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VIEW SYSTEMS INC
Form 10QSB
August 02, 2004

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

FORM 10-QSB

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

For the quarterly period ended June 30, 2004

TRANSITION REPORT PURSUANT SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

Commission File Number 0-30178

VIEW SYSTEMS, INC.
(Exact name of small business issuer as specified in its charter)

Nevada 59-2928366
(State of incorporation) (I.R.S. Employer Identification No.)

1100 Wilso Drive
Baltimore, Maryland 21223
(Address of principal executive offices)

(410) 646-3000
(Issuer's telephone number)

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

Yes No

As of July 26, 2004 View Systems, Inc. had 70,085,352 shares of common stock
outstanding.

Transitional small business disclosure format: Yes No

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PART I: FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

The financial information set forth below with respect to our statements of operations for the three and six month periods ended June 30, 2004 and 2003 is unaudited. This financial information, in the opinion of management, includes all adjustments consisting of normal recurring entries necessary for the fair presentation of such data. The results of operations for the six month period ended June 30, 2004 are not necessarily indicative of results to be expected for any subsequent period.

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View Systems, Inc.
Consolidated Financial Statements
June 30, 2004

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View Systems, Inc. and Subsidiaries
Consolidated Balance Sheets

ASSETS

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| | June 30, 2004 | December 31, 2003 |
|--|------------------|----------------------|
| | ----- | ----- |
| | (unaudited) | |
| Current Assets | | |
| Cash | \$ 19,506 | \$ 19,899 |
| Accounts Receivable (Net of Allowance of \$81,000) | 239,852 | 225,088 |
| Inventory | 93,241 | 93,241 |
| | ----- | ----- |
| Total Current Assets | 352,599 | 338,228 |
| | ----- | ----- |
| Property & Equipment (Net) | 27,203 | 44,693 |
| | ----- | ----- |
| Other Assets | | |
| Licenses | 1,626,854 | 1,626,854 |
| Due from Affiliates | 98,457 | 98,457 |
| Deposits | 4,819 | 4,819 |
| | ----- | ----- |
| Total Other Assets | 1,730,130 | 1,730,130 |
| | ----- | ----- |
| Total Assets | \$ 2,109,932 | \$ 2,113,051 |
| | ===== | ===== |

LIABILITIES AND STOCKHOLDERS' EQUITY

| | | |
|---|--------------|--------------|
| Current Liabilities | | |
| Accounts Payable | \$ 480,200 | \$ 648,714 |
| Accrued Expenses | 131,717 | 115,515 |
| Accrued Interest | 60,500 | 55,000 |
| Notes Payable | 111,885 | 131,500 |
| | ----- | ----- |
| Total Current Liabilities | 784,302 | 950,729 |
| | ----- | ----- |
| Stockholders' Equity | | |
| Preferred Stock, Authorized 10,000,000 Shares, \$.01 Par Value, Issued and Outstanding | - | - |
| Common Stock, Authorized 100,000,000 Shares, \$.001 Par Value, Issued and Outstanding 69,403,752 and 62,730,619, respectively | 69,404 | 62,730 |
| Additional Paid in Capital | 16,406,420 | 15,604,609 |
| Retained Earnings (Deficit) | (15,150,194) | (14,505,017) |
| | ----- | ----- |
| Total Stockholders' Equity | 1,325,630 | 1,162,322 |
| | ----- | ----- |
| Total Liabilities and Stockholders' Equity | \$ 2,109,932 | \$ 2,113,051 |
| | ===== | ===== |

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(Unaudited)

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|-------------------------------------|--|--------------|--------------------------------------|--------------|
| | 2004 | 2003 | 2004 | 2003 |
| Revenues, Net | \$ 158,041 | \$ 146,485 | \$ 192,394 | \$ 212,175 |
| Cost of Sales | 73,872 | 67,454 | 106,198 | 94,990 |
| Gross Profit (Loss) | 84,169 | 79,031 | 86,196 | 117,185 |
| Operating Expenses | | | | |
| Research & Development | - | 1,342 | - | 11,432 |
| General & Administrative | 325,100 | 175,821 | 380,678 | 285,797 |
| Professional Fees | 57,955 | (36,595) | 82,174 | 40,469 |
| Salaries & Benefits | 106,639 | 112,021 | 240,210 | 243,066 |
| Total Operating Expenses | 489,694 | 251,247 | 703,062 | 580,764 |
| Net Operating Income (Loss) | (405,525) | (172,216) | (616,866) | (463,579) |
| Other Income (Expense) | | | | |
| Interest Expense | (25,297) | (2,957) | (28,311) | (5,966) |
| Total Other Income (Expense) | (25,297) | (2,957) | (28,311) | (5,966) |
| Net Income (Loss) | \$ (430,822) | \$ (175,173) | \$ (645,177) | \$ (469,545) |
| Net Income (Loss) Per Share | \$ (0.01) | \$ (0.00) | \$ (0.01) | \$ (0.01) |
| Weighted Average Shares Outstanding | 64,523,490 | 45,275,619 | 63,671,982 | 44,937,195 |

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View Systems, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(Unaudited)

For the Six Months
Ended June 30,

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| | 2004 | 2003 |
|--|--------------|--------------|
| | ----- | ----- |
| Cash Flows from Operating Activities: | | |
| Net Income (Loss) | \$ (645,177) | \$ (469,545) |
| Adjustments to Reconcile Net Loss to Net Cash Provided by Operations: | | |
| Depreciation & Amortization | 17,490 | 119,370 |
| Stock Issued for Services | 239,380 | - |
| Change in Operating Assets and Liabilities: | | |
| (Increase) Decrease in: | | |
| Accounts Receivable | (14,764) | (67,355) |
| Inventories | - | 71,386 |
| Increase (Decrease) in: | | |
| Accounts Payable | (168,514) | (68,079) |
| Accrued Expenses | 32,507 | 5,500 |
| | ----- | ----- |
| Net Cash Provided(Used) by Operating Activities | (539,078) | (408,723) |
| Cash Flows from Investing Activities: | | |
| Advances (to)/ receipt from related party | - | 4,500 |
| | ----- | ----- |
| Net Cash Provided (Used) by Investing Activities | - | 4,500 |
| Cash Flows from Financing Activities: | | |
| Funds advanced (to) from stockholders | 491,685 | 317,500 |
| Proceeds from stock issuance | 47,000 | 86,550 |
| | ----- | ----- |
| Net Cash Provided (Used) by Financing Activities | 538,685 | 404,050 |
| | ----- | ----- |
| Increase (Decrease) in Cash | (393) | (173) |
| Cash and Cash Equivalents at Beginning of Period | 19,899 | 3,229 |
| | ----- | ----- |
| Cash and Cash Equivalents at End of Period | \$ 19,506 | \$ 3,056 |
| | ===== | ===== |
| Cash Paid For: | | |
| Interest | \$ - | \$ - |
| Income Taxes | \$ - | \$ - |
| Non-Cash Activities: | | |
| Stock Issued for Notes Payable and Accrued Interest | \$ 522,105 | \$ - |
| Stock Issued for Services | \$ 239,380 | \$ - |

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View Systems, Inc. (the Company) has elected to omit substantially all footnotes to the financial statements for the six months ended June 30, 2004 since there have been no material changes (other than indicated in other footnotes) to the information previously reported by the Company in their Annual Report filed on the Form 10-KSB for the twelve months ended December 31, 2003.

UNAUDITED INFORMATION

The information furnished herein was taken from the books and records of the Company without audit. However, such information reflects all adjustments which are, in the opinion of management, necessary to properly reflect the results of the interim period presented. The information presented is not necessarily indicative of the results from operations expected for the full fiscal year.

COMMON STOCK

During February 2004, the Company issued 200,000 shares of common stock for services valued at \$52,000.

During February 2004, the Company issued 44,500 shares of common stock for cash of \$10,000.

During March 2004, the Company issued 709,500 shares of common stock for services valued at \$151,980.

During March 2004, the Company issued 200,000 shares of common stock for cash of \$25,000.

During April 2004, the Company issued 33,333 shares of common stock for cash of \$5,000.

During May 2004, the Company issued 27,000 shares of common stock for cash of \$4,000.

During May 2004, the Company issued 31,250 shares of common stock for services valued at \$5,000.

During June 2004, the Company issued 160,000 shares of common stock for services valued at \$30,400.

During June 2004, the Company issued 24,000 shares of common stock for cash of \$3,000.

During June 2004, the Company issued 5,221,050 shares of common stock for notes payable and accrued interest of \$522,105.

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In this report references to "View Systems," "we," "us," and "our" refer to View Systems, Inc.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

The Securities and Exchange Commission ("SEC") encourages companies to disclose forward-looking information so that investors can better understand

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future prospects and make informed investment decisions. This report contains these types of statements. Words such as "may," "will," "expect," "believe," "anticipate," "estimate," "project," or "continue" or comparable terminology used in connection with any discussion of future operating results or financial performance identify forward-looking statements. You are cautioned not to place undue reliance on the forward-looking statements, which speak only as of the date of this report. All forward-looking statements reflect our present expectation of future events and are subject to a number of important factors and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

Executive Overview

View Systems develops and manufactures computer software and hardware for security and surveillance capabilities. Management believes that heightened attention to terrorism and other security threats will likely continue to drive growth in the market for security products. During the past year our revenues were primarily from sales of our VideoMaxx Digital Video product line and SecureScan Concealed Weapons Detection product lines. While we experienced a drop in revenues for the first quarter of 2004, revenues increased 360% in the second quarter of 2004 compared to the first quarter of 2004.

During the second quarter of 2004, sales of our ViewMaxx Digital Video have been steady, demonstrating the continuing market growth in closed circuit television surveillance products. We have entered into new market segments with this product and are concentrating on local sales and services.

We combined our SecureScan technology with School Technology Management, Inc.'s attendance program technology and the second phase of testing of the combined technology produced positive results. These positive results lead the National Institute of Justice to provide \$500,000 to fund further development of the SecureScan technology. A portion of this funding will go to the Idaho National Engineering and Environmental Laboratory, a portion to the further refinement of the sensor circuitry and we will receive a portion. In addition, \$600,000 has been committed by the Department of Energy for a cooperative research and development agreement related to the SecureScan technology for new and more sensitive magnetometers at a reduced cost. We will receive the new technology and this change will result in reduced manufacturing costs, a wider portal opening size and improved object recognition ability.

We rely on revenues, private financing and sales of common stock to fund our operations. While we have increased our revenues during the second quarter of 2004, we have incurred losses for the past two fiscal years and have an accumulated deficit of \$15,150,194 at June 30, 2004. Our auditors have expressed doubt that we can continue as a going concern based on these factors. Management believes we will incur operating losses for the near future while we continue to expand our product line and develop our sales and marketing channels. Management continues to seek additional funding of up to \$2 million to continue our business plan development during the next twelve months. However, we can not assure you that we will be successful at obtaining the necessary funding to continue this development.

For the next twelve months our primary challenge will be to more fully develop our product line and our sales and distribution network. During the first quarter of 2004 we entered into a cooperative research and development agreement with the U.S. Department of Energy's Idaho National Engineering and Environmental Laboratory ("Idaho Engineering Lab") for our FirstView Wireless Camera System, a first responder long range video

transmission system. During the second quarter of 2004 we set up a complete manufacturing line in the Baltimore, Maryland facility for building, testing and further development of the FirstView Wireless Camera product. We sold and delivered two FirstView units to organizations in Boston, Massachusetts who were involved with security for the Democratic national convention and we have received additional orders for this product.

Along with development of our product lines, we must establish a sales and distribution channel program for the United States. Our emphasis will be on marketing and sales programs through dealer channels, plus internal direct sales for our products, where applicable. We intend to build a United States domestic network of manufacturing representatives and dealers for the sale and distribution of our products within the 48 states. Our initial focus will be in the Mid-Atlantic and Northeast regions. In recent months we signed three new dealers for our products; however, we cannot assure you that we will be able to develop these sales and distribution channels to a level which will result in increased revenues or continued profitability. Some of the major distributors of safety products who have become our dealers and manufacturer representatives will be adding our products to their GSA schedules.

Another major emphasis for the next twelve months is to continue our SecureScan manufacturing cost reduction objectives. We reduced manufacturing costs of the SecureScan product by 25% in the first quarter of 2004. We intend to select key expensive components of the SecureScan system and replace them with performance equivalent, less expensive parts. The final phase of the manufacturing cost reductions will be cost reduction per unit in the fabrication of the gradiometer sensors. In addition, we anticipate completing circuitry conversions to fully digital signal processing from digital to analog and back to digital, along with replacing over-engineered housings in the SecureScan portals. We also intend to reduce assembly time and testing times to save additional manufacturing costs.

Liquidity and Capital Resources

For the short term management believes that revenues and additional financing will provide funds for operations and development of our business plan. For the long term, management expects that the development of our sales channels will increase our revenues; however, we will need to continue to raise additional funds through loans and sales of our common stock, as needed.

Operations - Our cash inflows are not sufficient to fund our day-to-day operations. Net cash used by operating activities for the six month period ended June 30, 2004 ("2004 six month period") was \$539,078 compared to net cash used by operating activities of \$408,723 for the six month period ended June 30, 2003 ("2003 six month period").

Financing - Historically, we have financed our operations primarily through revenues and private financing. We estimate that we will require additional financing of approximately \$500,000 to \$1 million to meet our needs for the next twelve months. Our goal is to use this financing to increase ongoing operations to self-sustaining levels and increase profits to the magnitude management feels is achievable. The first phase of our financing plan is to acquire a \$250,000 bridge loan that we will use to continue manufacturing the FirstView Wireless Camera product in our Baltimore, Maryland facility. The second phase involves the acquisition of \$500,000 in the next six months to increase sales and manufacturing personnel to support a national sales channel, lower manufacturing unit costs of the our products and continue

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development of an integrated application of the SecureScan technology with School Technology Management Inc.'s student time and attendance system.

Net cash provided by financing activities for the 2004 six month period was \$538,685 compared to \$404,050 for the 2003 six month period. The 2004 six month period financing activities consisted of advances from shareholders of \$491,685 and \$47,000 in proceeds received from sales of common stock. The 2003 six month period financing activities consisted of advances from shareholders of \$317,500 and \$86,550 in proceeds received from sales of stock.

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We intend to use any available cash to develop our products and expand our sales, marketing and promotional activities. Management believes that it will be essential to continue to raise additional capital, both internally and externally, to compete in our markets. We cannot assure you that we will be able to obtain financing on favorable terms and we may be required to further reduce expenses and scale back our operations. In addition to accessing the public and private equity markets, we will pursue bank credit lines and equipment leases for certain capital expenditures, if necessary.

Commitments and Contingent Liabilities

Our primary commitment is our operating lease for the manufacturing facility in Baltimore, Maryland. Our rent for this facility is \$2,260 per month with an annual escalator of 3%. Our total current liabilities of \$784,302 at June 30, 2004 include accounts payable of \$480,200, accrued expenses of \$131,717, accrued interest of \$60,500 and notes payable of \$111,885.

Off-balance Sheet Arrangements - None.

Results of Operations

The following discussions are based on the consolidated financial statements of View Systems and its subsidiaries. These charts and discussions summarize our financial statements for the three and six month periods ended June 30, 2003 and 2004 and should be read in conjunction with the financial statements, and notes thereto, included with this report at Item I, Part 1, above.

2003 and 2004 Interim Period Summary of Operations

| | Six months ended June 30, 2003 | Six months ended June 30, 2004 | Three months ended June 30, 2003 | Three months ended June 30, 2004 |
|------------------------------|--------------------------------------|--------------------------------------|--|--|
| | ----- | ----- | ----- | ----- |
| Revenues, net | \$ 212,175 | \$ 192,394 | \$ 146,485 | \$ 158,041 |
| Cost of sales | 94,990 | 106,198 | 67,454 | 73,872 |
| Gross profit | 117,185 | 86,196 | 79,031 | 84,169 |
| Total operating expenses | 580,764 | 703,062 | 251,247 | 489,694 |
| Net operating loss | (463,579) | (616,866) | (172,216) | (405,525) |
| Total other income (expense) | (5,966) | (28,311) | (2,957) | (25,297) |
| Net income (loss) | (469,545) | (645,177) | (175,173) | (430,822) |

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Net income (loss)
per share \$ (0.01) \$ (0.01) \$ (0.00) \$ (0.01)

Revenues for the 2004 six month period decreased 9.3% compared to the 2003 six month period and costs of sales increased 11.8% in the 2004 six month period compared to the 2003 six month period. As a result of the decreases in revenues and increases in cost of sales, our gross profit decreased 26.4% for the 2004 six month period compared to the 2003 six month period

Revenues for the three month period ended June 30, 2004 ("2004 second quarter") increased 7.9% compared to the three month period ended June 30, 2003 ("2003 second quarter") and costs of sales increased 9.5% in the 2004

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second quarter compared to the 2003 second quarter. As a result of these increases our gross profit increased 6.5% in the 2004 second quarter compared to the 2003 second quarter.

During the 2004 six month period total operating expense increased 21.0% compared to the 2003 six month period. During the 2004 second quarter total operating expense increased 94.9% compared to the 2003 second quarter. The increases for the 2004 periods were primarily the result of a increases in general and administrative expenses related to common shares issued for services in the 2004 six month period and increases in professional fees for technical and business consultants in the same period.

As a result of decreases in our gross profit and increases in our total operating expenses, our net operating loss increased 33.1% for the 2004 six month period compared to the 2003 six month period. Increases in gross profit for the 2004 second quarter were offset by the increases in our total operating expenses and resulted in our net operating loss increasing 135.5% for the 2004 second quarter compared to the 2003 second quarter.

Total other expense, which represents interest expense, increased in the 2004 periods primarily due to loans received in those periods.

Our net loss for the 2004 six month period increased 37.4 % in comparison to our net loss for the 2003 six month period and our net loss for the 2004 second quarter increased 145.9% in comparison to our net loss for the 2003 second quarter. Our net loss per share was \$0.01 for the 2004 and 2003 six month periods and the 2004 second quarter, but was \$0.00 for the 2003 second quarter.

Summary of Balance Sheet

| | For year ended December 31, 2003 | Quarter ended June 30, 2004 |
|----------------------|-------------------------------------|--------------------------------|
| | ----- | ----- |
| Cash | \$ 19,899 | \$ 19,506 |
| Total current assets | 338,228 | 352,599 |
| Total assets | 2,113,051 | 2,109,932 |

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| | | |
|---------------------------|--------------|--------------|
| Total current liabilities | 950,729 | 784,302 |
| Accumulated deficit | (14,505,017) | (15,150,194) |
| Total stockholders equity | \$ 1,162,322 | \$ 1,325,630 |

As of June 30, 2004 we had negative working capital of \$431,703. Our total current assets increased slightly from the year ended December 31, 2003, primarily due to increases in accounts receivable. At June 30, 2004 we own property and equipment valued at \$27,203 and licenses related to our technology valued at \$1,626,854. Our total current liabilities have decreased at June 30, 2004, compared to December 31, 2003, primarily due to conversion of debt of \$522,105 into common shares during the 2004 second quarter (See Part II, Item 2, for further details.)

Factors Affecting Future Performance

Our independent auditors have expressed concern whether we can continue as a going concern.

We have incurred ongoing operating losses and do not currently have financing commitments in place to meet expected cash requirements for the next twelve months. Our net loss for the six month period ended June 30, 2004 was \$645,177 and our net loss for the year ended December 31, 2003 was \$2,546,334. Our accumulated deficit

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was \$15,150,194 at the six month period ended June 30, 2004. We are unable to fund our day-to-day operations through revenues alone and management believes we will incur operating losses for the near future while we seek financing commitments during the next twelve months to fund further development of our business plan. While we have expanded our product line and expect to establish new sales channels, we may be unable to increase revenues to the point that we attain and are able to maintain profitability.

We may need additional external capital and may be unable to raise it.

Based on our current growth plan we believe we may require \$500,000 to \$1 million additional financing within the next twelve months to remain competitive in our market. Our success will depend upon our ability to access equity capital markets and borrow on terms that are financially advantageous to us. However, we may not be able to obtain additional funds on acceptable terms. If we fail to obtain funds on acceptable terms, then we might be forced to delay or abandon some or all of our business plans or may not have sufficient working capital to develop products, finance acquisitions, or pursue business opportunities. If we borrow funds, then we could be forced to use a large portion of our cash reserves, if any, to repay principal and interest on those funds. If we issue our securities for capital, then the interests of investors and shareholders will be diluted.

We are currently dependent on the efforts of our resellers for our continued growth and must expand our sales channels to increase our revenues.

We are in the process of developing and expanding our sales channels, but we expect overall sales to remain down as we develop our marketing activities. If we are unsuccessful in developing sales channels then we may have to abandon our business plan. We are actively recruiting and adding other

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additional resellers and must continue to recruit additional resellers and find other methods of distribution to increase customers.

ITEM 3. CONTROLS AND PROCEDURES

Our Chief Executive Officer who also acts in the capacity of principal financial officer has concluded that the disclosures related to the effectiveness of our disclosure controls and procedures and our internal control over financial reporting made in our annual report on Form 10-KSB, filed April 14, 2004, remain accurate.

PART II: OTHER INFORMATION

ITEM 2: CHANGES IN SECURITIES

The following discussion describes all securities sold by View Systems without registration during the second quarter of 2004 through a recent date, unless previously reported.

On July 9, 2004 we issued an aggregate of 805,600 common shares to investors for cash. We issued 100,000 shares to David Hume, 81,600 shares to Guy Parr, 600,000 shares to Donald Koerner, and 24,000 shares to Duane Anderson. We relied on an exemption from registration for a private transaction not involving a public distribution provided by Section 4(2) of the Securities Act.

On June 21, 2004 we issued an aggregate of 5,221,050 common shares to convert notes payable with accrued interest totaling \$522,105. We issued 1,246,440 shares to Compass Equity Partners, 3,039,000 shares to Niki Group and 935,610 shares to First Equity Holdings Corp. We relied on an exemption from registration for a private transaction not involving a public distribution provided by Section 4(2) of the Securities Act.

During the three month period ended June 30, 2004, we issued an aggregate of 84,333 shares to three investors for \$12,000 cash. We relied on an exemption from registration for a private transaction not involving a public distribution provided by Section 4(2) of the Securities Act.

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On June 3, 2004 we issued an aggregate of 160,000 shares in consideration for services valued at \$30,400. We issued 100,000 shares to Barry Feldman and 60,000 shares to Liem Nguyen. We relied on an exemption from registration for a private transaction not involving a public distribution provided by Section 4(2) of the Securities Act.

On May 11, 2004 we issued 31,250 common shares valued at approximately \$5,000 to InCap Group, Inc. in consideration for services. We relied on an exemption from registration for a private transaction not involving a public distribution provided by Section 4(2) of the Securities Act.

ITEM 5: OTHER INFORMATION

In June 2004, our Secretary and Chairman of the Board, William D. Smith, resigned those positions due to family health problems. Our board of directors appointed our director, Michael L. Bagnoli, as Secretary of the company, but Chairman of the Board has not been filled as of the date of this filing. The office of President remains vacant and our board of directors intends to fill that position as soon as practicable.

