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COMMODORE APPLIED TECHNOLOGIES INC

Form 10-Q

August 14, 2001

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q

(Mark One)

X                   QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
-----  
                  SECURITIES EXCHANGE ACT OF 1934  
                  For the quarterly period ended June 30, 2001  
                                                          OR  
-----  
                  TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
                  THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 1-11871

COMMODORE APPLIED TECHNOLOGIES, INC.  
-----

(Exact name of Registrant as specified in its charter)

Delaware  
-----  
(State or other jurisdiction of  
incorporation or organization)

11-3312952  
-----  
(I.R.S. Employer  
Identification No.)

2121 Jamieson Avenue, Suite 1406  
Alexandria, Virginia  
-----  
(Address of principal executive office)

22314  
-----  
(Zip Code)

Registrant's telephone number, including area code: (703) 567-1284  
-----

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

The number of shares the common stock outstanding at August 10, 2001  
was 55,086,153.

COMMODORE APPLIED TECHNOLOGIES, INC.

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## PART I - FINANCIAL INFORMATION

### ITEM 1: Financial Statements -----

#### COMMODORE APPLIED TECHNOLOGIES, INC. AND SUBSIDIARIES

#### CONDENSED CONSOLIDATED BALANCE SHEET (Dollars in Thousands, except per share data)

|                                                                                                           | June 30,<br>2001<br>-----<br>(unaudited) | December 31,<br>2000<br>----- |
|-----------------------------------------------------------------------------------------------------------|------------------------------------------|-------------------------------|
| ASSETS                                                                                                    |                                          |                               |
| Current Assets:                                                                                           |                                          |                               |
| Cash and cash equivalents                                                                                 | \$ 3,274                                 | \$ 1,980                      |
| Accounts receivable, net                                                                                  | 1,977                                    | 4,536                         |
| Prepaid assets and other current receivables                                                              | 412                                      | 625                           |
|                                                                                                           | -----                                    | -----                         |
| Total Current Assets                                                                                      | 5,663                                    | 7,141                         |
| Property and equipment, net                                                                               | 1,743                                    | 1,983                         |
| Other assets                                                                                              |                                          |                               |
| Patents and completed technology, net of<br>accumulated amortization of \$683 and<br>\$613, respectively. | 792                                      | 862                           |
| Covenants not to compete, net of<br>accumulated amortization of \$434 and                                 |                                          |                               |

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|                                                                                  |           |           |
|----------------------------------------------------------------------------------|-----------|-----------|
| \$175, respectively.                                                             | 2,191     | 2,450     |
| Goodwill, net of accumulated amortization<br>of \$1,050 and \$419, respectively. | 23,275    | 24,676    |
|                                                                                  | -----     | -----     |
| Total Intangibles                                                                | 26,258    | 27,988    |
| Other Assets                                                                     | 361       | 361       |
|                                                                                  | -----     | -----     |
| Total Assets                                                                     | \$ 34,025 | \$ 37,473 |
|                                                                                  | =====     | =====     |

See notes to condensed consolidated financial statements.

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COMMODORE APPLIED TECHNOLOGIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEET  
(Dollars in Thousands, except per share data)

|                                                                                                                                                                                                                                                                                                                                                                                                     | June 30,<br>2001<br>-----<br>(unaudited) | December 31,<br>2000<br>----- |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------|-------------------------------|
| LIABILITIES AND<br>STOCKHOLDERS' EQUITY                                                                                                                                                                                                                                                                                                                                                             |                                          |                               |
| Current Liabilities:                                                                                                                                                                                                                                                                                                                                                                                |                                          |                               |
| Accounts payable                                                                                                                                                                                                                                                                                                                                                                                    | \$ 1,820                                 | \$ 2,490                      |
| Related party payable                                                                                                                                                                                                                                                                                                                                                                               | 247                                      | 247                           |
| Current portion of long term debt                                                                                                                                                                                                                                                                                                                                                                   | 2,650                                    | 2,650                         |
| Line of credit                                                                                                                                                                                                                                                                                                                                                                                      | 445                                      | 1,459                         |
| Notes payable                                                                                                                                                                                                                                                                                                                                                                                       | 15,857                                   | 14,682                        |
| Other accrued liabilities                                                                                                                                                                                                                                                                                                                                                                           | 2,199                                    | 2,489                         |
|                                                                                                                                                                                                                                                                                                                                                                                                     | -----                                    | -----                         |
| Total Current Liabilities                                                                                                                                                                                                                                                                                                                                                                           | 23,218                                   | 24,017                        |
| Long term debt                                                                                                                                                                                                                                                                                                                                                                                      | 4,104                                    | 5,182                         |
|                                                                                                                                                                                                                                                                                                                                                                                                     | -----                                    | -----                         |
| Total Liabilities                                                                                                                                                                                                                                                                                                                                                                                   | 27,322                                   | 29,199                        |
| Minority interest                                                                                                                                                                                                                                                                                                                                                                                   | 78                                       | 419                           |
| Commitments and contingencies                                                                                                                                                                                                                                                                                                                                                                       | --                                       | --                            |
| Stockholders' Equity                                                                                                                                                                                                                                                                                                                                                                                |                                          |                               |
| Convertible Preferred Stock, Series E & F<br>Par value \$0.001 per share,<br>5% to 12% cumulative dividends,<br>601,700 shares authorized, 445,200 and 556,700<br>shares issued and outstanding<br>as of June 30, 2001 and December 31, 2000<br>respectively.<br>The shares had an aggregate liquidation<br>value of \$5,863 and \$7,332 at<br>June 30, 2001 and December 31, 2000<br>respectively. | --                                       | 1                             |

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Common Stock, par value \$0.001 per share,  
125,000,000 shares authorized, 55,036,153  
and 48,330,385 issued and outstanding,  
At June 30, 2001 and December 31, 2000,  
respectively.

|                                            |           |           |
|--------------------------------------------|-----------|-----------|
|                                            | 55        | 48        |
| Additional paid-in capital                 | 66,720    | 66,495    |
| Accumulated deficit                        | (60,150)  | (58,689)  |
|                                            | -----     | -----     |
| Total Stockholders' Equity                 | 6,625     | 7,855     |
|                                            | -----     | -----     |
| Total Liabilities and Stockholders' Equity | \$ 34,025 | \$ 37,473 |
|                                            | =====     | =====     |

See notes to condensed consolidated financial statements.

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### COMMODORE APPLIED TECHNOLOGIES, INC. AND SUBSIDIARIES

#### CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS (Unaudited - Dollars in Thousands, except per share data)

|                               | Three months ended |                  |
|-------------------------------|--------------------|------------------|
|                               | June 30,<br>2001   | June 30,<br>2000 |
|                               | -----              | -----            |
| Contract revenues             | \$ 3,130           | \$ 4,538         |
| Costs and expenses:           |                    |                  |
| Cost of sales                 | 1,122              | 3,927            |
| Research and development      | 76                 | 354              |
| General and administrative    | 1,350              | 1,065            |
| Depreciation and amortization | 629                | 217              |
| Minority interest             | 177                | -                |
|                               | -----              | -----            |
| Total costs and expenses      | 3,354              | 5,563            |
|                               | -----              | -----            |
| Loss from operations          | (224)              | (1,025)          |
|                               | -----              | -----            |
| Other income (expense):       |                    |                  |
| Interest income               | 8                  | 23               |
| Interest expense              | (583)              | (55)             |
|                               | -----              | -----            |
| Net other income (expense)    | (575)              | (32)             |
|                               | -----              | -----            |
| Loss before income taxes      | (799)              | (1,057)          |

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|                                                       |           |            |
|-------------------------------------------------------|-----------|------------|
| Income taxes                                          | (13)      | -          |
|                                                       | -----     | -----      |
| Net loss                                              | \$ (812)  | \$ (1,057) |
|                                                       | =====     | =====      |
| Loss per share - basic and diluted                    | \$ (0.02) | \$ (0.03)  |
|                                                       | =====     | =====      |
| Number of weighted average shares outstanding (000's) | 52,807    | 31,911     |
|                                                       | =====     | =====      |

See notes to condensed consolidated financial statements.

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COMMODORE APPLIED TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS  
(Unaudited - Dollars in Thousands, except per share data)

|                                                                             | Six months ended |                  |
|-----------------------------------------------------------------------------|------------------|------------------|
|                                                                             | June 30,<br>2001 | June 30,<br>2000 |
|                                                                             | -----            | -----            |
| Cash flows from operating activities:                                       |                  |                  |
| Net loss                                                                    | \$ (1,461)       | \$ (1,8          |
| Adjustments to reconcile net loss to net cash used in operating activities: |                  |                  |
| Depreciation and amortization                                               | 1,257            | 3                |
| Amortization of debt discount                                               | 1,064            |                  |
| Other non-cash charges                                                      | 196              |                  |
| Minority interest                                                           | 429              |                  |
| Changes in assets and liabilities, net of acquisitions:                     |                  |                  |
| Accounts receivable                                                         | 2,609            | 4                |
| Prepaid assets                                                              | 46               | (1               |
| Other assets                                                                | -                |                  |
| Accounts payable                                                            | (670)            | (5               |
| Other liabilities                                                           | (632)            | (5               |
|                                                                             | -----            | -----            |
| Net cash provided/(used) in operating activities                            | 2,838            | (2,2             |
| Cash flows from investing activities:                                       |                  |                  |
| Purchase of equipment                                                       | (57)             | (                |
| Acquisition of patents                                                      | -                | (                |

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|                                                    |          |        |
|----------------------------------------------------|----------|--------|
| Advances to related parties                        | -        | (      |
| Other investments                                  | -        | 3)     |
|                                                    | -----    | -----  |
| Net cash provided/(used) in investing activities   | (57)     | (4     |
| Cash flows from financing activities:              |          |        |
| Increase in (repayment of) line of credit          | (1,014)  | (1     |
| Increase in notes and loans payable                | 1,000    | 1      |
| Payments on notes payable                          | (1,673)  |        |
| Preferred stock dividends                          | -        | (2     |
| Proceeds from sale of preferred stock and warrants | -        | 1,7    |
| Proceeds from sale of common stock                 | 200      | 5      |
|                                                    | -----    | -----  |
| Net cash provided/(used) in financing activities   | (1,487)  | 2,1    |
| Increase (decrease) in cash                        | 1,294    | (6     |
| Cash, beginning of period                          | 1,980    | 1,7    |
|                                                    | -----    | -----  |
| Cash, end of period                                | \$ 3,274 | \$ 1,1 |
|                                                    | =====    | =====  |

See notes to condensed consolidated financial statements.

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### COMMODORE APPLIED TECHNOLOGIES, INC. AND SUBSIDIARIES

#### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

June 30, 2001

#### Note A - Basis of Presentation

The accompanying unaudited condensed consolidated financial statements for Commodore Applied Technologies, Inc. and subsidiaries (the "Company" or "Applied") have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. The financial statement information was derived from unaudited financial statements unless indicated otherwise. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six month periods ended June 30, 2001 are not necessarily indicative of the results that may be expected for the year ending December 31, 2001.

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited financial statements included in the Company's annual report on Form 10-K/A for the year ended December 31, 2000.

Certain prior-year amounts have been reclassified to conform to the

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current year presentation.

The accompanying financial statements have been prepared under the assumption that Applied will continue as a going concern. Such assumption contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. For the period ended June 30, 2001, and the years ended December 31, 2000, 1999 and 1998, Applied incurred losses of \$1,461,000, \$11,441,000, \$3,985,000 and \$13,353,000, respectively. Applied's continuation as a company is dependent upon its ability to generate sufficient cash flow to meet its obligations on a timely basis, to obtain additional financing as may be required, and ultimately to attain profitability. Potential sources of cash include new contracts, external debt, and the sale of new shares of company stock or alternative methods such as mergers or sale transactions. No assurances can be given, however, that Applied will be able to obtain any of these potential sources of cash.

Anticipated losses on contracts are provided for by a charge to income during the period such losses are identified. Changes in job performance, job conditions, estimated profitability (including those arising from contract penalty provisions) and final contract settlements may result in revisions to cost and income and are recognized in the period in which the revisions are determined. Allowances for anticipated losses totaled \$76,000 at December 31, 2000 and June 30, 2001.

The consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. All significant inter-company balances and transactions have been eliminated. The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the 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.

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### Note B - Segment Information

Using the guidelines set forth in SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information", the Company has identified three reportable segments in which it operates, based on the services it provides. The reportable segments are as follows: (i) Commodore Advanced Sciences, Inc., which primarily provides various engineering, legal, sampling, and public relations services to Government agencies on a cost plus basis; (ii) Commodore Solutions, Inc., which is commercializing technologies to treat mixed and hazardous waste; and (iii) Dispute Resolution Management, Inc., which was acquired (81%) on August 30, 2000, provides a package of services to help companies recover financial settlements from insurance policies to defray costs associated with environmental liabilities.

Applied evaluates segment performance based on the segment's net income (loss). Applied's foreign and export sales and assets located outside of the United States are not significant. Summarized financial information concerning Applied's reportable segments is shown in the following table.

Three Months Ended June 30, 2001  
(Dollars in Thousands)

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|                                    | Total     | ASI      | Solution | DRM    |
|------------------------------------|-----------|----------|----------|--------|
|                                    | -----     | ---      | -----    | ---    |
| Contract revenues                  | \$ 3,130  | \$ 1,076 | \$ 83    | \$ 1,9 |
| Costs and expenses                 |           |          |          |        |
| Cost of sales                      | 1,122     | 1,026    | 96       |        |
| Research and development           | 76        | --       | 76       |        |
| General and administrative         | 1,350     | 59       | 71       | 1,0    |
| Depreciation and amortization      | 629       | 19       | 114      |        |
| Minority interest                  | 177       | --       | --       |        |
|                                    | -----     | -----    | -----    | -----  |
| Total costs and expenses           | 3,354     | 1,104    | 357      | 1,0    |
|                                    | -----     | -----    | -----    | -----  |
| Income (loss) from operations      | (224)     | (28)     | (274)    | 9      |
| Interest income                    | 8         | --       | --       |        |
| Interest expense                   | (583)     | (10)     | --       |        |
| Income taxes                       | (13)      | --       | --       | (      |
|                                    | -----     | -----    | -----    | -----  |
| Net income (loss)                  | \$ (812)  | \$ (38)  | \$ (274) | \$ 9   |
|                                    | =====     | =====    | =====    | =====  |
| Total assets                       | \$ 34,025 | \$ 2,478 | \$ 1,604 | \$ 3,4 |
| Expenditures for long-lived assets | \$ 19     | \$ --    | \$ --    | \$     |

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Six Months Ended June 30, 2001  
(Dollars in Thousands)

|                               | Total    | ASI      | Solution | DRM    |
|-------------------------------|----------|----------|----------|--------|
|                               | -----    | ---      | -----    | ---    |
| Contract revenues             | \$ 7,151 | \$ 2,299 | \$ 185   | \$ 4,6 |
| Costs and expenses            |          |          |          |        |
| Cost of sales                 | 1,934    | 1,735    | 199      |        |
| Research and development      | 196      | --       | 196      |        |
| General and administrative    | 3,427    | 439      | 240      | 2,3    |
| Depreciation and amortization | 1,257    | 39       | 231      |        |
| Minority interest             | 429      | --       | --       |        |
|                               | -----    | -----    | -----    | -----  |



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|                                    |            |          |          |        |
|------------------------------------|------------|----------|----------|--------|
| Total costs and expenses           | 7,243      | 2,213    | 866      | 2,4    |
| Income (loss) from operations      | (92)       | 86       | (681)    | 2,2    |
| Interest income                    | 21         | --       | --       |        |
| Interest expense                   | (1,377)    | (36)     | --       |        |
| Income taxes                       | (13)       | --       | --       | (      |
| Net Income (loss)                  | \$ (1,461) | \$ 50    | \$ (681) | \$ 2,2 |
| Total assets                       | \$ 34,025  | \$ 2,478 | \$ 1,604 | \$ 3,4 |
| Expenditures for long-lived assets | \$ 57      | \$ --    | \$ --    | \$     |

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Three Months Ended June 30, 2000  
(Dollars in Thousands)

|                                    | Total      | ASI      | Solution | Co<br>Ov<br>an |
|------------------------------------|------------|----------|----------|----------------|
|                                    | -----      | ---      | -----    | ---            |
| Contract revenues                  | \$ 4,538   | \$ 4,488 | \$ 50    | \$             |
| Costs and expenses                 |            |          |          |                |
| Cost of sales                      | 3,927      | 3,808    | 119      |                |
| Research and development           | 354        | -        | 354      |                |
| General and administrative         | 1,065      | 416      | 20       |                |
| Depreciation and amortization      | 217        | 21       | 96       |                |
| Total costs and expenses           | 5,563      | 4,245    | 589      |                |
| Income (loss) from operations      | (1,025)    | 243      | (539)    |                |
| Interest income                    | 23         | --       | --       |                |
| Interest expense                   | (55)       | (23)     | (32)     |                |
| Net income (loss)                  | \$ (1,057) | \$ 220   | \$ (571) | \$             |
| Total assets                       | \$ 15,190  | \$ 2,941 | \$ 2,624 | \$             |
| Expenditures for long-lived assets | \$ 50      | \$ 12    | \$ -     | \$             |

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Six Months Ended June 30, 2000  
(Dollars in Thousands)

|                                    | Total      | ASI      | Solution   |     |
|------------------------------------|------------|----------|------------|-----|
|                                    | -----      | ---      | -----      | --- |
| Contract revenues                  | \$ 8,870   | \$8,775  | \$ 70      | \$  |
| Costs and expenses                 |            |          |            |     |
| Cost of sales                      | 7,858      | 7,703    | 155        |     |
| Research and development           | 600        | --       | 743        |     |
| General and administrative         | 1,845      | 696      | 19         |     |
| Depreciation and amortization      | 379        | 41       | 138        |     |
| Total costs and expenses           | 10,682     | 8,440    | 1,055      |     |
| Income (loss) from operations      | (1,812)    | 335      | (985)      |     |
| Interest income                    | 39         | --       | --         |     |
| Interest expense                   | (103)      | (56)     | (47)       |     |
| Net income (loss)                  | \$ (1,876) | \$ 279   | \$ (1,032) | \$  |
| Total assets                       | \$ 15,190  | \$ 2,941 | \$ 2,624   | \$  |
| Expenditures for long-lived assets | \$ 119     | \$ 14    | \$ 67      | \$  |

Note C - Contingencies

Applied has matters of litigation arising in the ordinary course of business, which in the opinion of management, will not have a material adverse effect on its financial condition or results of operations.

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ITEM 2. Management's Discussion and Analysis of Financial Condition  
-----  
and Results of Operations  
-----

Overview

Commodore Applied Technologies, Inc. and subsidiaries (the "Company" or "Applied"), is engaged in providing a range of engineering, technical, and financial services to the public and private sectors related to (i) remediating

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contamination in soils, liquids and other materials and disposing of or reusing certain waste by-products by utilizing SET, (ii) the settlement of complex, long-tail and latent insurance claims by utilizing a series of tools including an internally developed risk modeling program, FOCUS, and (iii) providing services related to, environmental management for on-site and off-site identification, investigation remediation and management of hazardous, mixed and radioactive waste.

The Company is currently working on the commercialization of these technologies through development efforts, licensing arrangements and joint ventures. Through Commodore Advanced Sciences, Inc. ("ASI") formerly Advanced Sciences, Inc., a subsidiary acquired on October 1, 1996, the Company has contracts with various government agencies and private companies in the U.S. As some government contracts are funded in one-year increments, there is a possibility for cutbacks as these contracts constitute a major portion of ASI's revenues, and such a reduction would materially affect the operations. However, management believes its existing client relationships will allow the Company to obtain new contracts in the future. Through Dispute Resolution Management, inc. ("DRM"), an 81% owned subsidiary acquired August 30, 2000, the Company has several engagements with various industrial, manufacturing and mining companies in the U.S. and in Europe for the recovery of insurance claims.

### RESULTS OF OPERATIONS

Three and Six Months Ended June 30, 2001 Compared to Three and Six Months Ended June 30, 2000

Revenues were \$3,130,000 and \$7,151,000 for the three and six months ended June 30, 2001, compared to \$4,538,000 and \$8,870,000 for the three and six months ended June 30, 2000. Such revenues were primarily from the Company's two subsidiaries, ASI and DRM.

In the case of DRM, revenues were \$1,971,000 and \$4,667,000 respectively for the three and six months ended June 30, 2001. The Company purchased its 81% interest in DRM on August 30, 2000 and was able to consolidate DRM's revenues and earnings as of that date. Revenues in DRM were primarily from completed settlement agreements between their clients and major insurers. Settlements are the result of 18 to 24 months of effort by various employees of DRM, of which the expenses are captured in general and administrative costs as incurred. Anticipated losses on engagements, if any, will be provided for by a charge to income during the period such losses are first identified.

In the case of ASI, revenues were \$1,076,000 and \$2,299,000 respectively for the three and six months ended June 30, 2001 as compared with \$4,488,000 and \$8,775,000 for the three and six months ended June 30, 2000. The decrease in revenues is primarily due to the completion of a five-year contract to provide technical management support services to the Department of Energy for the opening and operation of the Waste Isolation Pilot Plant near Carlsbad, New Mexico, which ended on December 31, 2000. ASI has been unsuccessful with replacing this contract volume to date. The revenues from ASI consisted of engineering and scientific services performed for the United States government under a variety of contracts, most of which provide for reimbursement of cost

plus fixed fees. Revenue under cost-reimbursement contracts is recorded under the percentage of completion method as costs are incurred and include estimated fees in the proportion that costs to date bear to total estimated costs. Currently, ASI has two major customers, each of which represent more than 10% of total revenue. The combined revenue for these two customers was \$1,076,000 and

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\$2,299,000 respectively (100% of total revenues) for the three and six months ended June 30, 2001. Cost of sales was \$1,026,000 and \$1,735,000 respectively for the three and six months ended June 30, 2001 compared to \$3,808,000 and \$7,703,000 respectively for the three and six months ended June 30, 2000. The decrease in cost of sales is due to a decrease in sales volume in the three and six months ended June 30, 2001.

In the case of Commodore Solution, Inc. ("Solution"), revenues were \$83,000 and \$185,000 respectively for the three and six months ended June 30, 2001 as compared with \$50,000 and \$70,000 respectively for three and six months ended June 30, 2000. The increase is primarily due to the increase in feasibility studies and commercial processing. Revenues were primarily from remediation services performed for engineering and waste treatment companies in the U.S. under a variety of contracts. Solution has two major customers, each of whom represents more than 10% of the revenue for the three and six months ended June 30, 2001. The combined revenue for these two customers was \$83,000 and \$185,000 respectively (100% of the Solution's total revenue) for the three and six months ended June 30, 2001. Cost of sales was \$96,000 and \$199,000 respectively for the three and six months ended June 30, 2001 as compared to \$119,000 and \$155,000 respectively for the three and six months ended June 30, 2000. The increase in cost of sales is attributable to greater sales and marketing expenses for the SET technology, which the Company anticipates will result in greater revenues from Solution in the remainder of 2001. Anticipated losses on engagements, if any, will be provided for by a charge to income during the period such losses are first identified.

For the three and six months ended June 30, 2001, the Company incurred research and development costs of \$76,000 and \$196,000 respectively as compared to \$354,000 and \$600,000 respectively for the three and six months ended June 30, 2000. Research and development costs include salaries, wages, and other related costs of personnel engaged in research and development activities, contract services and materials, test equipment and rent for facilities involved in research and development activities. Research and development costs are expensed when incurred, except those costs related to the design or construction of an asset having an economic useful life are capitalized, and then depreciated over the estimated useful life of the asset. The decrease in research and development expense is due to the continued commercialization focus of the Company.

General and administrative expenses for the three and six months ended June 30, 2001 were \$1,350,000 and \$3,427,000 respectively as compared to \$1,065,000 and \$1,845,000 respectively for the three and six months ended June 30, 2000. This difference is due to DRM's salaries and other expenses.

Interest income was \$8,000 and \$21,000 respectively for the three and six months ended June 30, 2001, as compared to \$23,000 and \$39,000 respectively for the three and six months ended June 30, 2000.

Interest expense for the three and six months ended June 30, 2001 was \$583,000 and \$1,377,000 respectively as compared to \$55,000 and \$103,000 respectively for the three and six months ended June 30, 2000. The increase in interest expense is primarily related to amortization of non-cash interest costs associated with the Company's purchase of 81% of DRM on August 30, 2000, the amortization of non-cash interest costs associated with the Brewer Promissory Note, the amortization of non-cash interest costs associated with the Bridge Loan Notes, and the amortization of non-cash interest costs associated with the Milford/Shaar Bridge Loan Notes.

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### LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2001 and December 31, 2000 ASI had a \$445,000 and \$1,459,000 outstanding balance, respectively, on its revolving lines of credit.

In October 2000, ASI refinanced their line of credit with KBK Financial, Inc. (the "KBK Credit Line"). The KBK Credit Line is not to exceed 85 percent of eligible receivables or \$2,500,000 and is due October 2002 with interest payable monthly at prime plus 2 percent (8.75 percent as of June 30, 2001). The KBK Credit Line is collateralized by the assets of Advanced Sciences and is guaranteed by the Company. The KBK Credit Line contains certain financial covenants and restrictions including minimum ratios that Advanced Sciences must satisfy. ASI was in compliance with the covenants of the KBK Credit Line at June 30, 2001.

In addition, the KBK Credit Line agreement stipulates that no payments shall be made by ASI to the Company other than monthly scheduled payments of principal with respect to the \$8,280,000 subordinated indebtedness owed by ASI to the Company (which is eliminated in consolidation) and intercompany indebtedness not to exceed \$20,000 in any month. In addition, ASI shall not incur indebtedness in excess of \$25,000, other than trade payables, the above subordinated indebtedness and other contractual obligations to suppliers and customers incurred in the ordinary course of business.

For the three and six months ended June 30, 2001, the Company incurred a net loss of \$812,000 and \$1,461,000 respectively as compared to a net loss of \$1,057,000 and \$1,876,000 respectively for the three and six months ended June 30, 2000. For the years ended December 31, 2000, 1999, and 1998, the Company incurred losses and also experienced net cash outflows from operating activities. At June 30, 2001 the Company had working capital deficit of \$17,555,000 and shareholders' equity of \$6,625,000.

In March 2000, the Company completed \$2.0 million in financing through a private placement. The Company issued 226,000 shares of a new Series F Convertible Preferred Stock, convertible into common stock of the Company at the market price, after September 30, 2000 and up through April 30, 2003 at which time it automatically converts to Common Stock. The Series F Convertible Preferred Stock has a variable rate dividend averaging 8.15% over the term of the security.

On September 15, 2000, the Company issued to S. Brewer Enterprises, Inc. (the "SB Enterprises") a 9.75% Secured Promissory Note (the "Brewer Promissory Note") in the aggregate principal amount of \$500,000. In connection with the Brewer Promissory Note, Commodore Environmental Services, Inc., pledged to SB Enterprises 500,000 shares of our common stock owned by Commodore Environmental Services, Inc. as security for the Brewer Promissory Note. The Company shall pay SB Enterprises the interest on a monthly basis in arrears and pay the outstanding principal amount on the earliest to occur (the "Maturity Date") of (i) the sale of the Company's interest in the Teledyne-Commodore, LLC; or (iii) on March 15, 2001. The Brewer Promissory Note may be prepaid at any time without penalty.

On March 15, 2001, SB Enterprises executed an Amended and Restated Promissory Note (the "Restated Brewer Note"), which extended the Maturity Date of the note until December 31, 2001. Additionally, the conversion feature of the Restated Brewer Note was changed to the 5-day average closing price of the Company's common stock prior to a conversion notice. On April 9, 2001 SB Enterprises issued a conversion notice for \$250,000 of the outstanding principal of the Brewer Restated Note. The Company issued SB Enterprises 1,041,667 shares of common stock of the Company as a result of the conversion notice.

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On November 13, 2000, the Company issued and sold to certain investors (the "Investors") 12% Senior Secured Promissory Notes (the "Bridge Loan Notes") in the aggregate principal amount of \$500,000. In connection with the Bridge Loan Notes, Commodore Environmental Services, Inc. issued and sold to the Investors 1,000,000 shares of our common stock owned by Commodore Environmental Services, Inc, at a purchase price of \$.01 per share. We shall pay each Investor the outstanding principal amount, together with all accrued and unpaid interest on the earliest to occur (the "Maturity Date") of (i) the prepayment of the Bridge Loan Notes out of one hundred percent (100%) of the first proceeds received by us as a cash distribution (whether in the form of an intercompany

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dividend, bonus, loan or otherwise) from DRM, or (ii) on February 12, 2001. The Bridge Loan Notes may be prepaid at any time, on five (5) business days prior notice, without penalty. The Company did not pay the Bridge Loan Notes as of the Maturity Date.

On April 16, 2001, the Investors executed a Memorandum of Understanding to extend the payment date of the \$500,000 of Bridge Loan Notes. Three of the holders of the Bridge Loan Notes have granted payment extensions until June 30 and July 31, 2001, while the fourth holder of the Bridge Loan Notes has extended only until May 1, 2001. The Company made the June 30, 2001 payment to three of the holders of the Bridge Loan Notes and made a partial payment to the fourth holder of the Bridge Loan Notes on June 19, 2001. The Company did not make the July 31, 2001 payment to three of the holders of the Bridge Loan Note and has not paid the balance owed to the fourth holder of the Bridge Loan Notes. As of July 02, 2001, the principal balance on the Bridge Loan Notes aggregates to \$225,000.

If the fourth holder of the Bridge Loan Notes declared a default on or after May 1, 2001, the other three holders of the Bridge Loan Notes also are permitted to declare a default. As of August 14, 2001 the Company has not been notified of the holder's intent to declare a default on the Bridge Loan Notes. In connection with the bridge loan extension, the Company issued to the Investors warrants for 500,000 shares of the Company's common stock at an exercise price of \$0.22 per share.

On May 23, 2001, a private investor purchased \$250,000 of the Company's common stock at the market price. The Company issued the private investor 1,923,077 shares of common stock of the Company as a result of the equity purchase. In connection with the purchase of the shares of the Company's common stock, the Company issued the private investor a 2-year warrant for 500,000 shares of the Company's common stock at an exercise price of \$0.22 per share.

On June 13, 2001, the Company issued and sold to Milford Capital Management, Inc. and the Shaar Fund, Ltd. (hereinafter known as "Milford/Shaar") one-year, 15% Senior Secured Promissory Notes (the "Milford/Shaar Bridge Loan Notes") in the aggregate principal amount of \$1,000,000. In connection with the Milford/Shaar Bridge Loan Notes, the Company issued to Milford/Shaar a five-year warrant for 333,333 shares of the Company's common stock at an exercise price of \$0.22 per share. The Company pledged its equipment and SET related intellectual property as collateral for the Milford/Shaar Bridge Loan Notes. The Company shall pay Milford/Shaar principal and interest on a monthly basis in arrears. The Milford/Shaar Bridge Loan Notes may be prepaid at any time without penalty.

The Company has an irrevocable obligation to repurchase from the former shareholders of DRM, by August 30, 2001, that number of 9.5 million shares of the Company's common stock (at a per share price equal to the greater of \$1.50 or the closing price of our common stock 30 days prior to purchase) as shall be

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necessary to provide the holders of such shares with a total of \$14.5 million. As partial security for the payment of such obligation, all of the shares of DRM common stock owned by the Company have been pledged to Messrs. William J. Russell and Tamie P. Speciale, the former sole stockholders of DRM. In the event the Company is unable to make such \$14.5 million payment, when due, the pledgees may foreclose on the DRM stock; in which event the Company would lose its entire equity ownership in the DRM subsidiary.

The Company originally intended to meet its repurchase obligation to the former shareholders of DRM by reacquiring their shares and selling those shares to generate the cash necessary to meet the obligation; however, the Company's ability to effect the repurchase obligation in this manner is heavily dependent on the stock price of the Company's common stock at the time of the repurchase. At August 13, 2001, the closing price of the Company's common stock on the American Stock Exchange, Inc. was \$0.12 per share.

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The Company currently requires additional cash to sustain existing operations and meet the Company's ongoing capital requirements. Excluding the Company's DRM subsidiary, the Company's current monthly operating expenses exceed its cash revenues by approximately \$200,000. The continuation of the Company's operations is dependent in the short term upon its ability to obtain additional financing and, in the long term, to generate sufficient cash flow to meet its obligations on a timely basis, to obtain additional financing as may be required, and ultimately to attain profitability.

The Company intends to meet its long term capital needs through obtaining additional contracts that will generate funds from operations and obtaining additional debt or equity financing as necessary or engaging in merger or sale transactions. There can be no assurance that such sources of funds will be available to the Company or that it will be able to meet its short or long term capital requirements.

### NET OPERATING LOSS CARRYFORWARDS

The Company has net operating loss carryforwards of approximately \$39,000,000. The amount of net operating loss carryforward that can be used in any one year will be limited by the applicable tax laws which are in effect at the time such carryforward can be utilized. A full valuation allowance has been established to offset any benefit from the net operating loss carryforwards. It cannot be determined when or if the Company will be able to utilize the net operating losses.

### FORWARD-LOOKING STATEMENTS

Certain matters discussed in this Quarterly Report are "forward-looking statements" intended to qualify for the safe harbors from liability established by Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These forward-looking statements can generally be identified as such because the context of the statement will include words such as the Company "believes," "anticipates," "expects" or words of similar import. Similarly, statements that describe the Company's future plans, objectives or goals are also forward-looking statements. Such statements may address future events and conditions concerning, among other things, the Company's results of operations and financial condition; the consummation of acquisition and financing transactions and the effect thereof on the Company's business; capital expenditures; litigation; regulatory matters; and the Company's plans and objectives for future operations and expansion. Any such

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forward-looking statements would be subject to the risks and uncertainties that could cause actual results of operations, financial condition, acquisitions, financing transactions, operations, expenditures, expansion and other events to differ materially from those expressed or implied in such forward-looking statements. Any such forward-looking statements would be subject to a number of assumptions regarding, among other things, future economic, competitive and market conditions generally. Such assumptions would be based on facts and conditions as they exist at the time such statements are made as well as predictions as to future facts and conditions, the accurate prediction of which may be difficult and involve the assessment of events beyond the Company's control. Further, the Company's business is subject to a number of risks that would affect any such forward-looking statements. These risks and uncertainties include, but are not limited to, the ability of the Company to commercialize its technology; product demand and industry pricing; the ability of the Company to obtain patent protection for its technology; developments in environmental legislation and regulation; the ability of the company to obtain future financing on favorable terms; and other circumstances affecting anticipated revenues and costs. These risks and uncertainties could cause actual results of the Company to differ materially from those projected or implied by such forward-looking statements.

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### ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

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Not applicable.

## PART II - OTHER INFORMATION

### ITEM 1. Legal Proceedings

There have been no material legal proceedings to which the Company is a party which have not been disclosed in previous filings with the Securities and Exchange Commission. There are no material developments to be reported in any previously reported legal proceedings.

### ITEM 2. Change in Securities

Not applicable.

### ITEM 3. Defaults among Senior Securities

Not applicable.

### ITEM 4. Submission of Matters to a Vote of Security Holders

Not applicable.

### ITEM 5. Other Events

Not applicable.

### ITEM 6. Exhibits and Reports on Form 8 - K

(a) Exhibits - None.



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(b) Reports on Form 8-K - None.

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SIGNATURES

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

Date: August 14, 2001

COMMODORE APPLIED TECHNOLOGIES, INC.  
(Registrant)

By /s/ James M. DeAngelis

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James M. DeAngelis - Senior Vice President  
and Chief Financial Officer (as both a duly  
authorized officer of the registrant and the  
principal financial officer of the registrant)

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