AQUACELL TECHNOLOGIES INC
Form 10QSB
February 13, 2004

U. S. SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Form 10-QSB

(Mark one)

__X__ Quarterly report under Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended December 31, 2003.

_____ Transition report under Section 13 or 15(d) of the Exchange Act
For the transition period from ______ to ______

Commission file number 1-16165

AQUACELL TECHNOLOGIES, INC.
(Exact Name of Small Business Issuers as Specified in its Charter)

Delaware	33-0750453
(State of Incorporation)	(IRS employer identification number)

10410 Trademark Street
Rancho Cucamonga, CA 91730
(Address of Principal Executive Offices)

(909) 987-0456
(Issuer's Telephone Number, Including Area Code)

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes __X__ No _____

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY
PROCEEDING DURING THE PRECEDING FIVE YEARS

Check whether the registrant filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Exchange Act after the distribution of Securities under a plan confirmed by a court.
Yes _____ No _____

APPLICABLE ONLY TO CORPORATE ISSUERS

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

Common Stock, $.001 par value	12,004,558 shares outstanding as of February 13, 2004.

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

AQUACELL TECHNOLOGIES, INC.

FORM 10-QSB

FOR THE QUARTER ENDED DECEMBER 31, 2003

TABLE OF CONTENTS

PART I - FINANCIAL INFORMATION

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

AQUACELL TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEET
December 31, 2003
(Unaudited)

ASSETS	
Current assets:	
Cash	$ 359,000

Notes receivable, including accrued interest of $1,000	24,000
Accounts receivable, net of allowance of $25,000	71,000
Inventories	373,000
Prepaid expenses and other current assets	103,000
Total current assets	930,000
Property and equipment, net	30,000
Other assets:	
Goodwill	1,042,000
Patents, net	87,000
Security deposits	13,000
Total other assets	1,142,000
	$ 2,102,000
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Accounts payable	$ 386,000
Accrued expenses	446,000
Preferred stock dividend payable	16,000
Customer deposits	1,000
Current portion of deferred payable- derivative	20,000
Current portion of long-term debt	4,000
Total current liabilities	873,000
Deferred payable-derivative, net of current portion	514,000
Long-term debt, net of current portion	1,000
Total liabilities	1,388,000
Commitments and contingencies	
Stockholders' Equity:	
Preferred stock - Class A, par value $.001; 1,870,000 shares authorized; 1,141,667 shares issued and outstanding	1,000
Preferred stock, par value $.001; 8,130,000 shares authorized; no shares issued	
Common stock, par value $.001; 40,000,000 shares authorized; 11,597,588 shares issued and outstanding	12,000
Additional paid-in capital	18,407,000
Accumulated deficit	(15,405,000)
	3,015,000
Unamortized deferred compensation	(2,301,000)
Total stockholders'equity	714,000
	$ 2,102,000

See notes to condensed consolidated financial statements.

AQUACELL TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2003	2002	2003	2002
Revenue:				
Net sales	$ 199,000	$ 204,000	$ 400,000	$ 1,134,000
Rental income............	1,000	2,000	1,000	4,000
	200,000	206,000	401,000	1,138,000
Cost of sales	148,000	139,000	277,000	604,000
Gross profit	52,000	67,000	124,000	534,000
Selling, general and administrative expenses:				
Salaries and wages.......	402,000	283,000	701,000	593,000
Legal, accounting and other professional expenses	50,000	30,000	100,000	104,000
Consulting fees and expenses-research and development	47,000	-	62,000	-
Stock based compensation.	227,000	55,000	602,000	100,000
Fair value adjustment of derivative	187,000	-	394,000	-
Write-off of accrued interest on notes	48,000	-	48,000	-
Other	319,000	245,000	574,000	522,000
	1,280,000	613,000	2,481,000	1,319,000
Loss from operations before other (expense) income ..	(1,228,000)	(546,000)	(2,357,000)	(785,000)
Other (expense) income:				
Interest expense	-	(18,000)	-	(22,000)
Interest income	-	14,000	1,000	32,000
	-	(4,000)	1,000	10,000
Net loss for the period ...	$(1,228,000)	$ (550,000)	$(2,356,000)	$ (775,000)
Weighted average shares outstanding- basic and				

diluted	10,697,000	8,601,000	10,023,000	8,601,000
Loss attributable to common stockholders:				
Net loss	$(1,228,000)	$ (550,000)	$(2,356,000)	$ (775,000)
Preferred stock dividends	16,000	-	32,000	-
Loss attributable to common stockholders	$(1,244,000)	$ (550,000)	$(2,388,000)	$ (775,000)
Net loss per common share	$ (0.12)	$ (0.06)	$ (0.24)	$ (0.09)

See notes to condensed consolidated financial statements.

AQUACELL TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended December 31,	
	2003	2002
Cash flows from operating activities:		
Net loss	$(2,356,000)	$ (775,000)
Adjustment to reconcile net loss to net cash used in operating activities:		
Write-off of accrued interest on notes receivable.	48,000	-
Fair value adjustment of derivative	394,000	-
Stock based compensation	602,000	100,000
Depreciation and amortization	27,000	31,000
Changes in:		
Accounts receivable	3,000	(258,000)
Accrued interest receivable	20,000	(32,000)
Prepaid expenses and other current assets	20,000	115,000
Inventories	(295,000)	(10,000)
Accounts payable	(349,000)	29,000
Accrued expenses	(55,000)	416,000
Customer deposits	(22,000)	16,000
Net cash used in operating activities	(1,963,000)	(368,000)
Cash flows from investing activities:		
Notes issued for purchase of property and equipment, net of payments	(2,000)	9,000
Collections on notes receivable	68,000	-
Purchase of property and equipment	(2,000)	(11,000)
Net cash provided by (used in) investing activities	64,000	(2,000)

Cash flows from financing activities:		
Proceeds from private placements of common stock .	2,555,000	-
Expenses of offerings	(259,000)	-
Preferred stock dividends paid	(28,000)	
Exercise of stock options and warrants	38,000	
Proceeds of loans from finance company, net of repayments	-	282,000
Proceeds (repayments) of loans from related parties	(80,000)	39,000
Net cash provided by financing activates	2,226,000	321,000
Increase (decrease) in cash	$ 327,000	$ (49,000)
Cash, beginning of period	32,000	51,000
Cash, end of period	$ 359,000	$ 2,000

Supplemental disclosure of cash flow information:		
Cash paid for interest	$ -	$ -
Supplemental schedule of non-cash investing and financing activities:		
Conversion of inventory to depreciable assets for advertising program	$ 6,000	& -
Issuance of common stock and warrants for services to the company	$ 2,564,000	$ 43,000
Principal payments on notes receivable by conversion of accrued officers salaries	$ -	$ 284,000
Dividends payable on preferred stock	$ 16,000	
Retirement of 82,422 shares of treasury stock	$ -	$ 251,000
Write-off of notes receivable against reserve	$ 177,000	$ -
Conversion of 43,333 shares of preferred stock to common stock	$ -	$ -

See notes to condensed consolidated financial statements

AQUACELL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2003 (Unaudited)

NOTE A - BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements include the accounts of AquaCell Technologies, Inc. and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with instructions to Form 10-QSB. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. The results of operations for the six months ended December 31, 2003 are not necessarily indicative of the results to be expected for the full year. For further information, refer to the Company's annual report filed on Form 10-KSB for the year ended June 30, 2003.

NOTE B - NOTES RECEIVABLE

At December 31, 2003, the notes receivable consisted of a note with a balance of $23,000 due from a non-director/non-employee stockholder. The note, bearing an annual interest rate of 8%, is unsecured and matured October 2002. The note that matured in October 2002 was extended for one year. In July 2003 the Company received a $68,000 principal payment plus accrued interest on this note and extended the remaining balance to June 30, 2004.

At December 31, 2003, notes receivable from non-director/non-employee stockholders and entities owned by them, in the amount of $177,000, were written off against the balance of the reserve against these notes in the amount of $177,000. Accrued interest of $48,000, in connection with these notes, was also written off at December 31, 2003.

Interest receivable at December 31, 2003 amounted to $1,000.

NOTE C - INVENTORIES

Inventories consist of the following at December 31, 2003:

Raw materials	$ 225,000
Work in progress	148,000
	$ 373,000

AQUACELL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2003 (Unaudited)

NOTE D - PROPERTY AND EQUIPMENT

Property and equipment is summarized as follows at December 31, 2003:

Furniture and fixtures	$ 35,000
Equipment - office	96,000
Machinery and equipment	122,000

Rental units	9,000
Leasehold improvements	10,000
Truck	11,000
Coolers placed for advertising program......	7,000
	290,000
Less accumulated depreciation	260,000
	$ 30,000

NOTE E - LONG TERM DEBT

At December 31, 2003 long-term debt consists of an installment note, secured by a truck, payable in monthly payments of $342 through February 2005. Maturities on the note are as follows:

Year ending:	
December 31, 2004............	$ 4,000
December 31, 2005............	1,000
	$ 5,000

NOTE F - EQUITY TRANSACTIONS

During July through September 2003 the Company completed a private placement of 1,703,000 shares of its common stock. The offering consists of one share of common stock at a price of $1.50 per share and one common stock purchase warrant exercisable at $4.00 per share. The warrant contains a call feature. The Company received proceeds of $2,296,000 net of expenses of $259,000. In connection with the offering the placement agent received 341,000 common stock purchase warrants exercisable at $4.00 per share.

During August 2003 the Company entered into marketing and consulting agreements with five separate entities. Consideration for these agreements included cash fees of $45,000 and 1,250,000 warrants to purchase shares of common stock of the Company at a price of $.01 per share. These warrants were valued at $2,564,000 utilizing the Black-Scholes valuation method. Such amount will be amortized to expense over the term of the agreements. Amortization amounted to $533,000 for the six months ended December 31, 2003.

AQUACELL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2003 (Unaudited)

NOTE G - DERIVATIVE

For the six months ended December 31, 2003, the Company recognized a $394,000 charge for the fair value of its put option to Corbett Water Technologies, Inc. and S & B Technical Products, Inc., regarding the return and cancellation of all exclusive distribution and marketing rights , which was classified as a derivative (See Note K(2) to Form 10-KSB). As of December 31, 2003 $602,000 has been liquidated through sales of 284,078 shares. The Company has calculated fair value of the unliquidated balance of the put option on the unsold shares (167,729) using the Black Scholes valuation method utilizing the following assumptions: risk-free interest rate of 3.1%, volatility of 88% and expected life of five months at December 31, 2003.

NOTE H - CONCENTRATION OF CREDIT RISK

The Company's financial instruments that are exposed to concentration of credit risk consists of cash. Such amounts are in excess of FDIC insurance limits.

6

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

Forward-Looking Statements

When used in this Form 10-QSB and in future filings by the Company with the Commission, statements identified by the words "believe", "positioned", "estimate", "project", "target", "continue", "will", "intend", "expect", "future", "anticipates", and similar expressions express management's present belief, expectations or intentions regarding the Company's future performance within the meaning of the Private Securities Litigation Reform Act of 1995. Readers are cautioned not to place undue reliance on any such forward-looking statements, each of which speaks only as of the date made. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. The Company has no obligations to publicly release the result of any revisions which may be made to any forward-looking statements to reflect anticipated or unanticipated events or circumstances occurring after the date of such statements.

Overview

The following discussions and analysis should be read in conjunction with the Company's condensed consolidated financial statements and the notes presented following the condensed consolidated financial statements. The discussion of results, causes and trends should not be constructed to imply any conclusion that such results or trends will necessarily continue in the future.

During the six months ended December 31, 2003 the Company raised net equity of $2,296,000 to enable the Company to move forward with the restructuring of its marketing program for its patented self-filling water coolers. A component of this program includes the cooler advertising program through its Aquacell Media subsidiary whereby the Company has started shipping and installing coolers in drug stores and health care facilities. Aquacell Media will retain ownership of these coolers and is selling advertising on the cooler's bottle band for health related and/or personal care items.

For the six months ended December 31, 2003 revenues were $401,000 representing a decrease of $737,000 from the same period of the prior year. Virtually the entire decrease was attributable to the lack of sales to Corbett Water Technologies, Inc. (Corbett) the Company's former exclusive distributor of its patented self-filling water coolers. The Company went through a lengthy negotiation process to recover its marketing rights, from Corbett and its parent company S & B Technical Products, Inc. (S&B), during which time the Company was impeded from pursuing new marketing avenues or channels of distribution. As a direct result of the Corbett and S&B distribution agreements and return of the exclusive marketing rights, the Company has incurred significant non-cash losses, aggregating $2,040,000 through December 31, 2003, since the inception of these agreements in October of 2001.

The period ended December 2003 represented the first period during which the Company has had the ability to restructure its marketing plan and form new sales and marketing alliances. As a part of this restructuring, we have engaged several new marketing partners, including internationally renowned security experts Beau Dietl & Associates, providing access to major corporations for the marketing and sales of our products that we expect to come to fruition over the next several months and provide significant revenues for the Company.

7

The Company is embarking on additional opportunities which we believe will provide long-term benefits to the Company.

The Company does not anticipate incurring significant marketing costs as it intends to utilize channels of distribution where the selling groups will be responsible for payment of their own sales and marketing expenses.

Results of Operations

During the six months ended December 31, 2003 on a consolidated basis, revenues were $401,000 as compared to $1,138,000 for the similar period of the preceding year resulting from the negotiation for the return of the exclusive distribution rights, from Corbett and S&B, discussed in the overview section.

On a consolidated basis, gross margin decreased to 31% for the six months ended December 31, 2003 as compared to 47% for the same period of the prior year. This decrease is attributable to the decrease in sales of the Company's patented self-filling water coolers as a result of its lengthy negotiations to recapture its exclusive marketing rights from Corbett and S&B and the restructuring of its marketing program as discussed in the Overview section. The majority of sales for the quarter were sales of systems build and sold by the Company's Water Science Technologies subsidiary which operates at a lower gross profit margin.

Net loss on a consolidated basis, attributable to common stockholders, for the six months ended December 31, 2003 was $2,388,000 or $0.24 per share, as compared to $775,000 or $.09 per share for the same period of the prior year. The increase in the loss is attributable to the decrease in revenues. Principal sources of the loss in the aggregate amount of $1,044,000 resulted from stock based compensation in the amount of $602,000, a fair value adjustment of a derivative in the amount of $394,00, and write-off of accrued interest on notes receivable in the amount of $48,000.

Salaries and wages increased by $108,000 for the six months ended December 31, 2003 over the prior year. Legal, accounting and other professional expenses decreased by approximately $4,000 for the six months ended December 31, 2003. Consulting fees and expenses in connection with the research and development of new business opportunities amounted to $62,000 for the six months ended December 31, 2003. Stock based compensation increased by $502,000 to $602,000 for the six months ended December 31, 2003 resulting from amortization of Black Scholes charges on common stock purchase warrants issued in connection with marketing and consulting agreements initiated during the period ended December 31, 2003. Other selling, general and administrative expenses, consisting primarily of rent - $78,000, telephone and utilities- $34,000, travel- $24,000, business promotion- $67,000, insurance- $52,000, and vehicle expenses-$53,000 increased by approximately $52,000 to $574,000 for the six months ended December 31, 2003.

During the six months ended December 31, 2003, the Company recorded a fair value adjustment of a derivative, in connection with a put option relating to the return and cancellation of all exclusive distribution and marketing rights from Corbett and S&B in the amount of $394,000.

Liquidity and Capital Resources

During the six months ended December 31, 2003 we raised, through the completion of a private placement of our common shares, net equity of approximately $2,296,000.

Cash used by operations during the six months ended December 31, 2003 amounted to $1,963,000. Net loss of $2,361,000 was reduced by non-cash stock based compensation in the amount of $602,000, write-off of accrued interest on notes receivable in the amount of $48,000, fair value adjustment of a derivative in the amount of $394,000 and depreciation and amortization of $27,000. Cash used by operations was further increased by an increase in inventories, in anticipation of business growth, in the amount of $295,000 and a decrease in accounts payable in the amount of $349,000. Net loss was further increased by net changes in accrued interest receivable, prepaid expenses, accrued expenses, customer deposits and accounts receivable amounting to $29,000.

Cash provided by investing activities during the six months ended December 31, 2003 represented collections on a note receivable in the amount of $68,000 decreased by expenditures for property and equipment in the amount of $2,000 and decreased by payments on notes issued for the purchase of equipment in the amount of $2,000.

Cash provided by financing activities was approximately $2,226,000. Proceeds from sales of common stock in a private placement amounted to $2,296,000 net of expenses of $259,000. Proceeds from exercise of stock options amounted to $38,000. The Company paid dividends of $28,000 on its Series A convertible preferred stock and the repayment of loans to related parties amounted to $80,000.

We have granted warrants in connection with our initial public offering, private placements, consulting, marketing and financing agreements that may generate additional capital of up to approximately $14,900,000 if exercised. There is no assurance however, that any of the warrants will be exercised.

In connection with the written put option regarding the return and cancellation of all exclusive distribution and marketing rights from Corbett and S&B reflected as a derivative in the accompanying financial statements, the Company has adjusted its liability to $534,000 at December 31, 2003. Such amount represents the fair value of liability in the event that the counterparty does not realize $1,339,000 from the sale of its shares owned in the Company. The net remaining obligation, if any, will be paid from 5% of future revenues to be generated by the Company's Global Water-Aquacell, Inc. subsidiary.

Management believes that its present cash balance and cash flows expected to be generated from future operations in combination with warrant conversions or future equity raises will be sufficient to meet presently anticipated needs for working capital and capital expenditures through at least the next 12 months; however, there can be no assurance in that regard. The Company presently has no material commitments for future capital expenditures.

9

ITEM 3. CONTROLS AND PROCEDURES

Within the 90 days prior to the date of this Report the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's chief executive officer and chief financial officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Rule 13a-14 adopted under the Securities Exchange Act of 1934. Based upon that evaluation, the chief executive officer and chief financial officer concluded that the Company's disclosure controls and procedures are effective. There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

PART II. OTHER INFORMATION

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

During the period covered by this Report on Form 10-QSB certain matters were submitted to a vote of security holders through the solicitation of proxies:

a) The Company held its annual meeting of stockholders on December 2, 2003.

b) One matter voted upon at the meeting was the election of two Company directors, to wit, James C. Witham and Glenn A. Bergenfield. The Company's three other directors, namely Karen B. Laustsen, Dr. William DiTuro, and Gary S. Wolff continued in office after the meeting.

c) Additional matters voted upon at the meeting were the appointment of Wolinetz, Lafazan & Company, PC as the Company's independent auditors; the ratification of an amendment to the Company's 1998 Incentive Stock Plan; and the ratification of the issuance of 1,703,031 shares of common stock in connection with a private placement completed in September, 2003 to comply with AMEX Rule 713. With respect to the election of Mr. Witham and Mr. Bergenfield as directors, Mr. Witham received 5,718,324 votes with 87,317 votes withheld and no abstentions. Mr. Bergenfield received 5,668,109 votes in favor of election with 137,532 votes withheld and no abstentions. Wolinetz, Lafazan & Company, PC was elected as the Company's independent auditors receiving 5,802,409 votes with 3,232 votes withheld and no abstentions. The amendment to the Company's 1998 Incentive Stock plan was passed, receiving 5,707,323 votes with 98,318 votes withheld and no abstentions. The ratification of the issuance of 1,703,031 shares of common stock in a private placement was passed, receiving 5,644,624 votes with 161,017 votes withheld and no abstentions. There were no broker non-votes recorded.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

A. Exhibits.

31.1 CEO's Certification Pursuant to Rule 13a-14(a)/15d-14(a)

31.2 CFO's Certification Pursuant to Rule 13a-14(a)/15d-14(a)

32.0 Certification Pursuant to 18 U.S.C. Section 1350

B. Reports on Form 8-K.

None.

SIGNATURE

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

AquaCell Technologies, Inc.

Registrant

Date: February 13, 2004

/s/ Gary S. Wolff

Name: Gary S. Wolff
Title: Chief Financial Officer

INDEX TO EXHIBITS

Exhibit Number	Description
31.1	CEO's Certification Pursuant to Rule 13a-14(a)/ 15d-14(a)
31.2	CFO's Certification Pursuant to Rule 13a-14(a)/ 15d-14(a)
32.0	Certification Pursuant to 18 U.S.C. Section 1350