	-
Expired	-	-	-	-
Canceled	-	-	-	-
Outstanding at June 30, 2007	2,468,484	\$ 1.35	6.43	\$ -
Exercisable at June 30, 2007	1,987,734	\$ 1.50	6.31	\$ -

**CONVERGENCE ETHANOL, INC. (fka Memms USA, INC.)**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

A summary of the status of the Company's non-vested option shares relating to employee and director compensation as of June 30, 2007, and changes during the three months then ended is presented below:

Non-vested Options	Shares	Weighted-Average Grant-Date Fair Value
Non-vested at October 1, 2006	539,324	\$ 1.25
Granted	750,000	\$ 0.48
Vested	(483,074)	\$ 1.16
Forfeited	(330,000)	\$ 1.09
Non-vested at June 30, 2007	476,250	\$ 0.60

As of June 30, 2007, there was approximately \$227,000 of total unrecognized compensation cost related to non-vested option share-based compensation arrangements. Of the amount, \$133,000 is expected to be recognized throughout the remainder of fiscal year ending September 30, 2007, and \$49,000 and \$45,000 is expected to be recognized throughout fiscal years ending September 30, 2008 and 2009, respectively.

**(18) Stockholders' Equity:**

During the month of October 2006, the Company issued and delivered 70,000 shares of the Company's common stock to one consultant for services valued at approximately \$38,500.

During the month of February 2007, the Company issued and delivered 44,606 shares of the Company's common stock to four individuals. These individuals never received the additional shares of stock they were eligible for resulting from the February 18, 2004 Lumalite Holdings, Inc. reverse merger. Shareholders of record prior to the reverse merger date were entitled to receive a multiplier of 1.712458 shares of stock for every share they owned which these individuals never received.

During the month of February 2007, the Company issued and delivered 33,613 shares of the Company's common stock to a Convergence director in exchange for \$20,000 of consulting services.

During the month of April 2007, the Company issued and delivered 75,000 shares of the Company's common stock to one consulting firm for services valued at approximately \$18,750.

During the month of April 2007, the Company issued and delivered 248,166 shares of the Company's common stock to seven individuals. These were recorded as liability to be satisfied through issuance of shares as of March 31, 2007.

During the month of April 2007, the Company issued and delivered 25,000 shares of the Company's common stock to one consulting firm valued at approximately \$12,863 to satisfy an account payable.

During the month of April 2007, the Company issued and delivered 41,854 shares of the Company's common stock to one individual.

In June, the Company issued and delivered 670,000 shares of common stock to 27 shareholders to satisfy its private placement obligations.

**(19) Legal settlement:**

On December 15, 2005, the Company and its officers entered into a Settlement Agreement and Release with the Weisdorn Parties and other Weisdorn related parties, effective as of July 1, 2005 (the "Settlement Agreement"), pursuant to which the Weisdorn Parties and other Weisdorn related Parties agreed to deliver to the Company all shares or rights to shares of the Company's common stock owned by such parties. The net common stock returned to the Company by the Weisdorn parties and other Weisdorn related parties was 2,699,684 shares.

The fair value of 2,699,684 shares of the Company's common stock at December 15, 2005 was \$3,779,558. The per share closing price of the Company's stock at December 15, 2005 was \$1.40.

**(20) Assignment of the Trumble Claims:**

The Company and the Weisdorn Parties further agreed the Weisdorn Parties, and each of them; assigned to the Company any and all rights or interest they, or any of them, have in or to the Trumble Claims. On December 15, 2005, the Company assumed Weisdorn Sr.'s obligation to purchase 165,054 shares from Mr. Trumble at \$1.86 per share for a total liability of \$307,000. The fair value of this obligation at December 15, 2005 is \$231,076 (165,054 shares at \$1.40 per share) with the difference charged to other income (\$75,924). This liability was paid in full as of December 31, 2006.

**CONVERGENCE ETHANOL, INC. (fka MemS USA, INC.)**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**(21) Commitments:**

Pursuant to his appointment as a director, Mr. Newsom and the Company entered into a Consulting Agreement. Pursuant to the Consulting Agreement, Mr. Newsom shall receive the following: (i) the sum of \$20,000, (ii) the sum of \$4,000 per month payable on the first day of each month during his tenure as a member of the Company's Board of Directors, (iii) an additional \$2,000 per trip, if Mr. Newsom makes more than three trips (per quarter) to attend meetings on the Company's business, (iv) \$250 per hour for work performed for the Company over and above time spent on trips to attend meetings on the Company's business, (v) travel expenses for trips to attend meetings on the Company's business, and (vi) options for the purchase of up to 300,000 shares of common stock of the Company at an exercise price of \$0.51 per share. The option period shall be 60 months from October 18, 2006.

The fees payable to the Director of the company is as follows:

For the year ended September 30,	
2007	\$12,000
2008	\$48,000
2009	\$48,000

**(22) Amendments to Articles of Incorporation and Bylaws:**

On December 5, 2006, the Company filed Articles of Merger with the Secretary of State of Nevada in order to effectuate a merger whereby the Company (as MEMS USA, Inc.) would merge with a newly formed wholly-owned subsidiary, Convergence Ethanol, Inc., as a parent/ subsidiary merger with the Company as the surviving corporation. This merger, which became effective as of December 5, 2006, was completed pursuant to Section 92A.180 of the Nevada Revised Statutes. Stockholder approval to this merger was not required under Section 92A.180. The purpose of this merger was to change the Company's name to "Convergence Ethanol, Inc."

**(23) Contingencies and Legal Proceedings:**

As a normal incident of the businesses in which the Company is engaged, various claims, charges and litigation are asserted or commenced from time to time against the Company. The Company believes that final judgments, if any, which might be rendered against the Company in current litigation are adequately reserved, covered by insurance, or would not have a material adverse effect on its financial statements. In addition, the Company is subject to the following proceedings:

On December 14, 2006, the Company filed a lawsuit entitled Convergence Ethanol, Inc. v. Daniel Moscaritolo, et al., in the United States District Court for the Central District of California, Case No. CV06-07971 ABC (FFMx). In this action, the Company brought suit against one of its former officers, Daniel Moscaritolo, for, among other things, violations of the federal securities laws and breaches of fiduciary duty. Specifically, the complaint alleges, among other things, that Mr. Moscaritolo sought and obtained shareholder proxies in violation of Section 14 of the Securities Exchange Act of 1934, and that he repeatedly breached his fiduciary duties to the corporation, while still an officer, in

an attempt to assert control over it.

On February 12, 2007, the federal court issued a preliminary injunction that, among other things, precludes Mr. Moscaritolo from voting the shareholder proxies that he obtained. Mr. Moscaritolo has filed an answer to the complaint and recently brought counterclaims against the Company. Specifically, the counterclaims allege: (1) Breach of Mr. Moscaritolo's "Employment Contract"; (2) Libel; (3) Nonpayment of Compensation; (4) Waiting Time Penalties; (5) Breach of the Covenant of Good Faith and Fair Dealing; and (6) Indemnification. The Company does not yet know what amount of damages the counterclaims seek, and the Court has not yet evaluated whether they are legally, much less factually, tenable. There has been no progress to report in settlement negotiations. A trial date has been set in March, 2008.

F-15

---

**CONVERGENCE ETHANOL, INC. (fka Mems USA, INC.)**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

On December 15, 2006, Mr. Moscaritolo and Mr. Hemingway, individually, and purporting to act derivatively on behalf of the shareholders of the Company, filed a lawsuit in Nevada State Court, County of Washoe (Case No.: CV0603002) against Mr. Latty and Mr. York for injunctive relief, declaratory relief, receivership, and accounting relating to the failed effort to remove them from the Board of Directors of the Company and seeking a court order approving their removal (the "Moscaritolo Action"). In January 2007, Mr. Moscaritolo and Mr. Hemingway voluntarily dismissed the Moscaritolo Action.

On January 10, 2007, Mr. Moscaritolo and Charles L. Christensen filed a lawsuit in the First Judicial District Court of the State of Nevada in and for Carson City (Case No.: 07-00035A) against the Company, Dr. Latty, and Mr. Newsom for injunctive relief to hold an Annual Shareholders Meeting. On February 9, 2007, the Company filed a Motion to Dismiss or Stay the Action based upon the Company Action pending in the United States District Court, Central District of California, Western Division. On February 22, 2007, the court ordered the Corporation to conduct a shareholders meeting on or before April 16, 2007; therefore, an annual meeting was scheduled for that date. On April 2, 2007 a notice of the meeting was sent to the shareholders. On April 4, 2007, the plaintiffs filed a motion for contempt based on the Company's alleged failure to follow appropriate procedures for the annual meeting. On April 9, 2007, the Company filed a motion in opposition disputing the contention. In addition, the Company requested an extension of time to May 24, 2007, to complete the annual meeting. The court ruled on the motions and dismissed the Plaintiffs motion for contempt and the Company's request for an extension of time.

On April 16, 2007, the Corporation conducted a shareholder meeting at the Corporation's California headquarters. Because an insufficient number of shares were present to constitute a quorum, the meeting was formally adjourned.

On May 1, 2007, the plaintiffs filed Motion for Clarification of Prior Orders. In that Motion, plaintiffs requested the Court to require Convergence to proceed with another shareholder meeting on or before June 13, 2007, to allow for a quorum to allow the Corporation to nominate directors. On May 11, 2007, the Corporation filed an Opposition to the motion. On June 4, 2007 the Nevada Court issued an order denying Plaintiff's motion for clarification of prior orders (and motion to compel a June 13th shareholder's meeting). The Court is satisfied with our scheduled meeting date of September 5, 2007 and has imposed no other obligations on the Company..

Mr. Moscaritolo filed a Sarbanes-Oxley Whistleblower complaint (No. 9-3290-07-019) on January 29, 2007, with the Occupational Safety and Health Administration under Section 806 of the Corporate and Criminal Fraud Accountability Act of 2002, and Title VIII of the Sarbanes-Oxley Act of 2002, 18 U.S.C. 1514A. On March 14, 2007, the Company submitted its Response to the Complaint. Since that time, no further proceedings have been scheduled on this matter by the Occupational Safety and Health Administration.

On June 15, 2007, two lawsuits were filed for wrongful termination and discrimination by two former employees who were discharged by the Company on December 1, 2006 under the captions Edgar P. Ninfranco v. California Mems USA Inc. et al. (Superior Court of California, Los Angeles County, Case No. BC372830) and Jose Luis Cabrera-Chavez v. California Mems USA Inc. et al. (Superior Court of California, Los Angeles County, Case No. BC372831). The responses to the complaints are due September 3, 2007. The Company strongly believes the claims against the company are without merit and intends to vigorously contest each lawsuit.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATIONS

The following discussion and analysis should be read in conjunction with our consolidated financial statements and notes to consolidated financial statements included elsewhere in this report. This report and our consolidated financial statements and notes to consolidated financial statements contain forward-looking statements, which generally include the plans and objectives of management for future operations, including plans and objectives relating to our future economic performance and our current beliefs regarding revenues we might generate and profits we might earn if we are successful in implementing our business strategies. The forward-looking statements and associated risks may include, relate to or be qualified by other important factors, including, without limitation:

- quarterly variations in our revenues and operating expenses;
- announcements of new products or services by us;
- fluctuations in interest rates;
- significant sales of our common stock, including “short” sales;
- the operating and stock price performance of other companies that investors may deem comparable to us; and
- news reports relating to trends in our markets or general economic conditions;
- anticipated trends in our financial condition and results of operations; and
- our ability to successfully develop, finance, construct and operate our planned ethanol production facilities; and
- the factors disclosed in our Annual Report on Form 10-KSB under the caption “Cautionary Statement Regarding Future Results, Forward-Looking Information and Certain Important Factors.”

We do not undertake to update, revise or correct any forward-looking statements.

Any of the factors described or referenced above could cause our financial results, including our net income or loss or growth in net income or loss to differ materially from prior results, which in turn could, among other things, cause the price of our common stock to fluctuate substantially.

### **Overview**

We are engaged in the business of developing bio-renewable energy projects and providing products and professionally engineered systems to the energy industry. The Company's mission is to support the energy industry in producing cleaner burning fuels. Each of three company-operating divisions has a specific eco-energy focus: (1) development of a woodwaste to bio-renewable fuel-grade alcohol/ethanol project, (2) selling engineered products; and (3) engineering, fabrication and sale of eco-focused energy systems. ISO 9001:2000-certified, operating divisions have served customers throughout the energy sector since 1952.

We were incorporated in the State of Nevada on April 12, 2002. On November 29, 2006, we incorporated a wholly-owned Nevada subsidiary for the sole purpose of effecting a name change of our company through a merger with our subsidiary. On December 5, 2006, we merged our subsidiary with and into our company, with our company

carrying on as the surviving corporation under the name Convergence Ethanol, Inc. Our name change was effected with NASDAQ on December 13, 2006 and our ticker symbol on the OTC Bulletin Board was changed to "CETH".

California-based Convergence Ethanol, Inc. is comprised of three wholly owned subsidiaries, California MEMS USA, Inc., ("CA MEMS") a California Corporation, Bott Equipment Company, Inc. ("Bott"), Gulfgate Equipment, Inc. ("Gulfgate") and a fourth majority-owned subsidiary, Hearst Ethanol One, Inc., a Federal Canadian Corporation ("HEO").

#### Current Business Summary

We are a renewable energy company with a mission to support the energy industry's production of cleaner burning fuels, through the development of profitable, bio-renewable energy projects and through the engineering, fabrication and sale of environmentally focused systems and equipment.

Our subsidiary, Hearst Ethanol One Inc. (HEO), is working on plans for a woodwaste-to-ethanol refinery to be built in Hearst Ontario Canada. The company owns 87% of HEO. We intend that the refinery will use modern catalytic processing, as used in oil refineries, to synthetically convert cellulosic woodwaste into ethanol. Given the high and rising price of corn, we believe that the conversion of low-cost woodwaste will be important in future ethanol production. Our plan of operation is to focus in geographic areas which offer abundant supplies of cellulosic woodwaste, superior transportation infrastructure, expedited permitting processes, high local demand for Ethanol and favorable, provincial and federal tax incentives. The Company's ability to complete this project is wholly dependent, however, on the successful fulfillment of several conditions, including receipt of all necessary environmental and other permits and the acquisition of capital for the development and construction of the plant.



Our Operating Subsidiaries:

HEO

The Company is currently developing a project that is expected to produce 120 million gallons a year of bio-renewable fuel-grade alcohol/ethanol. In April 2006, the Company incorporated Hearst Ethanol One, Inc., a Federal Canadian Corporation (“HEO”). HEO, which owns 720 acres in Hearst, Ontario, Canada and nearly 1.3 million cubic meters of woodwaste.

HEO plans to build an ecologically sound woodwaste refinery to produce bio-renewable, fuel-grade alcohol or ethanol. Organic woodwaste (organic chips or fiber), the raw material for fuel-grade alcohol/ethanol, is an overabundant waste stream of the Canadian forest products industries. The proposed refinery will use modern catalytic processing, as used in oil refineries, to synthetically convert organic woodwaste into fuel-grade alcohol or ethanol. We believe the convergence of technologies will enable the continuous production of bio renewable fuel-grade alcohol in high volume, at low cost. Currently, HEO is 87% owned by parent.

Fuel-grade alcohol/ethanol is the world's most used alternative liquid fuel. Worldwide demand is more than double production capacity. Next year's market for fuel-grade alcohol/ethanol in Canada is eight times greater than last year's production capability.

The Province of Ontario where our HEO facility will be located has mandated that all motor gasoline sold in Ontario must contain at least 5% ethanol starting on January 1, 2007, with the goal of 10% by 2010. We believe this will provide an assured market for fuel-grade alcohol/ethanol. HEO, owns 720 acres in Hearst, Ontario, has obtained forest resources, acquired construction permits, acquired a quarry for construction aggregate and owns a woodwaste repository containing nearly 1.5 million tons of woodwaste. We believe that the existing woodwaste on site will be sufficient to run the future plant for more than one year for production of 120 million gallons of fuel-grade alcohol/ethanol.

Formation of HEO

In April 2006, the Company incorporated Hearst Ethanol One, Inc., an Ontario corporation (“HEO”) for the purpose of building, owning and operating an ethanol production facility in Canada. On December 21, 2005, HEO entered into a land purchase agreement with C. Villeneuve Construction Company, Ltd. The transaction closed on April 7, 2006 and the Company owns 87% of HEO.

CA MEMS

Our CA MEMS subsidiary engineers, designs and oversees the construction of “Intelligent Filtration Systems” (“IFS”) for the gas and oil industry. These systems filter solids from oil or water. Our IFS™ systems are fully integrated and may be composed of a “Smart Backflush Filtration System” with an integral electronic decanting system, a carbon bed filter and an ion-exchange resin bed system. This equipment will purify an amine liquid by removing particulate, chemical contaminants, and heat stable salts to allow the amine to more effectively remove acid gases during oil refining. Unlike a typical canister filter system, such as the oil filter in an automobile, which needs to be periodically replaced and disposed of, the filters utilized in Intelligent Filtration Systems can last for decades. Furthermore, the filter system is self cleaning. Once the system recognizes that its filter is becoming clogged by debris filtered from the fluid flow, it turns the fluid flow through the filter off and “back flushes” the debris caked on the filter into a collection decanter. The system then turns the fluid flow through the system back on through the freshly cleaned filter. The filter cleaning process takes only seconds to complete and repeats as necessary to assure optimum filtration. A facility utilizing IFS technology needn't dispose of contaminated filters, but only need dispose of the contaminate itself. Thus, while a filtration system based upon IFS technology typically requires a greater capital investment on the part of the

purchaser, these costs are offset in the long run by savings in filter replacement and disposal costs.

The U.S. EPA and California CARB requirements for cleaner burning fuels have opened up additional oil refinery opportunities for the purchase of our IFS. We believe our IFS product can help our customers achieve lower operating costs and minimize wastes while enhancing their ability to meet the more stringent government requirements for cleaner burning fuels. The system dramatically reduces hazardous waste disposal costs.

The Company anticipates that it may be able to utilize its intelligent filtration systems as an integral part of any ethanol production facility that it may design. The Company is presently aware of three competitors offering similar technologies to CA MEMS IFS technology.

#### Gulfgate

Our Gulfgate subsidiary engineers, designs, fabricates and commissions eco-focused energy systems including particulate filtration equipment for the oil and power industries. Gulfgate also makes and sells vacuum dehydration and coalescing systems that remove water from turbine engine oils. These same systems are used by electric power generation facilities to remove water from transformer oils. To help meet its customers' diverse needs, Gulfgate maintains and operates a rental fleet of filtration and dehydration systems. All Convergence Ethanol is ISO 9001:2000 certified and is a qualified international vendor to the oil and gas industries. Gulfgate has served customers throughout the energy sector since 1957; we acquired Gulfgate in 2004.

Bott

Our Bott subsidiary is a stocking distributor for premier lines of industrial pumps, compressors, flow meters, valves and instrumentation. Bott sells aviation refueling systems for helicopter refueling on oil rigs throughout the world. Bott and Gulfgate have a combined direct sales force as well as commissioned sales representatives that sell their products. Gulfgate also constructs refueling systems that Bott sells for commercial marine vessels. Bott's customers include chemical manufacturers, refineries, power plants and other industrial customers.

Bott has served customers throughout the energy sector since 1952; we acquired Bott in 2004.

Former Subsidiary:

We created Can Am to manufacture, own and operate one ethanol production facility in British Columbia Canada. In June 2005, the Company and its Canadian counterpart each made a CN\$25,000 at risk deposit to open escrow toward purchase of 2,150 acres of land intended to serve as a plant site in British Columbia, Canada.

Subsequently, the Company paid an additional at-risk deposit of CN\$50,000 for an extension of the closing date of the purchase agreement. This project was discontinued upon the death of one of the principals.

Company History:

We were incorporated in the State of Nevada on April 12, 2002. Prior to the reverse acquisition described below, our corporate name was Lumalite Holdings, Inc. and we had not generated significant revenues and were considered a development stage company as defined in Statement of Financial Accounting Standards No. 7.

Pursuant to a Merger Agreement and Plan of Reorganization dated January 28, 2004 between us and MEMS USA, Inc., a California corporation ("CA MEMS"), we acquired all of the outstanding capital shares of CA MEMS in exchange for 10 million shares of our common stock. Since the stockholders of CA MEMS acquired approximately 75% of our issued and outstanding shares and the CA MEMS management team and board of directors became our management team and board of directors, according to FASB Statement No. 141 - "Business Combinations," this acquisition has been treated as a recapitalization for accounting purposes, in a manner similar to reverse acquisition accounting. In accounting for this transaction:

- CA MEMS is deemed to be the purchaser and surviving company for accounting purposes. Accordingly, its net assets are included in our consolidated balance sheet at their historical book values and the results of operations of CA MEMS have been presented for all prior periods; and
- Control of the net assets and business of our company were acquired effective February 18, 2004. This transaction has been accounted for as a purchase of our assets and liabilities by CA MEMS. The historical cost of the net liabilities assumed was \$-0-.

Pursuant to the transaction described above, we changed our name from Lumalite Holdings, Inc to MEMS USA, Inc. As described above, in 2006, we merged into a wholly owned subsidiary to change our name to Convergence Ethanol, Inc.

On October 26, 2004 ("Closing Date"), effective October 1, 2004, the Company purchased 100% of the outstanding shares of two Texas corporations, Bott Equipment Company, Inc. ("Bott") and Gulfgate Equipment, Inc. ("Gulfgate") from their president and sole shareholder, Mr. Mark Trumble.

On December 15, 2005, the Company assumed Weisdorn Sr.'s obligation to purchase 165,054 shares from Mr. Trumble at \$1.86 per share. This liability was paid in full as of October 31, 2006.

**Comparison of Operations**

Net sales for the three-month periods ended June 30, 2007 and 2006 were \$924,930 and \$2,029,431, respectively. We attribute this decline in sales (\$1,104,501) primarily to insufficient working capital which has limited our ability to purchase the materials necessary to complete work in process and accept new orders for our industrial pumps, valves, instrumentation and oil purification product lines.

Net sales for the nine-month periods ended June 30, 2007 and 2006 were \$6,380,115 and \$7,171,362, respectively. The sales decrease (\$791,247) for the nine months (-11%) ended June 30, 2007 as compared to the prior year was due primarily to lower entered orders resulting from turnover in key sales personnel and insufficient working capital which has limited our ability to purchase the materials necessary to complete work in process and accept new orders for our industrial pumps, valves, instrumentation and oil purification product lines. The delivery of the Company's first Intelligent Filtration System (\$1.6 Million) in December 2006 partially offset the \$2.4 million drop in sales in our other core products.

The Company computes gross profit as net sales less cost of sales. Gross profit for the three-month periods ended June 30, 2007 and 2006 were \$186,617 and \$474,517 respectively. The gross profit decrease for the three months ended June 30, 2007 as compared to the prior year was due primarily to lower sales volume and inventory write-offs. The gross profit margin is the gross profit divided by net sales, expressed as a percentage. Gross profit margin for the three-month periods ended June 30, 2007 and 2006 were 20.2% and 23.4% respectively. The decrease of 3.2% was primarily due to higher overhead charges and inventory adjustments.

Gross profit for the nine-month periods ended June 30, 2007 and 2006 were \$1,005,707 and \$1,586,353 respectively. The gross profit decrease for the nine months ended June 30, 2007 as compared to the prior year was due primarily due to a combination of lower sales volume, low margins on commercial aviation refueling systems shipments and the IFS shipment, and higher inventory adjustments. The gross profit margin is the gross profit divided by net sales, expressed as a percentage. Gross profit margin for the nine-month periods ended June 30, 2007 and 2006 were 15.8% and 22.1% respectively. This decrease of 6.3% was primarily due to lower margins on commercial aviation refueling systems shipments and the IFS shipment, higher overhead charges and higher inventory adjustments.

Selling, general and administrative (S,G&A) expenses were \$1,227,701 and \$1,161,641 for the three months ended June 30, 2007 and 2006, respectively. The increase in SG&A spending for the three months ended June 30, 2007 as compared to the prior year was due primarily to higher legal costs associated with the on-going litigation with an ex-employee (See Part II, Item 1, Legal Proceedings). Lower payroll costs resulting from last year's Profit Improvement Initiative and lower commission expense due to the lower sales volume and newly revised sales commission plans partially offset the higher legal costs.

Selling, general and administrative (SG&A) expenses were \$4,023,267 and \$3,837,378 for the nine months ended June 30, 2007 and 2006, respectively. The increase in S,G&A spending for the nine months ended June 30, 2007 as compared to the prior year was due primarily to higher legal costs associated with the on-going litigation with an ex-employee (See Part II, Item 1, Legal Proceedings). The higher legal costs were partially offset by lower payroll costs resulting from last year's profit improvement plan and lower commission expense due to the lower sales volume and newly revised sales commission plans.

We expect that over the near term, our selling, general and administration expenses will increase as a result of, among other things, increased accounting fees associated with increased corporate governance activities in response to the Sarbanes-Oxley Act of 2002, recently adopted rules and regulations of the Securities and Exchange Commission, the filing of a registration statement with the Securities and Exchange Commission to register for resale the shares of common stock and shares of common stock underlying warrants issued in various private offerings.

For the quarter ended June 30, 2007, shareholder's deficit was \$5,296,640 as compared to equity of \$577,844 for the prior year period ended September 30, 2006. The decrease in shareholder equity is primarily attributable to operating losses and the charges related to the convertible note. (See note 14 to the Consolidated Financial Statements in this Report).

Other expense (income), net for the three-month periods ended June 30, 2007 and 2006 were \$2,751,097 and \$18,385, respectively. The increase in other expense is attributable to the charges related to the convertible note. (See note 14 to the Consolidated Financial Statements in this Report).

Other expense (income), net for the nine-month periods ended June 30, 2007 and 2006 were \$2,927,475 and \$(3,650,746), respectively. The decrease in other income is attributable to proceeds from a legal settlement (see note 18 to the Consolidated Financial Statements in this Report) in the prior year and the charges related to the convertible note. (See note 14 to the Consolidated Financial Statements in this Report).

Net loss for the three-month period ended June 30, 2007 and 2006 was \$3,792,182 versus a net loss of \$702,376, respectively. Net income (loss) for the nine-month period ended June 30, 2007 and 2006 was \$(5,941,752) and \$1,402,854, respectively.

The Company implemented a Profit Improvement Initiative in the third quarter of 2006. The Profit Improvement Initiative includes: administrative workforce reduction, phase out of low margin products, tighter control of travel costs and a decrease in external costs across the company. The initiative is expected to deliver approximately \$1,200,000 in annualized savings, for only a one-time \$200,000 maximum related pre-tax charge, taken in fiscal year 2007. There can be no assurance that we will achieve all the cost savings that we expect or that those measures will not have an adverse effect on our business and results of operations.

This initiative reflects our ongoing commitment to improve our rate of return on invested capital and deliver stronger bottom-line performance. Senior management is focused on ensuring that our cost structure is competitive and that it is aligned with the company's strategic market opportunities, such as our development of a woodwaste-to-ethanol refinery in Ontario, Canada.

Workforce reductions were primarily made in non-revenue generating areas, with the greatest reductions in corporate headquarters administrative jobs and outside consulting.

### **Liquidity and Capital Resources**

Our cash and cash equivalents were \$168,764 as of June 30, 2007, compared to cash and cash equivalents of \$130,550 as of September 30, 2006.

Our plan of operations over the next 12 months includes the continued pursuit of our goal to design, engineer, build and operate one or more ethanol plants. In that regard we are dependent upon Hearst Ethanol One, Inc.'s efforts to raise the necessary capital.

Currently the Company's working capital is not sufficient to satisfy our immediate working capital requirements at our current level of operations. As of the date of this report we need a minimum of \$250,000 to meet our insurance premiums, payrolls, taxes, utilities and rent payments between now and September 1, 2007. At present the Company is negotiating with one or more financial institutions but, has no firm commitment for additional funds. In the absence of such a commitment, there is no assurance that such funds will be available on commercially reasonable terms, if at all. Should we be unable to raise the required funds, our ability to finance our continued operations will be materially adversely affected.

In addition to the funding requirements outlined above we believe that we will require a minimum of \$2.5 million in the next 30 days to bring our past due accounts payable current and fund our planned operations through the end of the first fiscal quarter of 2008. This funding is also in addition to the capital required for the development of any ethanol production project. We plan to obtain these fund through debt or private placement sales of our equity securities. As of the date of this report the Company has no firm commitment for additional funds. In the absence of a funding commitment there is no assurance that such funds will be available on commercially reasonable terms, if at all. Should we be unable to raise the required funds, our ability to finance our continued operations will be materially adversely affected.

The Company is investigating the options of either selling its two Texas subsidiaries (Bott & Gulfgate) or electing to consent to a voluntary Chapter 11 proceeding, (re-organization), which would allow the Company to continue operating under supervision of the bankruptcy court. The breathing room provided under Chapter 11 would allow the Company to attempt to raise equity or debt financing to provide the necessary capital to reorganize its affairs. There is no guarantee that the Company will be permitted to proceed under Chapter 11 and, further, there is no guarantee that the Company will be successful in raising equity and/or debt financing sufficient to reorganize its affairs. However, as of the date of this report, no firm decision has been made by the Management. As of the date of this report, no orders have been entered by this court, no receivers or other similar officers have been appointed, nor has the court assumed jurisdiction over the Company's business.

### **ITEM 3. CONTROLS AND PROCEDURES**

Our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended) are designed to ensure that information required to be disclosed in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission and that such information is accumulated and communicated to our management, as appropriate, to allow timely decisions regarding required disclosure. Our Chief Executive Officer and Chief Financial Officer have reviewed the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report and have concluded that the disclosure controls and procedures, overall, were effective as of the end of the period covered by this report. There has been no change in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the period covered by this report that have materially affected, or are reasonably likely to materially affected, the Company's internal control over financial reporting.

## **PART II - OTHER INFORMATION**

## ITEM 1. LEGAL PROCEEDINGS

As a normal incident of the businesses in which the Company is engaged, various claims, charges and litigation are asserted or commenced from time to time against the Company. The Company believes that final judgments, if any, which might be rendered against the Company in current litigation are adequately reserved, covered by insurance, or would not have a material adverse effect on its financial statements. In addition, we are subject to the following proceedings:

On December 14, 2006, the Company filed a lawsuit entitled Convergence Ethanol, Inc. v. Daniel Moscaritolo, et al., in the United States District Court for the Central District of California, Case No. CV06-07971 ABC (FFMx). In this action, the Company brought suit against one of its former officers, Daniel Moscaritolo, for, among other things, violations of the federal securities laws and breaches of fiduciary duty. Specifically, the complaint alleges, among other things, that Mr. Moscaritolo sought and obtained shareholder proxies in violation of Section 14 of the Securities Exchange Act of 1934, and that he repeatedly breached his fiduciary duties to the corporation, while still an officer, in an attempt to assert control over it.

On February 12, 2007, the federal court issued a preliminary injunction that, among other things, precludes Mr. Moscaritolo from voting the shareholder proxies that he obtained. Mr. Moscaritolo has filed an answer to the complaint and recently brought counterclaims against the Company. Specifically, the counterclaims allege: (1) Breach of Mr. Moscaritolo's "Employment Contract"; (2) Libel; (3) Nonpayment of Compensation; (4) Waiting Time Penalties; (5) Breach of the Covenant of Good Faith and Fair Dealing; and (6) Indemnification. We do not yet know what amount of damages the counterclaims seek, and the Court has not yet evaluated whether they are legally, much less factually, tenable. There has been no progress to report in settlement negotiations. A trial date has been set in March, 2008



On December 15, 2006, Mr. Moscaritolo and Mr. Hemingway, individually, and purporting to act derivatively on behalf of the shareholders of the Company, filed a lawsuit in Nevada State Court, County of Washoe (Case No.: CV0603002) against Mr. Latty and Mr. York for injunctive relief, declaratory relief, receivership, and accounting relating to the failed effort to remove them from the Board of Directors of the Company and seeking a court order approving their removal (the "Moscaritolo Action"). In January 2007, Mr. Moscaritolo and Mr. Hemingway voluntarily dismissed the Moscaritolo Action.

On January 10, 2007, Mr. Moscaritolo and Charles L. Christensen filed a lawsuit in the First Judicial District Court of the State of Nevada in and for Carson City (Case No.: 07-00035A) against the Company, Dr. Latty, and Mr. Newsom for injunctive relief to hold an Annual Shareholders Meeting. On February 9, 2007, the Company filed a Motion to Dismiss or Stay the Action based upon the Company Action pending in the United States District Court, Central District of California, Western Division. On February 22, 2007, the court ordered the Corporation to conduct a shareholders meeting on or before April 16, 2007; therefore, an annual meeting was scheduled for that date. On April 2, 2007 a notice of the meeting was sent to the shareholders. On April 4, 2007, the plaintiffs filed a motion for contempt based on the Company's alleged failure to follow appropriate procedures for the annual meeting. On April 9, 2007, the Company filed a motion in opposition disputing the contention. In addition, because of time constraints associated with the plaintiffs' proxy solicitation and the need to conduct a meaningful annual meeting with an opportunity for full shareholder participation, the Company requested an extension of time to May 24, 2007, to complete the annual meeting. The court ruled on the motions and dismissed the Plaintiffs motion for contempt and the Company's request for an extension of time.

On April 16, 2007, the Corporation conducted a shareholder meeting at the Corporation's California headquarters. Because an insufficient number of shares were present to constitute a quorum, the meeting was adjourned and no date was set to continue the meeting.

On May 1, 2007, the plaintiffs filed Motion for Clarification of Prior Orders. In that Motion, plaintiffs requested the Court to require Convergence to proceed with continuing the shareholder meeting on or before June 13, 2007, to allow the continuation of the meeting without setting a new record date. On May 11, 2007, the Corporation filed an Opposition to the motion. In that Opposition, the Corporation offered to continue the annual meeting on September 5, 2007. On June 4, 2007 the Nevada Court issued an order denying Plaintiff's motion for clarification of prior orders (and motion to compel a June 13th shareholder's meeting).

Mr. Moscaritolo filed a Sarbanes-Oxley Whistleblower complaint (No. 9-3290-07-019) on January 29, 2007, with the Occupational Safety and Health Administration under Section 806 of the Corporate and Criminal Fraud Accountability Act of 2002, and Title VIII of the Sarbanes-Oxley Act of 2002, 18 U.S.C. 1514A. On March 14, 2007, the Company submitted its Response to the Complaint. Since that time, no further proceedings have been scheduled on this matter by the Occupational Safety and Health Administration.

On June 15, 2007, two lawsuits alleging wrongful termination and discrimination were filed by two former employees, who were discharged by the Company on December 1, 2006. The two lawsuits are captioned *Edgar P. Ninfranco v. California Mems USA Inc. et al.* (Superior Court of California, Los Angeles County, Case No. BC372830) and *Jose Luis Cabrera-Chavez v. California Mems USA Inc. et al.* (Superior Court of California, Los Angeles County, Case No. BC372831). The responses to the complaints are due September 3, 2007. The Company strongly believes the claims against the company are without merit and intends to vigorously contest each lawsuit.

## **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

During the month of October 2006, the Company issued and delivered 70,000 shares of the Company's common stock to one consultant for services valued at approximately \$38,500.

During the month of February 2007, the Company issued and delivered 44,606 shares of the Company's common stock to four individuals. These individuals never received the additional shares of stock they were eligible for resulting from the February 18, 2004 Lumalite Holdings, Inc. reverse merger. Shareholders of record prior to the reverse merger date were entitled to receive a multiplier of 1.712458 shares of stock for every share they owned which these individuals never received.

During the month of February 2007, the Company issued and delivered 33,613 shares of the Company's common stock to a Convergence director in exchange for \$20,000 of consulting services.

During the month of April 2007, the Company issued and delivered 75,000 shares of the Company's common stock to one consulting firm for services valued at approximately \$21,750.

During the month of April 2007, the Company issued and delivered 248,166 shares of the Company's common stock to seven individuals.

During the month of April 2007, the Company issued and delivered 25,000 shares of the Company's common stock to one consulting firm valued at approximately \$12,863 to satisfy an account payable.

During the month of April 2007, the Company issued and delivered 41,854 shares of the Company's common stock to one individual.

During the month of June 2007, the Company issued and delivered 670,000 shares of the Company's common stock to 27 individuals to satisfy its private placement obligations.

Exemption from the registration provisions of the Securities Act of 1933 for the transactions described above is claimed under Section 4(2) of the Securities Act of 1933, among others, on the basis that such transactions did not involve any public offering and the purchasers were sophisticated or accredited with access to the kind of information registration would provide.

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

On June 1, the Company received a default and demand notice (the "June Notice") from GCA Strategic Investment Fund Limited ("GCA"). The June Notice demands payment of (i) the outstanding principal amount owed under the Note of \$3,530,000.00, (ii) accrued and unpaid liquidated damages of \$334,173.01, (iii) additional liquidated damages of \$2,353.33 per day after June 1, 2007, (iv) accrued and unpaid default interest of \$225,920.00 pursuant to the Note, and (v) additional default interest of \$1,765.00 per day after June 1, 2007. The June Notice also states that legal proceedings will be instituted against the Company without further notice seeking a judgment against the Company for all outstanding indebtedness and all court costs and that GCA intends to hold the Company liable for reasonable attorneys' fees, as provided in the Purchase Agreement, unless the Company pays the total amount demanded within ten (10) days of the Company's receipt of the June Notice. (Reference SEC Form 8-K filed June 7, 2007).

On June 11, CGA submitted an offer to the Company to resolve the current default. The terms of that offer were unacceptable to the Company.

As of the date of this report, the Company and CGA have not reached a settlement agreement. Negotiations with CGA are currently on-going and the Company is hopeful that a settlement agreement will be reached to resolve the current default by the end of August, 2007.

### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None

### **ITEM 5. OTHER INFORMATION**

None

### **ITEM 6. EXHIBITS**

(a) Exhibits

- 3.1 Articles of Incorporation, as amended, of Convergence Ethanol, Inc. (incorporated by reference from Exhibit 3.1 to the Registrant's Form 10-QSB/A for the quarter ended December 31, 2006)
- 3.2 Bylaws, as amended, of Convergence Ethanol, Inc. (incorporated by reference from Exhibit 3.2 to the Registrant's Form 10-QSB/A for the quarter ended December 31, 2006)
- 31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934
- 31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934

32.1 Certification of Chief Executive and and Chief  
Financial Officers Pursuant to 18 U.S.C Section 1350.

8

---

**SIGNATURES**

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

**CONVERGENCE ETHANOL, INC.**  
(Registrant)

Date: August 21, 2007

/s/ James A.  
Latty  
James A. Latty  
Chief Executive Officer