PROFILE TECHNOLOGIES INC
Form 10QSB
May 17, 2004

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

FORM 10-QSB

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended: March 31, 2004

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from ___________________ to _________________

Commission file number
0-21151

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

DELAWARE	91-1418002
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
2 Park Avenue, Suite 201 Manhasset, New York	11030
(Address of Principal Executive Office)	(Zip Code)

516-365-1909
(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 [X] No [ ]

As of April 30, 2004, the number of shares outstanding of the issuer's common stock, the only class of common equity, were 5,491,661.

Transitional Small Business Disclosure Format (Check one): Yes [ ] No [X]

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PART I-- FINANCIAL INFORMATION

Item 1. Financial Statements.

PROFILE TECHNOLOGIES, INC.
Condensed Balance Sheets
(unaudited)

Assets	March 31, 2004	Ju 2
Current assets:		

Cash	$ 21,645	$
Accounts receivable	--	
Contract work-in-progress	--	
Prepaid expenses and other current assets	20,635	
Total current assets	42,280	
Equipment, net	71,317	
Patents, net	31,411	
Other Assets	2,415	
Total assets	$ 147,423	$
Liabilities and Stockholders' Deficit		
Current liabilities:		
Notes payable to stockholders	$ 908,760	$
Accounts payable	266,290	
Deferred wages	308,530	
Other accrued liabilities	196,569	
Total current liabilities	1,680,149	1
Long term convertible debt net of discount of $104,022 at March 31, 2004	33,478	
Stockholders' deficit:		
Common stock, $0.001 par value. Authorized 15,000,000 shares; issued and outstanding 5,461,661 shares at March 31, 2004 and June 30, 2003	5,462	
Additional paid-in capital	8,473,051	8
Accumulated deficit	(10,044,717)	(9
Total stockholders' deficit	(1,566,204)	
Commitments, contingencies and subsequent events		
Total liabilities and stockholders' deficit	$ 147,423	$

See accompanying notes to condensed financial statements

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PROFILE TECHNOLOGIES, INC.
Condensed Statements of Operations
(unaudited)

	For the three months ended March 31,		For the
	2004	2003	2004

Revenues	$ --	$ --	$ 222,579
Cost of revenues	7,667	56,604	172,171
Gross profit (loss)	(7,667)	(56,604)	50,408
Operating expenses:			
Research and development	40,679	45,996	108,545
General and administrative	212,958	242,695	657,500
Total operating expenses	253,637	288,691	766,045
Loss from operations	(261,304)	(345,295)	(715,637
Other income	--	--	1,762
Interest income	--	--	--
Interest expense	13,851	3,813	37,304
Net loss	$ (275,155)	$ (349,108)	$ (751,179
Basic and diluted net loss per share	$ (0.05)	$ (0.06)	$ (0.14
Shares used to calculate basic and diluted net loss per share	5,461,661	5,461,659	5,461,661

See accompanying notes to condensed financial statements

PROFILE TECHNOLOGIES, INC.
Condensed Statements of Cash Flows
(unaudited)

	For the nine month March 31,
	2004
Cash flows from operating activities:	
Net loss	$(751,179)
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization	75,732
Accreted interest and discount on notes payable and convertible debt	1,278
Gain on disposal of fixed assets	--
Stock compensation	18,050
Changes in certain assets and liabilities:	
Accounts receivable	11,310
Prepaid expenses and other current assets	30,098
Other assets	--
Accounts payable	76,387
Deferred wages	161,872
Other accrued liabilities	(5,331)
Net cash used in operating activities	(381,783)

Cash flows used in investing activities:	
Purchase of equipment	(1,820)
Disposal of fixed assets	--
Net cash provided by (used in) investing activities	(1,820)
Cash flows from financing activities:	
Proceeds from issuance of subordinated debt and attached warrants	137,500
Proceeds from issuance of notes payable to stockholders	267,748
Net cash provided by financing activities	405,248
Increase (decrease) in cash	21,645
Cash at beginning of the period	--
Cash at end of the period	$ 21,645
Supplementary disclosure of cash flow information:	
Note payable converted to common stock	$ --
Issuance of stock and warrants previously subscribed	--

See accompanying notes to condensed financial statements

PROFILE TECHNOLOGIES, INC
March 31, 2004
Notes to Condensed Financial Statements
(Unaudited)

1. Description of Business

Profile Technologies, Inc. (the "Company") is in the business of developing and commercializing potential processes for the nondestructive, noninvasive testing of both above ground and buried pipelines for the effectiveness of pipeline cathodic protecting systems and coating integrity. The Company's future revenues are currently dependent upon the market's acceptance of its sole developed process.

2. Basis of Presentation

The unaudited interim condensed financial statements and related notes of the Company have been prepared pursuant to the instructions to Form 10-QSB. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted pursuant to such instructions. The condensed financial statements and related notes should be

read in conjunction with the audited financial statements and notes thereto included in the Company's annual report on form 10-KSB for the year ended June 30, 2003 (filed October 14, 2003). The information furnished reflects, in the opinion of management, all adjustments, consisting of only normal recurring items, necessary for fair presentation of the results of the interim periods presented. Interim results are not necessarily indicative of results for a full year.

3. Stock Based Compensation

The Company has elected to follow the measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations in accounting for its employee stock options rather than the alternative fair value accounting provided for by Statements of Financial Accounting Standards No. 123 (SFAS No. 123), Accounting for Stock Based Compensation. Compensation cost for stock options issued to employees is measured as the excess, if any, of the fair market price of the Company's stock at the date of grant over the amount an employee must pay to acquire the stock. Had compensation cost for the Company's option and warrant awards been determined consistent with SFAS No. 123, the Company's net loss would have been increased to the pro forma amounts indicated below:

	Three months ended March 31		Nine
	2004	2003	2004
Net loss:			
As reported	$ 275,155	$ 349,108	$ 751,1
Plus: stock-based employee compensation expense included in reported net loss	--	--	--
Less: stock based compensation expense determined under fair value based method for all employee rewards	--	--	31,6
Net loss	$ 275,155	$ 349,108	$ 782,7
Net loss per share			
Basic and diluted - as reported	$ (0.05)	$ (0.06)	$ (0.
Basic and diluted - pro forma	$ (0.05)	$ (0.06)	$ (0.

4. Net Loss Per Share

Basic loss per share is computed by dividing the net loss by the weighted average number of common shares outstanding during the period. Diluted loss per share is computed by dividing the net loss by the weighted average number of common and dilutive common equivalent shares outstanding during the period. As

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the Company had a net loss attributable to common shareholders in each of the periods presented, basic and diluted net loss per share are the same.

Excluded from the computation of diluted loss per share for the three and nine months ended March 31, 2004, because their effect would be antidilutive,

are options and warrants to acquire 3,138,818 shares of common stock with a weighted-average exercise price of $1.69. Excluded also from the computation of diluted loss per share for the three and nine months ended March 31, 2003, because their effect would be antidilutive, are options and warrants to acquire 2,853,817 shares of common stock with a weighted-average exercise price of $2.32. For the three and nine months ended March 31, 2004 and 2003, additional potential dilutive securities that were excluded from the diluted loss per share computation are the exchange rights discussed in footnote 5 that could result in options to acquire up to 223,000 shares of common stock with an exercise price of $1.00 per share at March 31, 2004 and March 31, 2003.

5. Notes Payable - Stockholders

In April 2002, the Company issued non-interest bearing bridge notes payable to two officers in the amounts of $15,000 and $7,500, convertible into 21,428 and 10,714 equity units, respectively. Each equity unit is comprised of one share of common stock accompanied by a detachable five-year warrant to purchase an additional share of common stock with an exercise price of $1.05. To the extent that the notes are not converted before maturity, both notes are payable in full when the Company determines it has sufficient working capital to do so. The note in the amount of $15,000 was converted to 21,428 equity units described above in July 2002. On September 29, 2002, the officer owed $7,500 died unexpectedly from a stroke before converting any part of this loan. As of May 15, 2004, the officer's estate had not converted any part of the $7,500 loan into equity units.

The Company has entered into various loan agreements with Murphy Evans, President, a director and stockholder of the Company. On March 6, 2003, the Company's Board of Directors approved the Loan Amendment and Promissory Note (the "Amended Evans Loan") between the Company and Murphy Evans. The Amended Evans Loan aggregates all previous debt and supercedes and replaces all of the terms of the previous loans with Mr. Evans, including any conversion features. The Amended Evans Loan bears interest on the aggregate principal balance at a rate of 5% per annum, payable on June 30 and December 31 of each year, with the principal balance due and payable in full on December 31, 2003.

Accrued interest and the outstanding principal balance of the Amended Evans Loan were $40,382 and $792,990, respectively as of March 31, 2004 and $7,199 and $377,150, respectively as of March 31, 2003. As of March 31, 2004, the accrued interest and outstanding principal balance were due and payable. Due to insufficient funds, the Company has not repaid these amounts. Corresponding interest expense related to the Amended Evans Loan was $9,629 and $27,624 for the three and nine months ended March 31, 2004, respectively and $3,449 and $15,000 for the three and nine months ended March 31, 2003, respectively. All advances from Mr. Evans are convertible into any debt or equity offering by the Company.

Under the terms of a previous loan with Mr. Evans, the Company cancelled 150,000 warrants with exercise prices ranging from $3.00 per share to $7.50 per share (old warrants), previously held by Mr. Evans and issued 150,000 five-year warrants with an exercise price of $1.05 per share and an expiration date of May 13, 2007.

The cancellation of the old warrants is an effective re-pricing and will be accounted for as a "variable plan" until such time as the warrants are exercised, expire or are forfeited. Variable plan accounting will result in intrinsic value associated with the warrants being adjusted to compensation expense based on each reporting period's ending stock value. As of March 31, 2004, no intrinsic value had been recorded related to these warrants as the stock price was below the exercise price.

In September 2002, the Company entered into two non-interest bearing bridge

loans in the respective principal amounts of $40,000 and $10,000 (the "Stockholder Loans") payable to two stockholders of the Company. The terms of the Stockholder Loans provide for payment at such time as the Company determines it has sufficient working capital to repay the principal balances of the Stockholder Loans. The Stockholder Loans are convertible into 57,142 and 14,286 equity units, respectively, at any time prior to re-payment. Each equity unit is comprised of one share of the Company's common stock, with a detachable 5-year warrant to purchase one additional share at an exercise price of $1.05 per share As of May 15, 2004, neither stockholder had converted either Stockholder Loan into equity units.

On June 19, 2003, the Company entered into a promissory note (the "2003 Gemino Note") in the principal amount of $34,047 with Henry Gemino, the Chief Executive Officer, Chief Financial Officer, and a director and stockholder of the Company. The 2003 Gemino Note bears interest at 5% per annum, payable on each June 30 and December 31 of each year, with the principal balance due and payable in full on December 31, 2003. During the nine months ended March 31, 2004, Mr. Gemino loaned the Company an additional $24,223. As of March 31, 2004, accrued interest of $2,068 and the outstanding principal balance of $58,270 were due and payable. Due to insufficient funds, the Company has not repaid these amounts. The note is convertible into any debt or equity offering made by the

Company. Corresponding interest expense related to the 2003 Gemino Note was $734 and $2,068 for the three and nine months ended March 31, 2004, respectively and $0 for both the three and nine months ended March 31, 2003.

The following is a summary of notes payable to stockholders as of March 31, 2004.

Amended Evans Loan	$792,990
Officer Notes	65,770
Stockholder Notes	50,000
Total	$908,760

As of May 15, 2004, the Company has not made the interest payments under the Amended Evans Loan and the 2003 Gemino Note, which were due and payable on June 30, 2003 and December 31, 2003 and did not repay the outstanding principal balance. As of May 15, 2004, neither Mr. Evans nor Mr. Gemino has made any demand for payment, or exercised any remedies, under these notes.

6. Liquidity and Subsequent Event

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. The Company incurred cumulative losses of $10,044,717 through March 31, 2004 and had negative working capital of $1,637,869 as of March 31, 2004. Additionally, the Company has expended a significant amount of cash in developing its technology and patented processes. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management recognizes that in order to meet the Company's capital requirements, and continue to operate, additional financing, including seeking industry-partner investment through joint ventures or other possible arrangements, will be necessary. The Company is evaluating alternative sources of financing to improve its cash position and is undertaking efforts to raise capital. If the Company is unable to raise additional capital or secure additional revenue contracts and generate positive cash flow, it is unlikely

that the Company will be able to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

To reduce cash outflows, certain of the Company's employees, officers and directors have agreed to defer a portion of their salaries and consulting fees from August 2001 until the Company has sufficient resources to pay the amounts owed or to exchange such amounts into options as described below. At March 31, 2004, the Company has accrued approximately $446,430 related to the deferred payment of the salaries and consulting fees of which $308,530 is included under deferred wages and $137,900 in accrued liabilities. On March 18, 2002, the Board of Directors approved a right whereby for each dollar of deferred salary and fees as of that approval date, the employee, officer or director could exchange their deferred amount for an option to purchase two shares of common stock with a five-year term at an exercise price of $1.00 per share. Deferred salaries and fees as of March 18, 2002 were $111,500, resulting in the issuance of 223,000 options under the terms mentioned above. No conversions have occurred to date. As there was no intrinsic value associated with these exchange rights, no additional compensation cost has been recorded.

On June 19, 2003, the Board of Directors approved the offering (the "2003 Offering") of $1,000,000 in convertible debentures (the "Debentures"). The Debentures are convertible into that number of shares of the Company's common stock equal to the amount of the converted indebtedness divided by $0.50 per

share. The Debentures bear interest at a rate of 5% per annum, payable quarterly. The Company is required to redeem each Debenture on the 5th anniversary of the date of the Debenture. The Company may, in its discretion, redeem any Debenture at any time prior to the mandatory redemption date of the Debenture by providing not less than 60 days' prior written notice to the holder of the Debenture.

Upon the purchase of, and for each $0.50 of the Debenture's principal amount, the Company will issue to an investor a warrant (the "Warrant") to purchase one (1) share of the Company's common stock at an exercise price of $0.75 per share. The Warrants will be exercisable at any time prior to the 5th anniversary date of the redemption of the Debenture.

As of March 31, 2004, the Company had raised $137,500 from the 2003 Offering. Warrants issued in connection with the 2003 Offering were recorded as paid-in capital at their fair value, estimated at $95,950, based on an option pricing model with the following assumptions: warrant life of 10 years, risk free interest rates ranging from 3.74% to 4.45%, volatility of 120%, and a zero dividend yield. The remaining value of the Debentures results in a beneficial conversion feature that reduces the book value of the convertible debt to not less than zero. Accordingly, the Company recorded a $105,300 discount on the convertible debt issued under the 2003 Offering. The Company amortizes the discount using the effective interest method over the five-year life of the Debentures. The Company recorded interest expense related to the Debentures of $1,186 and $2,903 for the three and nine months ended March 31, 2004, respectively and $0 for both the three and nine months ended March 31, 2003.

The Board of Directors approved an extension of the 2003 Offering through May 15, 2004. Subsequent to March 31, 2004, the Company raised an additional $107,500 from the 2003 Offering. As of May 15, 2004, the Company has raised a total of $245,000 in the 2003 Offering.

Pending the deployment of the Company's new hardware (as discussed in the "General" section) and the receipt of new contracts, and in an effort to reduce its "burn rate" to the lowest practicable level, the Company has furloughed all of its field crews. If and when revenue- generating contracts are obtained, the Company may re-hire former crew personnel or may hire and train new crews. The Company was not obligated to make any severance payments for salaries, health benefits or accrued vacation and sick time related to the termination of any of its employees.

7. NASDAQ Delisting

In June 2001, the Company announced that it received a Nasdaq Staff Determination, indicating that the Company failed to comply with the minimum bid price and net tangible asset/shareholder equity requirements of the Nasdaq Marketplace Rules for continued listing set forth in Marketplace Rule 4310(c)(4), and that its securities were, therefore, subject to delisting from the Nasdaq SmallCap Market. On August 10, 2001, the Nasdaq Stock Market suspended trading in the Company's common stock. Effective Monday, August 13, 2001, the Company began trading on the Over the Counter Bulletin Board under the symbol PRTK.

Item 2. Management's Discussion of Financial Condition and Results of Operations.

General

Since its formation in 1988, Profile Technologies, Inc., a Delaware corporation (the "Company"), has been engaged in the business of researching and developing a high speed scanning process, which is nondestructive and noninvasive, to test remotely buried, encased and insulated pipelines for corrosion. The Company's electromagnetic wave inspection process, referred to as the Company's "Inspection EMWSM" or "EMW," is a patented process of analyzing the waveforms of electrical impulses in a way that extracts point-to-point information along a segment of pipeline to illustrate the integrity of the entire pipeline. This process involves sending electrical pulses along the pipe being tested from two directions toward a varying intersecting point between the two pulser locations. One or more of the modified pulses is analyzed to determine whether an anomaly exists at the intersecting location.

The EMW process is designed to detect external corrosion of pipelines which occurs under pipe insulation and on buried pipes, without the need for taking the lines out of service, physically removing the insulation or digging up pipes, and then visually inspecting the outside of the pipe for corrosion. The Company often can inspect the pipelines by using various access points to the

pipelines that already exist for other reasons. Where such access is not already available, the Company's technology permits the inspection of pipelines with a minimal amount of disturbance to the coating or insulation on the pipeline. In addition, the Company's technology permits an inspection of the entire pipeline, as opposed to other technologies which only conduct inspections at points selected for the testing. Such "spot inspections" are not necessarily accurate in indicating the overall condition of a pipe segment.

The most common forms of pipeline corrosion under insulation are localized corrosion of carbon steel and chloride stress corrosion cracking of stainless steel. Refineries, chemical plants, utilities, natural gas transmission companies and the petroleum industry have millions of miles of pipeline, and

much of this pipeline is exposed to harsh and severe environments. As a result, there is an on-going effort by these industries to ensure that the quality of the pipe meets standards established by regulatory bodies and the industry to protect operating personnel and the environment.

In the summer of 1998, the Company completed its first commercial contract on the North Slope of Alaska, testing approximately 100 road and carribou crossings on British Petroleum pipelines under a contract with ASCG Inspection, Inc.

In the summer of 1999, the Company followed up its initial Alaska work under a contract with another large multi-national oil company to test approximately 250 below grade pipes. During the summer of 2000, the Company expanded its Alaska efforts by testing a total of 372 below-ground pipes. In 2001, the Company tested 441 lines in Alaska. In 2002, the Company inspected 364 lines.

Based on estimates provided by its customers, the Company originally planned to inspect between 400 and 500 below-grade lines in Alaska in the calendar year 2003. However, based on the Company's final work scopes and the fact that more than 40 lines could not be tested for physical reasons, the Company successfully tested 250 below-grade pipes during the calendar year 2003.

In 2003, the Company's Alaska customers completed a five-year program of inspecting road-crossings and caribou-crossings. It appears that this program will not be budgeted for during 2004, although it may be restored in future years. However, the Company's contracts are still in effect and the Company will continue its efforts to obtain additional work in Alaska.

In anticipation of this possibility, the Company has designed and is now fabricating new hardware for the testing of direct-buried pipe in the lower-48 states. Field testing of the new hardware should be completed during the quarter ended June 30, 2004. If the test results confirm the design capabilities, the Company has agreed to demonstrate those capabilities to a number of eastern U.S. natural gas pipelines and distributors during the summer of 2004 in an effort to secure commercial contracts.

On December 15, 2003, the federal Department of Transportation (DOT) issued regulations under the Pipeline Safety Improvement Act of 2002 requiring regulated companies to gather baseline integrity data on pipelines in so-called "high consequence areas" ("HCA's") initially over a ten-year period and then every seven years thereafter. Based on consultations with industry representatives, the Company believes that its new buried pipe inspection hardware will provide these companies with a superior tool for gathering required baseline integrity data.

There can be no assurance that the new hardware can be successfully tested and deployed on a commercial basis. However, failure to do so could have a serious and material effect on the business and financial condition of the Company.

Pending the deployment of its new hardware and the receipt of new contracts, and in an effort to reduce its out-of-pocket expenses to the lowest practicable level, the Company has furloughed all of its field crews. If and when contracts are obtained, the Company may-re-hire former crew personnel or may hire and train new crews.

Revenues

The Company derives revenue solely from the sale of the EMW inspection technology service. The Company relies upon several employees, including the Chief Executive Officer and the Chief Operating Officer for the Company's sales functions. The Company relies solely upon the employees of the Company to conduct its sales activities.

During the nine months ended March 31, 2004, all of the Company's revenues were attributable to two customers. These customers individually accounted for 9% and 91%, and 36% and 64%, of revenues during the nine months ended March 31, 2004 and 2003, respectively.

Marketing

The Company's sales and marketing strategy includes positioning the Company's EMW technology as the method of choice to detect pipeline corrosion where the pipelines are either inaccessible to other inspection tools or much more costly to inspect with tools other than Profile's EMW inspection. As discussed in the "General" section, upon fabrication and testing of its new buried pipe inspection hardware, the Company intends to concentrate its 2004 marketing efforts on the pipeline and utility buried pipe inspection markets in the lower-48 states, particularly in HCA's.

There can be no assurance that the Company will be successful in concentrating its marketing efforts for the EMW technology on natural gas utility and pipeline markets.

Critical Accounting Estimates and Policies

The discussion and analysis of financial condition and results of operations is based upon the Company's financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including contract revenue recognition and impairment of long-lived assets. The Company bases its estimates on historical experience and on various other assumptions that the Company believes to be reasonable under the circumstances, the results of which form its basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ materially from these estimates under different assumptions and conditions, and such variations may be adverse.

The Company recognizes revenue from service contracts using the percentage-of-completion method of contract accounting. Contract revenues earned are measured using either the percentage-of-contract costs incurred to date to total estimated contract costs or, when the contract is based on measurable units of completion, revenue is based on the completion of such units. Historically, the majority of the Company's revenue has been recognized based on the completion of measurable units. Anticipated losses on contracts, if any, are charged to earnings as soon as such losses can be estimated. Changes in estimated profits on contracts are recognized during the period in which the change in estimate is known. The Company records claims for additional compensation on contracts upon revision of the contract to include the amount to be received for the additional work performed. Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools and repairs, and depreciation costs. Selling, general, and administrative costs are charged to expense as incurred. Service contracts generally extend no more than six months.

The Company reviews long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount which the carrying amount of the asset exceeds the fair value of the asset.

Results of Operations

The Company's operating results depend exclusively on its ability to market its EMW inspection technology. If the Company is not able to automate completely the EMW inspection process and fully implement its new technology, the Company may not be able to obtain future contracts to sell or to license its EMW technology. Since the Company's revenues are derived solely from the marketing and sale of its EMW technology, any failure to obtain future contracts will have a material adverse effect on the business and financial condition of the Company.

Revenues were $0 for the three months and decreased to $222,579 for the nine months ended March 31, 2004, compared to $0 for the three months and $339,609 for the nine months ended March 31, 2003. The Company did not generate any revenues during the three months ended March 31, 2004 and the corresponding period in the previous year due to the fact that the Company typically is unable to work on the North Slope of Alaska during this time period due to adverse weather conditions. The decrease in revenues for the nine months ended March 31, 2004 compared to the corresponding period in 2003 is attributable to the decreased overall work scope in Alaska during the summer and fall of 2003 compared with the same period in 2002.

Cost of revenues decreased to $7,667 for the three months and $172,171 for the nine months ended March 31, 2004, compared to $56,604 for the three months and $256,217 for the nine months ended March 31, 2003. This decrease during both the three and nine month periods is due to the decrease in the Company's overall work scope in Alaska during the summer and fall of 2003 compared with the corresponding period in 2002. As a result of the decrease in work scope, the Company furloughed several key employees during the quarter ended March 31, 2004 who were previously spending time on revenue generating contracts.

The Company incurred a gross loss of $7,667 for the three months and a gross profit of $50,408 for the nine months ended March 31, 2004, compared to a gross loss of $56,604 for the three months and gross profit of $83,392 for the nine months ended March 31, 2003. The decrease in gross loss for the three months ended March 31, 2004 is due to a decrease in contract related travel and equipment expenses. Additionally, the Company did not have any employees working on revenue generating contracts during this period. The decrease in gross profit for the nine months ended March 31, 2004, as compared to the same period in the prior year is primarily due to a lower overall work scope in Alaska during the summer of 2003.

Research and development expenses decreased to $40,679 for the three months and $108,545 for the nine months ended March 31, 2004, compared to $45,996 for the three months and $145,388 for the nine months ended March 31, 2003. The decrease for both the three and nine month periods ended March 31, 2004 compared to the same periods ended March 31, 2003 is attributable to the fact that certain employees spent less time on research and development activities and

more time on general and administrative activities when not working on revenue generating contracts during these periods.

General and administrative expenses decreased to $212,958 for the three months and $657,500 for the nine months ended March 31, 2004, compared to $242,695 for the three months and $688,502 for the nine months ended March 31, 2003. General and administrative costs decreased for the three months ended March 31, 2004 due to certain equipment and patents being fully amortized during the current period. Additionally, there was a general decrease in fees paid for consulting and salary related expenditures as a result of insufficient cash resources and the lay off of certain employees. General and administrative costs remained relatively consistent for the nine months ended March 31, 2004, compared to the same period in the prior year because the Company's cost structure includes a significant amount of fixed costs.

Loss from operations decreased to $261,304 for the three months and $715,637 for the nine months ended March 31, 2004, compared to $345,295 for the three months and $750,498 for the nine months ended March 31, 2003. The decrease for both the three and nine months ended March 31, 2004 compared to the same periods in the prior year is primarily due to a decrease in fees paid for consulting and a general decrease in salary related expenses. Due to insufficient cash resources, the Company has had to restrict expenditures related to both research and development and general and administrative activities. Additionally, the Company furloughed several key employees during the quarter ended March 31, 2004.

Interest expense increased to $13,851 for the three months and $37,304 for the nine months ended March 31, 2004, compared to $3,813 for the three months and $17,701 for the nine months ended March 31, 2003. The increase during the three and nine month periods ended March 31, 2004 is a result of the interest accrued in relation to the notes payable to stockholders described in Note 4 above as well as accreted interest on the convertible debentures as described in Note 5 above.

Liquidity and Capital Resources

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. The Company incurred cumulative losses of $10,044,717 through March 31, 2004, and had negative working capital of $1,637,869 as of March 31, 2004. Additionally, the Company has expended a significant amount of cash in developing its technology and patented processes. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management recognizes that in order to meet the Company's capital requirements, and continue to operate, additional financing, including seeking industry-partner investment through joint ventures or other possible arrangements, will be necessary. The Company is evaluating alternative sources of financing to improve its cash position and is undertaking efforts to raise capital. If the Company is unable to raise additional capital or secure additional revenue contracts and generate positive cash flow, it is unlikely that the Company will be able to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

To reduce cash outflows, certain of the Company's employees, officers and directors have agreed to defer a portion of their salaries and consulting fees from August 2001 until the Company has sufficient resources to pay the amounts owed or to exchange such amounts into options as described below. At March 31,

2004, the Company has accrued approximately $446,430 related to the deferred payment of the salaries and consulting fees of which $308,530 is included under deferred wages and $137,900 in accrued liabilities. On March 18, 2002, the Board of Directors approved a right whereby for each dollar of deferred salary and fees as of that approval date, the employee, officer or director could exchange their deferred amount for an option to purchase two shares of common stock with a five-year term at an exercise price of $1.00 per share. Deferred salaries and fees as of March 18, 2002 were $111,500, resulting in the issuance of 223,000 options under the terms mentioned above. No conversions have occurred to date. As there was no intrinsic value associated with these exchange rights, no additional compensation cost has been recorded.

On June 19, 2003, the Board of Directors approved the offering (the "2003 Offering") of $1,000,000 in convertible debentures (the "Debentures"). The Debentures are convertible into that number of shares of the Company's common stock equal to the amount of the converted indebtedness divided by $0.50 per share. The Debentures bear interest at a rate of 5% per annum, payable quarterly. The Company is required to redeem each Debenture on the 5th anniversary of the date of the Debenture. The Company may, in its discretion, redeem any Debenture at any time prior to the mandatory redemption date of the Debenture by providing no less than 60 days' prior written notice to the holder of the Debenture.

Upon the purchase of, and for each $0.50 of the Debenture's principal amount, the Company will issue to an investor a warrant (the "Warrant") to purchase one (1) share of the Company's common stock at an exercise price of $0.75 per share. The Warrants will be exercisable at any time prior to the 5th anniversary date of the redemption of the Debenture.

As of March 31, 2004, the Company had raised $137,500 from the 2003 Offering. Warrants issued in connection with the 2003 Offering were recorded as paid-in capital at their fair value, estimated at $95,950, based on an option pricing model with the following assumptions: warrant life of 10 years, risk free interest rate of 4.45%, volatility of 120%, and a zero dividend yield. The remaining value of the Debentures results in a beneficial conversion feature that reduces the book value of the convertible debt to not less than zero. Accordingly, the Company recorded a $105,300 discount on the convertible debt issued under the 2003 Offering. The Company amortizes the discount using the effective interest method over the five-year life of the Debentures. The Company recorded interest expense related to the Debentures of $1,186 and $2,903 for the three and nine months ended March 31, 2004, respectively and $0 for both the three and nine months ended March 31, 2003.

The Board of Directors approved an extension of the 2003 Offering through May 15, 2004. Subsequent to March 31, 2004, the Company raised an additional $107,500 from the 2003 Offering. As of May 15, 2004, the Company has raised a total of $245,000 in the 2003 Offering.

The Company's contractual obligations consist of commitments under deferred salaries and fees and repayment of loans payable to certain officers, directors and stockholders. The Company does not have any contractual obligations related to its operating leases. However, the Company expects to continue to incur costs on leased properties, as the Company has extended such leases in the past or will use alternate facilities. As of March 31, 2004, deferred salary and consulting fees were equal to $446,430. The salaries and fees will continue to be deferred until the Company has sufficient resources to pay the amounts owed, or the employees, officers, or directors exchange such amounts as described

above.

As of March 31, 2004, the Company had outstanding loans payable to certain officers, directors and stockholders with principal amounts, in the aggregate, equal to $908,760. The terms of the various notes are described below under "Part II, Item 2, Changes in Securities."

Capital will be expended to support operations until the Company can generate sufficient cash flows from operations. In order for the Company to generate cash flows from operations, the Company must generate additional revenue generating contracts. Management is currently directing the Company's activities towards obtaining additional service contracts, which, if obtained, will necessitate the Company attracting, hiring, training and outfitting qualified technicians. If additional service contracts are obtained, it will also necessitate additional field test equipment purchases in order to provide the services. The Company's intention is to purchase such equipment for its field crews for the foreseeable future, until such time as the scope of operations may require alternate sources of financing equipment. The Company expects that if additional contracts are secured, and revenues increase, working capital requirements will increase. There can be no assurance that the Company's process will gain widespread commercial acceptance within any particular time frame, or at all. The Company will incur additional expenses as it hires and trains field crews and support personnel related to the successful receipt of commercial contracts. Additionally, the Company anticipates that cash will be used to meet capital expenditure requirements necessary to develop infrastructure to support future growth. There can be no assurance that the Company will be able to secure additional revenue generating contracts to provide sufficient cash.

Pending the deployment of the Company's new hardware (as discussed in the "General" section above) and the receipt of new contracts, and in an effort to reduce its expenses to the lowest practicable level, the Company has furloughed all of its field crews. If and when revenue- generating contracts are obtained, the Company will re-hire former crew personnel or may hire and train new crews. The Company was not obligated to make any severance payments for salaries, health benefits or accrued vacation and sick time related to the termination of any of its employees.

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-QSB contains "forward-looking statements." 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 projected future results, future plans, objectives or goals or future conditions or events are also forward looking statements. Actual results are inherently difficult to predict. Any such forward-looking statements are 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.

The forward-looking statements contained in this report are based on current expectations that involve a number of risks and uncertainties. Such forward-looking statements are based on assumptions that the Company will obtain or have access to adequate financing to continue its operations, that the

Company will market and provide products and services on a timely basis, that

there will be no material adverse competitive or technological change with respect to the Company's business, demand for the Company's products and services will significantly increase, that the Company will be able to secure additional fee-for-services or licensing contracts, that the Company's executive officers will remain employed as such by the Company, that the Company's forecast accurately anticipate market demand, and that there will be no material adverse change in the Company's operations, business or governmental regulation affecting the Company or its customers. The foregoing assumptions are based on judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond the Company's control. Although the Company believes the expectations reflected in the forward-looking statements are reasonable, the Company cannot guarantee future results, levels of activity, performance or achievements.

Item 3. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in the Company's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported. The Company's executive officers, including the Company's Chief Executive Officer, who also serves as Chief Financial Officer, and the Chief Operating Officer, are responsible for establishing and maintaining disclosure controls and procedures for the Company. These executives have designed such controls to ensure that all material information related to the Company is made known to them by others within the organization. As of March 31, 2004, the Company's Chief Executive Officer and Chief Operating Officer completed an evaluation of the Company's disclosure controls and procedures, and such evaluation has provided them with reasonable assurance that the Company's disclosure controls and procedures are effective in alerting them in a timely manner to material information required to be included in the Company's periodic filings with the SEC. They did not discover any significant deficiencies or material weaknesses within the controls and procedures that require modification. There were no changes in the Company's internal control over financial reporting identified in connection with the Company's evaluation that occurred during the fiscal quarter ended March 31, 2004 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II-- OTHER INFORMATION

Item 1. Legal Proceedings.

The Company is not a party to any pending or threatened legal proceedings.

Item 2. Changes in Securities.

On March 18, 2002, the Board of Directors approved an offering of 1,000,000 shares of the Company's common stock at a price of $0.70 per share, with attached warrants (the "2002 Offering"). Each warrant entitles the holder to purchase one share of common stock at an exercise price of $1.05 per share until April 4, 2007. The Company did not incur or pay any commissions with respect to offers and sales of securities under the 2002 Offering. The 2002 Offering

terminated on December 31, 2002. As of December 31, 2002, the Company had raised a total of $336,273 from the 2002 Offering. All of the investors were accredited investors. The 2002 Offering is exempt from registration under Section 4(2) of the Securities Act of 1933, as amended (the "Securities Act").

In April 2002, the Company issued non-interest bearing bridge notes payable to two officers in the amounts of $15,000 and $7,500, convertible into 21,428 and 10,714 equity units, respectively. Each equity unit is comprised of one share of common stock accompanied by a detachable five-year warrant to purchase an additional share of common stock with an exercise price of $1.05. These notes are exempt from registration under the Securities Act pursuant to Section 4(2) thereof. To the extent that the notes are not converted before maturity, both notes are payable in full when the Company determines it has sufficient working capital to do so. The note in the amount of $15,000 was converted to 21,428 equity units described above in July 2002. On September 29, 2002, the officer

owed $7,500 died unexpectedly from a stroke before converting any part of this loan. As of May 15, 2004, the officer's estate had not converted any part of the $7,500 loan into equity units.

The Company has entered into various loan agreements with Murphy Evans, President, a director and stockholder of the Company. On March 6, 2003, the Company's Board of Directors approved the Loan Amendment and Promissory Note (the "Amended Evans Loan") between the Company and Murphy Evans. The Amended Evans Loan aggregates all previous debt and supercedes and replaces all of the terms of the previous loans with Mr. Evans, including any conversion features. The Amended Evans Loan bears interest on the aggregate principal balance at a rate of 5% per annum, payable on June 30 and December 31 of each year, with the principal balance due and payable in full on December 31, 2003. The Amended Evans Loan is exempt from registration under Section 4(2) of the Securities Act.

As of March 31, 2004, accrued interest of $40,382 and the outstanding principal balance of $792,990 were due and payable. Due to insufficient funds, the Company has not repaid these amounts. Corresponding interest expense related to the Amended Evans Loan was $9,629 and $27,624 for the three and nine months ended March 31, 2004, respectively and $3,449 and $15,000 for the three and nine months ended March 31, 2003, respectively. All advances from Mr. Evans are convertible into any debt or equity offering by the Company.

Under the terms of a previous loan with Mr. Evans, the Company cancelled 150,000 warrants with exercise prices ranging from $3.00 per share to $7.50 per share (old warrants), previously held by Mr. Evans and issued 150,000 five-year warrants with an exercise price of $1.05 per share and an expiration date of May 13, 2007.

The cancellation of the old warrants is an effective re-pricing and will be accounted for as a "variable plan" until such time as the warrants are exercised, expire or are forfeited. Variable plan accounting will result in intrinsic value associated with the warrants being adjusted to compensation expense based on each reporting period's ending stock value. As of March 31, 2004, no intrinsic value had been recorded related to these warrants as the stock price was below the exercise price.

As of May 15, 2004, the Company has not made the interest payments due on June 30 and December 31, 2003 and did not repay the outstanding principal balance. As of May 15, 2004, Mr. Evans has not made any demand for payment, or exercised any of his remedies, under the Amended Evans Loan.

In September 2002, the Company entered into two non-interest bearing bridge loans in the respective principal amounts of $40,000 and $10,000 (the "Stockholder Loans") payable to two stockholders of the Company. The terms of the Stockholder Loans provide for payment at such time as the Company determines it has sufficient working capital to repay the principal balances of the Stockholder Loans. The Stockholder Loans are convertible into 57,142 and 14,286 equity units, respectively, at any time prior to re-payment. Each equity unit is comprised of one share of the Company's common stock, with a detachable 5-year warrant to purchase one additional share at an exercise price of $1.05 per share. The Stockholder Loans are exempt from registration under Section 4(2) of the Securities Act. As of May 15, 2004, neither stockholder had converted either Stockholder Loan into equity units.

On June 19, 2003, the Board of Directors approved a promissory note (the "2003 Gemino Note") in the principal amount of $34,047 payable to Henry E. Gemino, the Chief Executive Officer, Chief Financial Officer and a director and stockholder of the Company. The 2003 Gemino Note bears interest at the rate of 5% per annum, payable on each June 30 and December 31 of each year. The outstanding balance under the 2003 Gemino Note was due and payable in full on December 31, 2003. During the nine months ended March 31, 2004, Mr. Gemino loand the Company an additional $24,223. The 2003 Gemino Note is exempt from registration under Section 4(2) of the Securities Act. As of March 31, 2004, accrued interest of $2,068 and the outstanding principal balance of $58,270 were due and payable. As of May 15, 2004, the Company had not made the interest payments due on June 30, 2003 or December 31, 2003 and has not repaid the outstanding balance due and payable on December 31, 2003. Mr. Gemino has not made any demand for payment, or exercised any of his remedies under the 2003 Gemino Note.

On June 19, 2003, the Board of Directors approved the offering (the "2003 Offering") of $1,000,000 in convertible debentures (the "Debentures"). The Debentures are convertible into that number of shares of the Company's common stock equal to the amount of the converted indebtedness divided by $0.50 per share. The Debentures bear interest at a rate of 5% per annum, payable quarterly. The Company is required to redeem each Debenture on the 5th

anniversary of the date of the Debenture. The Company may, in its discretion, redeem any Debenture at any time prior to the mandatory redemption date of the Debenture by providing no less than 60 days' prior written notice to the holder of the Debenture.

Upon the purchase of, and for each $0.50 of the Debenture's principal amount, the Company will issue to an investor a warrant (the "Warrant") to purchase one (1) share of the Company's common stock at an exercise price of $0.75 per share. The Warrants will be exercisable at any time prior to the 5th anniversary date of the redemption of the Debenture. The 2003 Offering is exempt from registration under Section 4(2) of the Securities Act.

As of March 31, 2004, the Company had raised $137,500 from the 2003 Offering. The Board of Directors approved an extension of the 2003 Offering through May 15, 2004. Subsequent to March 31, 2004, the Company raised an additional $107,500 from the 2003 Offering. As of May 15, 2004, the Company has raised a total of $245,000 in the 2003 Offering.

Item 3. Defaults Upon Senior Securities.

On March 6, 2003, the Board of Directors approved the terms of the Amended Evans Loan between the Company and Murphy Evans. See "Part II, Item 2, Changes in Securities." The Amended Evans Loan amends and supersedes the indebtedness under all previous loans between Mr. Evans and the Company by aggregating the debt under all of these loans by Mr. Evans into one promissory note bearing interest on the aggregate principal balance at a rate of 5% per annum, payable on June 30 and December 31 of each year. The outstanding balance under the Amended Evans Loan was due and payable in full on December 31, 2003. On June 19, 2003, the Board of Directors approved the 2003 Gemino Note, the terms of which are described above in Item 2, "Changes in Securities."

As of March 31, 2004, the outstanding principal balance of the Amended Evans Loan was equal to $792,990. As of May 15, 2004, the Company has not made the interest payments in the amount of $13,061 and $17,692 which were due and payable to Mr. Evans on June 30, 2003 and December 31, 2003, respectively. As of March 31, 2004, the Company's total arrearage under the Amended Evans Loan with respect to accrued interest payments was equal to $40,382. As of May 15, 2004, Mr. Evans has not made any demand for payment, or exercised any of his remedies, under the Amended Evans Loan.

As of March 31, 2004, the outstanding principal balance of the 2003 Gemino Note was equal to $58,270. As of May 15, 2004, the Company has not made the interest payments in the amount of $0 and $1,334 which were due and payable to Mr. Gemino on June 30, 2003 and December 31, 2003, respectively. As of March 31, 2004, the Company's total arrearage on the 2003 Gemino Note with respect to accrued interest payments was equal to $2,068. As of May 15, 2004, Mr. Gemino has not made any demand for payment, or exercised any of his remedies, under the 2003 Gemino Note.

Item 4. Submission of Matters to a Vote of Shareholders.

None

Item 5. Other Information.

None.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits.

Exhibit 3i	Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Registration Statement on Form SB-2 filed with the Commission on May 10, 1996)

Exhibit 3ii	Bylaws of the Company (incorporated by reference to Exhibit 3.3 to the Company's Registration Statement on Form SB-2 filed with the Commission on May 10, 1996)
Exhibit 31.1	Certification of Henry E. Gemino, as Chief Executive Officer and Chief Financial Officer of the Company, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 31.2	Certification of Philip L. Jones, as Chief Operating Officer of the Company, pursuant to Section 302 of

the Sarbanes-Oxley Act of 2002.

Exhibit 32.1 Certification under Section 906 of the Sarbanes-Oxley Act of 2002 by Henry E. Gemino, as Chief Executive Officer and Chief Financial Officer of the Company.

Exhibit 32.2 Certification under Section 906 of the Sarbanes-Oxley Act of 2002 by Philip L. Jones, as Chief Operating Officer of the Company.

(b) Reports on Form 8-K

None.

SIGNATURES

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.

PROFILE TECHNOLOGIES, INC.
(Registrant)

Date: May 15, 2004

/s/ Henry E. Gemino

Henry E. Gemino
Chief Executive Officer and
Chief Financial Officer