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AIRTECH INTERNATIONAL GROUP INC
Form 10QSB
October 15, 2001

QUARTERLY REPORT FOR SMALL BUSINESS ISSUERS SUBJECT
TO THE 1934 ACT REPORTING REQUIREMENTS

FORM 10-QSB

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

(Mark One)

/x/ QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934

For the quarterly period ended August 31, 2001

/ / TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from _____ to _____

0-19796

Commission File No.

AIRTECH INTERNATIONAL GROUP, INC.

(Exact name of registrant as specified in its charter)

WYOMING

(State or other jurisdiction of
incorporation or organization)

98-0120805

(I.R.S. Employer
Identification No.)

12561 Perimeter, Dallas, Texas 75228

(Address of principal executive offices)

Registrant's telephone number, including area code: (972) 960-9400

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

Yes [X] No []

As of August 31, 2001, approximately 39,998,669 shares of Common Stock,
\$0.05 par value, were outstanding.

Traditional Small Business Disclosure Format

Yes [X] No []

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TURNER, STONE & COMPANY
12700 Park Central Drive
Suite 1610
Dallas, Texas 75251

INDEPENDENT ACCOUNTANT'S REPORT

Board of Directors and Stockholders

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Airtech International Group, Inc. and subsidiaries
Dallas, Texas

We have reviewed the accompanying consolidated balance sheet of Airtech International Group, Inc. and subsidiaries as of August 31, 2001 and the related statement of operations, stockholders' equity and cash flows for the three months then ended. These consolidated financial statements are the responsibility of the Company's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statement taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying August 31, 2001 consolidated financial statements for them to be in conformity with generally accepted accounting principles.

/s/ Turner, Stone & Company, LLP

Certified Public Accountants
October 14, 2001
Dallas, Texas

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PART 1--Financial Information

Item I Financial Statements

Airtech International Group, Inc. and Subsidiaries Consolidated Balance Sheets August 31, 2001 and 2000

ASSETS

CURRENT ASSETS

2001

Cash	\$	240,819
Trade accounts receivables, net of allowance for doubtful accounts of \$150,000 and \$20,000 respectively		957,152
Notes receivable, current portion		437,250

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Inventory	1,005,829
Prepaid expenses and other assets	76,178

Total current assets	2,717,228

PROPERTY AND EQUIPMENT--net of accumulated depreciation of \$206,669 and \$182,374 respectively	169,520
NOTES RECEIVABLE--net of current portion, net of allowance for Doubtful accounts of \$0 and \$0, respectively	1,078,312
OTHER ASSETS	
Goodwill, net of \$116,385 and \$40,810 of accumulated amortization, respectively	62,668
Intellectual properties, net of \$282,725 and \$153,300 of accumulated amortization, respectively	804,672
Other, Prepaid Royalties	93,556

Total other assets	960,896

	\$ 4,925,956
	=====

The accompanying notes are an integral part of the financial statements

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Airtech International Group, Inc. and Subsidiaries
Consolidated Balance Sheets
August 31, 2001 and 2000

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES	2001

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Notes payable--current portion	\$ 277,185
Accounts payable, trade	355,080
Note payable--officers	106,688
Accrued payroll and payroll taxes	419,788
Current portion of convertible debentures	1,900,000
Other accrued expenses	957,786

Total current liabilities	4,016,527

LONG-TERM LIABILITIES	
Deferred revenue	340,000
Product Marketing Obligation	-
Convertible Debentures	547,399

Total long-term liabilities	887,399

Total liabilities	4,903,926

COMMITMENTS AND CONTINGENCIES	-
STOCKHOLDERS' EQUITY	
Series M cumulative, convertible preferred, 1,013,000 and 990,625	
Shares outstanding respectively; liquidation preference of \$1.00	
per share	1013
Common stock--\$.05 par value, 100,000,000 shares authorized;	
39,998,669 and 22,367,740 shares issued and outstanding, respectively	1,999,933
Additional paid-in capital	9,794,175
Retained deficit	(11,773,091)

Total stockholders' equity	22,030

	\$ 4,925,956
	=====

The accompanying notes are an integral part of the financial statements.

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Airtech International Group, Inc. and Subsidiaries Consolidated Statements of Operations For the Three Months Ended August 31, 2001 and 2000

REVENUES	2001

Product sales	\$ 413,625

Total revenues	413,625

COSTS AND EXPENSES	
Salaries and wages	104,182
Research and Development	31,001
Cost of sales	228,766
Advertising	30,855
Depreciation and amortization	106,654
Other general & administrative expense	126,858

Total costs and expenses	628,316

LOSS FROM OPERATIONS	(214,691)
Interest expense	(171,615)

NET LOSS BEFORE INCOME TAXES	(386,306)
Income taxes	-

NET LOSS	\$ (386,306)
	=====
LOSS PER COMMON SHARE--BASIC	\$ (0.01)
	=====
LOSS PER COMMON SHARE--DILUTED	\$ (0.01)
	=====

The accompanying notes are an integral part of the financial statements

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Airtech International Group, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
For the Three Months Ended August 31, 2001 and 2000

CASH FLOWS FROM OPERATING ACTIVITIES:	2001

Net Loss	\$ (386,306)
Adjustments to reconcile net income to cash	
Depreciation and amortization	106,654
Stock payments for interest on convertible debentures	99,113
Changes in operating assets and liabilities	
Accounts receivable	(155,068)
Inventory	(22,681)
Accounts payable	80,973
Accrued expenses	60,308
Other receivables	(8,794)

Net cash used in operating activities	(225,801)

CASH FLOWS FROM INVESTING ACTIVITIES	
Expenditures for other assets	(8,104)

Net cash used in investing activities	(8104)

CASH FLOWS FROM FINANCING ACTIVITIES	
Proceeds from issuance of convertible debentures	172,000
Proceeds from issuance of common stock	-

Net cash provided by financing activities	172,000

INCREASE (DECREASE) IN CASH	(61,905)
CASH, BEGINNING OF PERIOD	302,724

CASH, END OF PERIOD	\$ 240,819
	=====

The accompanying notes are an integral part of the financial statement

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Airtech International Group, Inc.
and Subsidiaries
Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies

Organization

Airtech International Group, Inc. (the Company), formerly Interactive Technologies Corporation (ITC), was incorporated in the state of Wyoming on August 8, 1991. As of May 31, 1998, in connection with the acquisition discussed below, the Company manufactures and sells air purification products.

On May 31, 1998, the Company acquired all of the outstanding common stock shares of Airtech International Corporation (AIC), which through its subsidiaries, manufactures and sells various air filtration and purification products. The total purchase price of \$22,937,760 was funded through the issuance of 10,500,000 shares of common stock valued at \$.625 per share, the issuance of 11,858,016 shares of Series A convertible preferred stock shares valued at \$.625 per share and the issuance of \$9,000,000 of convertible debentures.

However, because these convertible securities were converted into common stock within two months following acquisition, the shareholders of AIC obtained control of the company. As a result, AIC became the acquirer for financial reporting purposes.

The transaction was accounted for using the purchase method of accounting with AIC for accounting and reporting purposes the acquirer. Accordingly, the purchase price of the net assets acquired has been allocated among the net assets based on their relative fair value of zero.

Principles of consolidation

The accompanying consolidated financial statements include the general accounts of the Company and its subsidiaries, AIC, Airsopure, Inc., Airsopure International Group, Inc. (dormant) and McCleskey Sales and Service, Inc.

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(dormant) each of which has a fiscal year ended May 31. All material intercompany accounts and balances have been eliminated in the consolidation. Turner, Stone & Company, the Company's independent accountants, has performed limited reviews of the interim financial information included herein. Their report on such reviews accompanies this filing.

Amortization

Intellectual property is allocated to the Company's air filtration products based on expected sales as a percent of total sales by product. The Company records amortization beginning when the product is initially inventoried for sale. Amortization is recorded ratably over a ten-year term.

Goodwill acquired and recorded in the financial acquisition of ITC, is being amortized under the straight line method over 5 years.

A prepaid royalty fee, paid pursuant to a December 1995 agreement and related to the Company's portable medical unit, is being amortized using the straight-line method over 24 months beginning January 2000.

Inventories

Inventories are carried at the lower of cost or net realizable value (market) and include component parts used in the assembly of the Company's line of air purification units, filters and finished goods comprised of completed products. The costs of inventories are based upon specific identification of direct costs and allocable costs of direct labor, packaging and other indirect costs.

Property and equipment

Property and equipment are stated at cost less accumulated depreciation. Depreciation of property and equipment is currently being provided by straight line and accelerated methods for financial and tax reporting purposes, respectively, over estimated useful lives of five to seven years.

Product marketing obligation

Property marketing obligations pursuant to Statement of Financial Accounting Standards, "SFAS" No. 68, the Company has recorded funds raised in an arrangement to develop, produce and market the Model S-999 as a product marketing obligation. As of June 2001, the partnership has been dissolved with the conversion of all limited partners into common stock of the Company.

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Airtech International Group, Inc.
and Subsidiaries
Notes to Consolidated Financial Statements

Revenue recognition

Revenues from the Company's operations are recognized at the time products are shipped or services are provided. Revenue from franchise sales are recognized at the time all material services relating to the sale of a franchise have been performed by the Company.

Management estimates

The preparation of financial statements in conformity with generally

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accepted accounting principles 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.

Cash flow

For purposes of the statement of cash flows, cash includes demand deposits, short term cash equivalent investments and time deposits with maturities of less than three months. None of the Company's cash is restricted.

Loss per share

The basic and diluted loss per share are based upon 36,384,736 and 21,647,192 respectively, weighted average shares of common stock outstanding over the three month period ending August 31, 2001 and 2000. No effect has been given to the assumed conversion of convertible preferred stock, convertible debentures, product market obligation guarantees (for the quarter ended August 31, 2000) and the assumed exercise of stock options and warrants, as the effect would be antidilutive.

Research and Development

The Company's research and development activities consists of retooling and developing its Model S-12 and S-30 products, including applying the Company's technology in photo-catalytic conversion to the other air purification products. The costs of research and development are charged to expense when incurred.

2. Liabilities

The Company's notes payable consist of loans from various corporations and individuals. The notes contain no significant restrictions bear interest at rates from 10% to 18%. The notes are in default since May 1999.

3. Commitments and Contingencies

Operating Leases

The company is currently obligated under noncancellable operating leases for its Dallas office and warehouse facility, which expires in September 2004.

Minimum future rental payments required under the above operating lease is as follows:

Year ending May 31	
2002.....	21,600
2003.....	43,200
2004.....	47,500

	\$112,300

4. Financial instruments

The Company's financial instruments consist of its cash, marketable securities accounts and notes receivable, and trade payables.

Cash and Marketable Securities

The Company maintains its cash in bank deposit and other accounts, which, at times, may exceed federally insured limits. The Company invests excess cash not required for operations in US Treasury repurchase agreements in connection with its cash management account with its primary bank. The Company has not experienced any losses in such accounts, and does not believe it is subject to any credit risks involving its cash.

Accounts and notes receivable, trade

The Company accounts and notes receivables are unsecured and represent sales not collected to date. Management believes these accounts and notes receivables are fairly stated at estimated net realizable amounts.

5. Stock options and warrants

Through the quarter ended August 31, 2001 and 2000, the Company has issued various stock options and warrants to employees and others and uses the intrinsic value method of accounting for these stock options. Compensation cost for options granted has not been recognized in the accompanying financial statements because the amounts are not material and its exercise price exceeded the common stock fair market value at the date of option. The options and warrants expire between September 2001 and February 2006 and are exercisable at prices from \$0.10 to \$10.00 per option or warrant. Exercise prices were set at or above the underlying common stock's fair market value on the date of grant.

6. DESCRIPTION OF CONVERTIBLE SECURITIES

We have summarized below the material provisions of our securities which are convertible into shares of our common stock.

SERIES "M" CONVERTIBLE PREFERRED STOCK AND RELATED WARRANTS

We have 1,013,000 shares of Series "M" Convertible preferred stock outstanding at August 31, 2001. Holders of our Series "M" preferred have the right to convert their shares into shares of our common stock on a one-for-one basis at any time. The Series "M" preferred automatically converts to shares of our common stock on December 31, 2001. The holders of Series "M" preferred are entitled to receive quarterly dividend distributions equal to 4.57% of the gross revenues generated from the sales of our Series 950 units until January 31, 2002. The dividends are paid on or before the sixtieth day of each calendar quarter based upon the gross revenues from our Series 950 unit from the previous quarter. The holders of Series "M" preferred were also issued warrants to purchase 990,625 shares of our common stock. These warrants expired on May 31, 2000.

AIRSOPURE 999 LIMITED PARTNERSHIP INTERESTS

We have \$430,000 of limited partnership interests outstanding in Airsopure 999, L.P. ("Airsopure LP"). Airsopure, Inc., at May 31, 2001 our wholly-owned subsidiary ("Airsopure"), is the sole general partner of Airsopure LP. Under the limited partnership agreement, the limited partners are entitled to receive 1.7% of the gross revenues generated from sales of our Model S-999 automobile air purification system with the remaining gross revenues paid to Airsopure. The limited partners are entitled to receive distributions until December 31, 2003,

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at which time 100% of gross revenues are paid to Airsopure. All limited partners were converted to common stock in June 2001 by the issuance of 2,639,926 shares of our common stock. The Limited Partnership was dissolved at May 31, 2001.

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Airtech International Group, Inc. and Subsidiaries Notes to Consolidated Financial Statements

12% CONVERTIBLE DEBENTURES DUE 2004 AND ATTACHED WARRANTS

In January 2000, our board of directors authorized the issuance of up to \$5,000,000 of our 12% Convertible Debentures Due 2004 under a private placement memorandum. As of August 31, May 31, 2001, we have sold \$300,000 in principal amount of our 12% debentures. At any time after one year from the date of issuance, holders of our 12% debentures are entitled to convert our 12% debentures on a dollar for dollar basis into shares of our common stock. Semi-annual interest payments are due and payable on our 12% debentures commencing September 1, 2000. Each 12% debenture in the principal amount of \$25,000 includes a warrant to purchase shares of our common stock at an exercise price of \$2.00 per share. The warrants expire two years from the date of issuance. At our option, our 12% debentures may be converted on a dollar for dollar basis into shares of our common stock or paid in cash at face value on the maturity date. Prior to maturity, we may with the consent of the debenture holder, redeem our 12% debentures in cash at a premium together with accrued interest to date.

6% CONVERTIBLE DEBENTURES DUE 2002 AND ATTACHED WARRANTS

On February 22, 2000, we sold \$2,500,000 in principal amount of our 6% Convertible Debentures Due 2002 to PK Investors LLC. Our 6% debentures have a maturity date of February 22, 2002 at which time the principal amount and all accrued interest is due and payable. No interest payments are due prior to maturity of the 6% debentures. We may, at our option, pay the accrued interest at maturity by issuing shares of our common stock to the debenture holder at a price equal to the conversion price of our common stock as described below. Our 6% debentures are convertible at any time at the option of the holder into shares of our common stock. The conversion price of our common stock used in calculating the number of shares issuable upon conversion (or in payment of interest) is the lesser of:

- 110% of the average closing bid price of our common stock for the five trading days prior to the date of initial payment; and

- the product obtained by multiplying 0.80 by the average of the three lowest closing bid prices of our common stock during the thirty trading days prior to the date we receive a conversion notice from a debenture holder.

In the event we have a "change of control", the holders of our 6% debentures may require us to redeem the 6% debentures at a redemption price equal to 125% of the aggregate outstanding principal and accrued interest on the 6% debentures. A "change of control" includes:

- acquisition by an entity or group of more than 50% of our voting stock;
- merger or consolidation;
- a change in a majority of our existing board of directors; or
- a sale of substantially all of our assets.

The holders of our 6% debentures also have attached warrants to purchase 250,000 shares of our common stock at an exercise price of \$2.6124 per share.

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The warrants expire on February 22, 2005.

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Airtech International Group, Inc. and Subsidiaries Notes to Consolidated Financial Statements

12% CONVERTIBLE DEBENTURES DUE MARCH 30, 2003 and ATTACHED WARRANTS

On March 29, 2001, we entered into a securities purchase agreement with AJW Partners, LLC and New Millennium Partners II, LLC to raise up to \$1,000,000 through the sale to these investors of our 12% Convertible Debentures Due 2003 with attached warrants to purchase up to 600,000 shares of our common stock. Upon execution of the securities purchase agreement, the investors purchased \$800,000 in principal amount of 12% debentures with attached warrants to purchase 500,000 shares of our common stock. The purchase price paid by the investors for our 12% debentures and attached warrants was \$800,000 which represents the total amount we have received under the purchase agreement through April 30, 2001. Under the terms of our purchase agreement, the investors are obligated and did purchase the remaining \$200,000 in principal amount of our 12% debentures with attached warrants to purchase 100,000 shares of common stock for a purchase price of \$200,000. The investors purchased \$200,000 of the convertible debentures July 20, 2001.

Description of 12% Debentures

Our 12% debentures have a maturity date of March 30, 2003 at which time the principal amount and all accrued interest on the 12% debentures is due and payable. Interest payments on the 12% debentures are due and payable quarterly commencing June 1, 2001 or at the option of the debenture holder upon conversion of the 12% debentures into shares of our common stock. If the debenture holder elects, we will pay any accrued interest on conversion by issuing shares of our common stock to the debenture holder at a price equal to the conversion price of our common stock as described below. The 12% debentures are secured by a security agreement under which we pledged substantially all of our assets, including our goods, fixtures, equipment, inventory, contract rights, and receivables.

The 12% debentures are convertible at any time at the option of the holder into shares of our common stock, provided at no time may a holder of our 12% debentures and its affiliates own more than 4.9% of our outstanding common stock without giving us 30 days prior written notice of the debenture holder's intent to waive the 4.9% ownership limitation. The conversion price of our common stock used in calculating the number of shares issuable upon conversion, or in payment of interest on the 12% debentures, is the lesser of 50% of the average of the lowest three trading prices of our common stock for the twenty trading days ending one trading day prior to the date we receive a conversion notice from a debenture holder; and a fixed conversion price of \$0.25.

Also, under the terms of the 12% debentures, if we at any time distribute any shares of our common stock in a consolidation, exchange of shares, re-capitalization or reorganization, the 12% debenture holders are entitled to participate in the distribution as if the debenture holders had converted the 12% debentures; distribute any of our assets to our stockholders as a dividend, stock repurchase, return of capital, or otherwise, the 12% debenture holders are entitled to participate in the distribution as if the debenture holder had converted the 12% debentures; or issue or sell any shares of our common stock

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for no consideration or at a price less than \$0.25 per share, then the fixed conversion price of \$0.25 described above shall be reduced to the price per share we receive on the issuance or sale.

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Airtech International Group, Inc. and Subsidiaries Notes to Consolidated Financial Statements

Our 12% debentures have an imbedded beneficial conversion feature which enables the debenture holders to convert the 12% debentures at the lesser of a 50% discount to the market price of our common stock and \$0.25 per share. As of the date of sale of the 12% debentures, the imbedded discount attributable to the 12% debentures was \$900,000. We have reflected this discount in our financial statements by writing off \$146,700 of the discount as of the date of each sale of the 12% debentures. We will amortize the remaining \$753,300 of the discount over the three year term of the 12% debentures. If a 12% debenture is converted prior to the expiration of the three year term, we will write off to interest expense any remaining discount attributable to the converted 12% debenture.

Description of Warrants

The warrants purchased by the investors on March 29, 2001 entitle the investors to purchase 500,000 shares of our common stock at an exercise price equal to the lesser of 90% of the average of the lowest three trading prices of our common stock for the twenty trading days ending one trading day prior to the date of exercise of the warrant; and \$0.102 per share.

The warrants expire on March 29, 2004. The warrants are subject to exercise price adjustments upon the occurrence of certain events including stock dividends, stock splits, mergers, reclassifications of stock or our re-capitalization. The exercise price of the warrants is also subject to reduction if we issue any rights, options or warrants to purchase shares of our common stock at a price less than the market price of our shares as quoted on the OTC Bulletin Board. Also, if at any time, we declare a distribution or dividend to the holders of our common stock in the form of cash, indebtedness, warrants, rights or other securities, the holders of the warrants are entitled to receive the distribution or dividend as if the holder had exercised the warrant.

The warrants attached to our 12% debentures have an imbedded beneficial exercise feature which enables the warrant holders to exercise the warrants at the lesser of a 10% discount to the market price of our common stock and \$0.102 per share. As of the date of sale of the warrants, the imbedded discount allocable to the warrants was \$100,000. The discount was determined from the Black-Scholes option pricing method. In our financial statements, we will amortize and write-off to interest expense the \$100,000 discount over the three year term of the warrants. If a warrant is exercised prior to the expiration of the three year term, we will write off to interest expense any remaining discount attributable to the exercised warrant.

Consent and Standstill Agreement of 6% Debenture Holders

Our 6% debenture holders consented to the sale of our 12% debentures. The 6% debenture holders also agreed that neither they nor their affiliates would for a period beginning March 29, 2001 and ending 8 months from the date the registration statement relating to the securities offered by this prospectus is declared effective by the SEC offer to sell, contract to sell, pledge, grant any

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rights or otherwise dispose of any shares of our common stock held by the 6% debenture holders without the prior consent of the 12% debenture holders; or engage in any hedging transactions which are designed or reasonably expected to lead to or result in a disposition of the shares of our common stock held by the 6% debenture holders.

The 6% debenture holders may however; convert the 6% debentures into a maximum of 200,000 shares of our common stock per month on a non-cumulative basis; and sell up to 100,000 shares per month of common stock converted after March 29, 2001 or 200,000 shares if the selling price is at least \$0.75 per share, with any unsold converted shares held in escrow by our legal counsel

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

FORWARD LOOKING STATEMENTS

Certain statements contained in this report that are not historical fact are "forward-looking statements" as that term is defined in the Private Securities Litigation Reform Act of 1995. The words or phrases "will likely result," "are expected to," "will continue," "is anticipated," "believes," "estimates," "projects" or similar expressions are intended to identify these forward-looking statements. These statements are subject to risks and uncertainties beyond our reasonable control that could cause our actual business and results of operations to differ materially from those reflected in our forward-looking statements. The safe harbor provisions provided in the Securities Litigation Reform Act do not apply to forward-looking statements we make in this report. Forward-looking statements are not guarantees of future performance. Our forward-looking statements are based on trends which we anticipate in our industry and our good faith estimate of the effect on these trends of such factors as industry capacity, product demand and product pricing. The inclusion of projections and other forward-looking statements should not be regarded a representation by us or any other person that we will realize our projections or that any of the forward-looking statements contained in this prospectus will prove to be accurate.

BACKGROUND AND GENERAL

On May 31, 1998, Interactive Technologies acquired all of the outstanding shares of common stock of Airtech Corporation for a purchase price of \$22,937,760. The financial statements reflect the combination as a reverse merger with Airtech Corporation as the acquiring entity for accounting and reporting purposes and Interactive Technologies as the surviving entity for legal purposes. Interactive Technologies effectively issued shares of common stock for the outstanding shares of Airtech Corporation, with the stockholders of Airtech Corporation ultimately acquiring control of Interactive Technologies. For this reason, Airtech Corporation is considered the acquiring entity for purposes of our financial statements.

RESULTS OF OPERATIONS FOR THE QUARTER ENDED AUGUST 31, 2001 COMPARED TO THE QUARTER ENDED AUGUST 31, 2000

REVENUES

Our consolidated total revenues decreased \$105,012 or 20.2% from \$518,637 for the three months ended August 31, 2000 compared to the three months ended August 31, 2001 of \$413,625. This decrease in sales is due to the cessation of sales from the consumer direct sale franchise group. In the first quarter, August 31, 2000 the Company opened four retail outlets for sale of the portable unit. These stores were closed in March 2001.

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COSTS AND EXPENSES

Our consolidated total costs and expenses decreased \$524,352 or 45% from \$1,152,668 in 2000 to \$628,316 in 2001. The major components of this \$524,352 decrease were:

Salaries and wages decreased \$236,468 or 69% from \$340,650 in 2000 to \$104,182 for 2001. This decrease is the result of many factors including decreased commissions on sales of our products through the retail direct sale stores. Also, we have decreased the total number of employees (outside of the retail store group) by seven individuals. In addition, management has reduced and/or eliminated their personal salaries.

Cost of sales decreased \$55,706 or 19% to \$228,766 for 2001 as compared to \$284,766 for 2000. This decrease is due to the 20% decrease in product sales. The percentage cost of goods sold remained constant at 55% of sales in 2000 and 2001. The higher gross margins of the retail direct sale stores sales were replaced by higher margin sales of the Company's newest product, the Model S-30.

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Research and development costs decreased \$44,249 from \$75,250 in August 31, 2000 to \$31,001 in costs for August 31, 2001. This decrease of 59% is due to the reduction of costs associated with the completion of the Model S-30 for sale.

Advertising costs decreased \$92,749 to \$30,855 for 2001 from \$123,604 for 2000. This is a 75% decrease in costs. The decrease is due to the introduction of new products and the implementation of our new residential franchise sales approach, which increased promotional costs, including brochures and travel expenses for the August 31, 2000 quarter and no similar costs in 2001.

Depreciation and amortization increased \$28,467 to \$106,654 for the three months ended August 31, 2001 compared to \$78,187 for 2000. This increase is primarily due to increased amortization of prepaid royalties.

General and administrative expenses decreased \$123,647 to \$126,858 for the three months ended August 31, 2001 from \$250,505 in 2000. This 49% decrease is due to decreases in litigation expenses of legal fees and settlement costs. The decrease in facilities costs after combining the office and warehouse functions in one location. In addition, outside consultant fees and investment bankers fees decreased during 2001.

Interest expense of \$171,615 for 2001 is \$109,005 higher or 174% than the \$62,610 interest expense in 2000, due to the interest accrual on the outstanding 6% debentures issued in February 2000 and the 12% debentures issued in March and July 2001. In addition, the 12% convertible debentures sold in March and July 2001 contained an imbedded beneficial conversion feature, wherein an additional \$92,115 in interest was charged as interest expense and as a discount to the debentures.

The result of these revenues and costs and expenses is a net loss of \$(386,306) or (\$0.01) per share of common stock (basic and diluted) for the three months ended August 31, 2001 compared to a net loss of \$(696,641) or (\$0.03) per share of common stock for the three months ended August 31, 2000. This represents a 45% decrease in our net loss and a \$0.02 decrease in loss per share of our common stock compared to 2000. The average number of shares of our common stock increased from 2000 to 2001 so the loss per share on our common stock is not comparable.

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CAPITAL EXPENDITURES

We do not have any large capital expenditures planned for fiscal year 2002. We are considering product design changes to include a plastic casing design for two of our products, which will require approximately \$400,000 in capital expenditures. The final decision, however, to change the product design will be based on estimated sales of the products which will enable us to recover the capital expenditures within nine to twelve months. Any minor capital expenditures will be met with cash on hand. In the event our product sales increase beyond current manufacturing capacities, then additional capital expenditures will be required to increase production capacity. We anticipate, however, that any additional capital expenditures to increase production capacity would not exceed \$500,000. These capital expenditures would also be offset by increased product sales which created the need to increase our current manufacturing capacities.

LIQUIDITY AND CAPITAL RESOURCES

As of August 31, 2001, we had total current assets of \$2,717,228 less current liabilities of \$4,016,527 which resulted in net current liabilities of \$1,299,299. When the current portion of the convertible debentures that we expect to be converted into common stock are subtracted from total current liabilities the current assets exceed the adjusted liabilities by \$600,701. We expect to have sufficient funds necessary to finance the manufacture, distribution and sale of our products including management and advertising support for fiscal year 2002. Additional general and administrative expenses have been reduced during the first quarter 2002. We also expect that our cash balance and operations are adequate to sustain our continued operations during

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fiscal year 2002. After reducing the net loss for the quarter ending August 31, 2001 by the non cash items of Depreciation, amortization and interest expense paid by common stock in accordance with the convertible debenture agreements, the net cash used is reduced to \$108,037 for the three months ended August 31, 2001.

We expect to sell four international franchises during 2002 for up to \$250,000 per license. Our estimated franchise sales are based upon our good faith estimate of the market for our franchises and our products. We cannot assure you that our franchise sales or distributorship sales will meet our goals.

We also expect sales of our products to increase in fiscal year 2002. For the year 2001, our product sales were \$1,735,901 in comparison in 2000, our product sales were approximately \$543,615. This 2000 sales were in turn an increase from the sales year ended May 31, 1999 of \$388,412. This trend indicates the sales of our products are increasing. Although the results of sales for the first quarter were less than expected and less than the comparable quarter for 2000, the sales mix of our new Model S-30 through our distributors, direct sales and franchisees we believe represent a positive trend, we cannot assure you that this positive trend will continue.

Our sales projections are based upon our good faith estimates of the marketability of our products and we cannot assure you that we will achieve these results during fiscal year 2002.

If our current cash and revenues from franchise and product sales are insufficient to fund our continued growth, we will rely on our external funding sources to provide continued liquidity. For the quarter ended August 31, 2001, we increased cash from financing activities by the sale of convertible

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debentures of \$200,000.

The 6% and 12% debentures held by Investors includes attached warrants to purchase 1,150,000 shares of our common stock. If the investors exercise all 1,150,000 warrants to purchase our common stock, we could receive up to \$656,000 in cash from the exercise. The warrants currently held by Investors expire from 2003 through 2005. We cannot assure you that the Investors will exercise any warrants in the future.

During fiscal year 2002, we intend to focus on the production, marketing and sale of our existing line of air purification products, our new in line Model S-30. For this reason, we do not project significant expenditures during fiscal year 2002 on our products which are in production and sale. We believe our existing product line is sufficient to sustain our future sales growth. If we do not receive Medicare approval of our Medicare 950, we intend to actively pursue the marketing of this unit through private health insurance companies and health care providers, even without a HCPCS code number.

We do not have a large capital expenditures program planned for fiscal year 2002. Therefore, we believe our projected increase in franchise and product sales combined with funds generated from external financing sources will be sufficient to offset any cash losses from operations. If our current and new product sales, distributor/franchise sales, new areas of distribution sales and funds from our external sources are insufficient to maintain operations, the resulting lack of capital could force us to substantially curtail or cease our operations. Any curtailment of operations would have a material adverse effect on our ability to manufacture and distribute our products and our profitability.

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Part II- Other Information

ITEM 1. LEGAL PROCEEDINGS

In 1997, we were named as a defendant in a cause of action styled LLB Realty, L.L.C. v. Interactive Technologies Corp., Cause No. MER-L-1535-97, in the Superior Court of New Jersey, Mercer County. The complaint alleges damages relating to a lease agreement entered into with the plaintiff's for office facilities in New Jersey. We never occupied the space based upon the plaintiff (lessor) failing to finish-out the space pursuant to our specifications. The complaint alleges damages of approximately \$250,000 for remaining lease payments, finish-out costs and lost revenues. The Court ruled in favor of the plaintiffs and will hold a hearing to determine damages. Although we are in negotiations for a settlement relating to the complaint, the outcome of these negotiations is uncertain. We have established a reserve in our consolidated financial statements in the amount of \$200,000 in anticipation of a settlement.

We have been named as a defendant in a number of routine lawsuits arising in the ordinary course of our business. In some of these cases a judgment was rendered against us. We have answered these routine causes of action where appropriate, negotiated settlements where appropriate and agreed to a payment schedule with respect to others. We have fully reserved for these claims and causes of action in our consolidated financial statements in the aggregate amount of \$65,000.

ITEM 2 CHANGES IN SECURITIES

On July 20, 2001, issuance of \$200,000 in 12% Convertible Debentures in a Private Placement. On June 10, 2001, issued a Private Placement of 2,639,926 shares of Common Stock to convert the limited partners in the Airsopure 999 L.P., reflected in the Financial Statements as Product Marketing Obligation of

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\$430,000. Issued in a Private Placement in June 2001 335,000 shares of Common Stock to the 12% Convertible Debenture holders (Private Placement) for interest owed under the Debenture. Partial conversion of 6% and 12% Convertible Debentures and payment of accrued interest owing into 4,252,939 shares of Common Stock, issued under a SB-2 Registration Statement.

ITEM 3 DEFAULT UPON SENIOR SECURITIES

None

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

None.

ITEM 5 OTHER INFORMATION

DIVIDENDS

We have paid no dividends on our shares of common stock and we have no current intention to pay dividends on our shares of common stock in the future. Holders of our Series "M" Convertible Preferred Stock have a preferred dividend right to receive dividend distributions equal to 4.57% of the gross revenues generated from sales of our Series 950 units until January 31, 2002. Except for required dividend payments on the Series "M" convertible preferred stock, we intend to retain any future earnings for reinvestment in our business. As of August 31, 2001, no dividends have been paid on the Series "M" convertible preferred stock. Future dividends will be dependent upon our financial condition, results of operations, capital requirements and other relevant factors. In August 2001, we announced that the Company will be issuing a dividend to shareholders of record October 31, 2001. This dividend will be one share of Humitech, Inc. common stock, for every ten shares of Airtech International Group, Inc. common stock owned at October 31, 2001. Humitech, Inc. purchased, in August, 2001, one hundred per cent of the outstanding common stock of our dormant subsidiary, Airsopure International Group, Inc. in a stock exchange whereby we received approximately ten percent of the combined company stock in Humitech. We are issuing one hundred per cent of our ownership in Humitech in the dividend to shareholders.

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ITEM 6. (a) EXHIBITS AND (b) REPORTS ON FORM 8-K.

(a) Exhibits

- 3.1* Restated Articles of Incorporation filed December 27, 1991 of the Company's predecessor in name, Interactive Technologies Corporation, Inc.
- 3.2* Articles of Amendment dated filed May 14, 1997 of the Company's predecessor in name Interactive Technologies Corporation, Inc.
- 3.3* Articles of Amendment of the Company filed October 16, 1998
- 3.4 Bylaws of the Company's predecessor in name, Interactive Technologies Corporation, Inc. (incorporated by reference to the Company's Form 10 filed on January 14, 1992)
- 4.1* Specimen Common Stock Certificate
- 4.2* Specimen Series "M" Preferred Stock Certificate
- 4.3* Form of Warrant to purchase shares of Common Stock granted to holders of Series "M" Convertible Preferred Stock
- 4.4* Form of Securities Purchase Agreement dated February 22, 2000 by and between the Company and PK Investors LLC
- 4.5* Form of 6% Convertible Debenture Due 2002
- 4.6* Form of Warrant to purchase shares of Common Stock granted to holders of 6% Convertible Debentures Due 2002
- 4.7* Registration Rights Agreement dated February 22, 2000 by and between the

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- Company and PK Investors LLC relating to the registration of the Common Stock and Warrants related to Exhibits 4.4 and 4.5
- 4.8* Form of Conditional Warrant to Purchase 6% Convertible Debentures and Warrants to Purchase Common Stock
- 4.9** Form of 12% Convertible Debenture Due 2005
- 4.10** Form of Warrant to purchase shares of Common Stock granted to holders of 12% Convertible Debentures Due 2005
- 10.1 Stock Purchase Agreement dated May 5, 1997 by and between Interactive Technologies Corporation, Inc. and Airtech International Corporation (incorporated by reference to Exhibit 10.5 to Company's Annual Report filed on August 28, 1997 for the year ended May 31, 1997, file No. 19796)
- 10.2* Employment Agreement dated May 1, 1997 between the Company and C.J. Comu
- 10.3* Employment Agreement dated May 1, 1997 between the Company and John Potter
- 10.4*Form of Franchise Agreement relating to franchises offered by Airsopure International Group, Inc., a wholly-owned subsidiary of the Company
- 10.5*Form of Development Agreement offered to franchisees by Airsopure International Group, Inc., a wholly-owned subsidiary of the Company
- 10.6*Form of Offering Circular presented to franchisees by Airsopure International Group, Inc., a wholly-owned subsidiary of the Company
- 21** Subsidiaries of the Registrant

o Incorporated by reference to the Company's Registration Statement on Form SB-2 filed on May 8, 2000, Registration No. 333-36554.

** Incorporated by reference to the Company's Form 10-K/SB filed September 14, 2000.

Item 6. Exhibits and Reports on Form 8-K

(b) Reports on Form 8-K

None

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SIGNATURES

In accordance with the requirements of the Securities Act of 1934, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized and in the capacity as the registrant's Chief Executive officer and Chief Financial and Accounting Officer, respectively.

Dated: October 15, 2001

AIRTECH INTERNATIONAL GROUP, INC.

By: /s/ C. J. COMU

C. J. Comu,
Chief Executive Officer and Chairman

By: /s/ James R. Halter

James R. Halter,
Chief Financial, Accounting Officer
and Director