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COMMODORE APPLIED TECHNOLOGIES INC

Form 10-Q/A

November 22, 2005

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

(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, 2005  
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.)

150 East 58th Street, Suite 3238  
New York, New York  
-----  
(Address of principal executive office)

10155  
-----  
(Zip Code)

Registrant's telephone number, including area code: (212) 308-5800

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 .  
-----

Indicate by check mark whether the registrant is an accelerated filer (as defined by Exchange Act Rule 12b-2). Yes \_\_\_ No X.

The number of shares the common stock outstanding at November 21, 2005 was 7,819,185.

Explanatory Note

The purpose of this Amendment No. 1 to the Quarterly Report on Form

## Edgar Filing: COMMODORE APPLIED TECHNOLOGIES INC - Form 10-Q/A

10-Q/A is to restate the Company's consolidated condensed financial statements for the three and six months ended June 30, 2005 (the "Financial Statements") and to modify the related disclosures. Please see Note B and H to the Financial Statements included in the amended Form 10-Q.

The restatement arose from the Company's determination that it had not accounted for the embedded conversion option of the Convertible Secured Note and the Series I Convertible Preferred Stock entered into on April 12, 2005 as embedded derivatives. The Company has determined that the fair value of the embedded derivatives should be recorded as a liability, with any changes in the fair value of the embedded derivatives between reporting dates as a derivative loss or gain, as appropriate. The Company has also shown the effects of the reverse stock split effective August 29, 2005, and has also shown separately the effect of dividends accrued to preferred stockholders on loss per share. Subsequent to the reverse stock split, the effect of dividends accrued to preferred stockholders affected loss per share, due to the reduced number of common shares outstanding.

This amended Form 10-Q/A does not attempt to modify or update any other disclosures set forth in the original Form 10-Q, except as required to reflect the effects of the restatement as described in Note B and H to the Financial Statements included in the amended Form 10-Q/A. Additionally, this amended Form 10-Q/A, except for the restatement information and the effects of the reverse stock split, speaks as of the filing date of the original Form 10-Q and does not update or discuss any other Company developments after the date of the original filing. All information contained in this amended Form 10-Q/A and the original Form 10-Q is subject to updating and supplementing as provided in the periodic reports that the Company has filed and will file after the original filing date with the Securities and Exchange Commission.

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COMMODORE APPLIED TECHNOLOGIES, INC.

FORM 10-Q/A

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PART I - FINANCIAL INFORMATION

ITEM 1: Financial Statements  
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COMMODORE APPLIED TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS  
 (Dollars in Thousands, except per share data)  
 (unaudited)

ASSETS	June 30, 2005 ----- (restated)	December 31, 2004 -----
Current Assets:		
Cash and cash equivalents	\$ 32	\$ 15
Accounts receivable, net	2,364	259
Prepaid assets and other current receivables	15	-
	-----	-----
Total Current Assets	2,411	274
Property and Equipment, net	163	95
	-----	-----
Total Assets	\$ 2,574	\$ 369
	=====	=====

See notes to condensed consolidated financial statements.

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

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LIABILITIES AND STOCKHOLDERS' DEFICIT	June 30, 2005 ----- (restated)	December 31, 2004 -----
Current Liabilities:		
Accounts payable	\$ 1,685	\$ 1,045
Related party payable	255	253
Line of credit	116	-
Notes payable	261	258
Embedded derivative liability	8,651	0
Other accrued liabilities	4,132	5,107
	-----	-----
Total Current Liabilities	15,100	6,663
Long Term Debt	5,096	3,034
	-----	-----
Total Liabilities	20,196	9,697
Commitments and Contingencies	--	--
Stockholders' Deficit		
Convertible Preferred Stock, Series I & H Par value \$0.001 per share, 10% cumulative dividends, Series I, 3% cumulative dividends for Series H 1,550,000 authorized, 1,190,302 shares and 1,001,200 shares issued and outstanding as of June 30, 2005 and December 31, 2004, respectively. The shares had an aggregate liquidation value of \$6,381 and \$3,677 at June 30, 2005 and December 31, 2004, respectively.	1	1
Common Stock, par value \$0.001 per share, 300,000,000 shares authorized, 7,819,185 and 6,717,303 issued and outstanding, at June 30, 2005 and December 31, 2004, respectively.	8	7
Additional Paid-in Capital	68,843	67,503
Accumulated Deficit	(86,211)	(76,576)
	-----	-----
Treasury Stock, 171,875 shares	(17,359) (263)	(9,065) (263)
	-----	-----
Total Stockholders' Deficit	(17,622)	(9,328)
	-----	-----
Total Liabilities and Stockholders' Deficit	\$ 2,574	\$ 369
	=====	=====

See notes to condensed consolidated financial statements.

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(Unaudited - Dollars in Thousands, except per share data)

	Three months ended June 30, 2005 ----- (restated)	Three months ended June 30, 2004 -----	Six months ended June 30, 2005 ----- (restated)
Contract revenues	\$ 2,733	\$ 112	\$ 4,359
Costs and expenses:			
Cost of sales	2,631	255	4,020
Research and development	-	1	-
General and administrative	401	472	961
Depreciation and amortization	6	65	12
Total costs and expenses	----- 3,038	----- 793	----- 4,993
Loss from operations	----- (305)	----- (681)	----- (634)
Other expense:			
Interest expense	(202)	(97)	(350)
Net loss on embedded derivative liability	(8,651)	--	(8,651)
Net other expense	----- (8,853)	----- (97)	----- (9,001)
Loss before income taxes	(9,158)	(778)	(9,635)
Income taxes	--	--	--
Net loss	----- \$ (9,158)	----- \$ (778)	----- \$ (9,635)
Dividends accrued to preferred stockholders	91	73	158
Net loss applicable to common shareholders	----- (9,249)	----- (851)	----- (9,793)
Loss per share - basic and diluted	----- \$ (1.24)	----- \$ (0.13)	----- \$ (1.39)
Number of weighted average shares outstanding (000's) basic and diluted	----- 7,442	----- 6,362	----- 7,021

See notes to condensed consolidated financial statements.

## COMMODORE APPLIED TECHNOLOGIES, INC. AND SUBSIDIARIES

### CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited - Dollars in Thousands, except per share data)

Six months ended  
June 30, June 30,

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	2005 ----- (restated)	2004 -----
Cash flows from operating activities:		
Net loss	\$ (9,635)	\$ (1,447)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	12	129
Amortization of debt discount	-	15
Loss on embedded derivative liability	8,651	-
Changes in assets and liabilities:		
Accounts receivable, net	(2,872)	(26)
Prepaid assets	(15)	(4)
Checks written in excess of cash	-	(13)
Accounts payable	640	(6)
Other liabilities	2,408	500
	-----	-----
Net cash used in operating activities	(811)	(852)
Cash flows from investing activities:		
Purchase of equipment	(72)	-
	-----	-----
Net cash used in investing activities	(72)	0
Cash flows from financing activities:		
Advances from (to) related parties, net	-	43
Increase in (repayment of) line of credit	116	(47)
Increase in notes and loans payable	684	863
Proceeds from sale of common stock	100	-
Proceeds from exercised warrants	-	14
	-----	-----
Net cash provided by financing activities	900	873
Increase (decrease) in cash	17	21
Cash, beginning of period	15	-
	-----	-----
Cash, end of period	\$ 32	\$ 21
	=====	=====

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, 2005

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 generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. The financial statement information was

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derived from unaudited financial statements unless indicated otherwise. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements.

In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the six-month period ended June 30, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005.

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 for the year ended December 31, 2004.

Certain prior-year amounts have been reclassified to conform to the 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 six months ended June 30, 2005, and for the years ended December 31, 2004, 2003, and 2002, Applied incurred losses of \$9,635,000, \$2,404,000; \$2,957,000; and \$5,972,000, respectively. The Company has also experienced net cash inflows (outflows) from operating activities of (\$1,532,000), (\$955,000), and (\$123,000) for the years ended December 31, 2004, 2003 and 2002 respectively. The financial statements do not include any adjustments that might be necessary should Applied be unable to continue as a going concern. Applied's continuation as a going concern 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, 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 \$376,000 and \$376,000 at June 30, 2005 and December 31, 2004, respectively. These allowances are included in other accrued liabilities in the accompanying financial statements.

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In as much as Applied rescinded certain options during 2002 and reissued new options to the option holders, the options are considered variable options and will be revalued each quarter to determine the effect on operations, if any. During the three and six months ended June 30, 2005, no expense has been recognized for the variable options as the fair market value of Applied's common stock at June 30, 2005 was lower than the exercise price of the variable options.

The consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. All significant intercompany balances and transactions have been eliminated. The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the

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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.

The Company accounts for stock-based compensation under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations. No stock-based employee compensation cost is reflected in net income (loss), as all options vested had an exercise price equal to the market value of the underlying common stock on the date of grant or the date of repricing. No options held by employees were issued or vested during the three and six months ended June 30, 2005 and 2004, therefore, there would be no effect on net income and earnings per share if the company had applied the fair value recognition provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation.

### B - Restatement of financial statements

The Company's previously issued condensed consolidated financial statements as of and for the three and six months ended June 30, 2005, have been restated to record the accounting of the embedded conversion option of the Convertible Secured Note and the Series I Convertible Preferred Stock, entered into on April 11, 2005, as embedded derivatives with an increase to current liabilities. As a result of this restatement the Company recorded \$8,651 of additional current liability related to the fair value of the embedded derivatives for the conversion features of the note and the preferred stock, and an additional expense of \$8,651 recorded as loss for the derivative valuation for the three and six months ended June 30, 2005.

The following table summarizes the effect of the restatement reclassification adjustments on the financial statements as of and for the three and six months ended June 30, 2005 (in thousands).

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	Three Months Ended		Six Months E
	June 30, 2005 (Restated)	June 30, 2005 (Previously Reported)	June 30, 2005 (Restated)
Contract revenues	\$ 2,733	\$ 2,733	\$ 4,359
Total costs and expenses	3,038	3,038	4,993
LOSS FROM OPERATIONS	(305)	(305)	(634)
Other expense:			
Interest expense	(202)	(202)	(350)
Net loss on embedded derivative liability	(8,651)	--	(8,651)
NET LOSS	\$ (9,158)	\$ (507)	\$ (9,653)



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	Six Months Ended June 30, 2005	
	(Restated)	(Previously Reported)
	-----	
Total current liabilities	\$ 15,100	\$ 6,702
Total liabilities	20,196	11,545
Accumulated deficit	(86,211)	(77,560)
Total stockholders' deficit	(17,622)	(8,708)

The fair value of the conversion features was calculated as of June 30, 2005, using the Black-Scholes pricing model, with the following inputs:

Dividend yield	-
Volatility	236%
Useful life (years)	3.79
Risk-free interest rate	3.72%

Note C - Supplemental cash flow information

During the three and six month periods ended June 30, 2005, 0 and 5,500 shares of Series E Preferred Stock were converted into 0 and 291,629 shares of the Company's common stock, respectively. During the three and six month periods ended June 30, 2005, the Company paid no dividends on the Series E Preferred Stock conversions. The Company accrued dividends on Preferred Stock Series E for the three and six-month periods ended June 30, 2005, of \$0 and \$24,923 respectively, which is included in Other Accrued Liabilities.

During the three and six month periods ended June 30, 2005, no shares of Preferred Stock Series F were converted into shares of the Company's common stock. The Company accrued dividends on Preferred Stock Series F for the three and six-month periods ended June 30, 2005, of \$0 and \$36,355, respectively, which is included in Other Accrued Liabilities.

On April 12, 2005, the Company entered into an exchange agreement with The Shaar Fund, LTD (the "Shaar Exchange Agreement"). Under terms of the Shaar Exchange Agreement, the Company agreed that Shaar will exchange all of its right, title and interest in and to the remaining outstanding shares of the Series E Preferred and Series F Preferred (including all other accrued and unpaid dividends thereon) for 395,302 shares of the Company's Series I Preferred.

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During the three and six month periods ended June 30, 2005, no shares of Preferred Stock Series H were converted into shares of common stock. The company paid no accrued dividends on Preferred Stock Series H. The Company accrued dividends on Preferred Stock Series H for the three and six-month periods ended June 30, 2005, of \$6,000 and \$12,000, respectively, which is included in Other Accrued Liabilities.

During the three and six month periods ended June 30, 2005, 5,000 and 5,000 shares of Series I Preferred Stock were converted into 6,203,473 and 6,203,473 shares of the Company's common stock, respectively. During the three and six month periods ended June 30, 2005, the Company paid no dividends on the Series I Preferred Stock conversions. The Company accrued dividends on Preferred Stock Series I for the three and six-month periods ended June 30, 2005, of

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\$84,598 and \$84,598 respectively, which is included in Other Accrued Liabilities.

### Note D - Other Accrued Liabilities

Other accrued liabilities consist of the following (in thousands):

	June 30, 2005	December 31, 2004
	(unaudited)	
Compensation and employee benefits	\$ 2,102	\$ 1,876
Dividend payable	153	1,696
Accrued interest	393	664
Subcontractors	674	-
Loss reserve	376	376
Exit and forbearance fees on notes payable	-	219
Related parties	185	185
Other	249	91
	\$ 4,132	\$ 5,107

### Note E - Segment Information

The Company has identified three reportable segments in which it operates, based on the guidelines set forth in the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 131. These three 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) Corporate overhead and other miscellaneous activities.

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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 tables.

Three Months Ended June 30, 2005  
(Dollars in Thousands)

	Total	ASI	Solution	Corporate Overhead and Other
Contract revenues	\$ 2,733	\$ 2,664	\$ 69	\$ --
Costs and expenses				
Cost of sales	2,631	2,578	53	--
Research and development	--	--	--	--
General and administrative	401	19	--	382
Depreciation and amortization	6	6	--	--
	3,038	2,603	53	382

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Income (Loss) from operations	(305)	61	16	(382)
Interest income	--	--	--	--
Interest expense	(202)	--	--	(202)
Net loss on embedded derivative	(8,651)	--	--	(8,651)
Income taxes	--	--	--	--
Net Income (Loss)	<u>\$ (9,158)</u>	<u>\$ 61</u>	<u>\$ 16</u>	<u>\$ (9,235)</u>
Total assets	\$ 2,574	\$ 2,466	\$ 86	\$ 22
Expenditures for long-lived assets	\$ 22	\$ 20	\$ --	\$ 2

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Six Months Ended June 30, 2005  
(Dollars in Thousands)

	Total	ASI	Solution	Corporate Overhead and Other
Contract revenues	\$ 4,359	\$ 4,273	\$ 86	\$ --
Costs and expenses				
Cost of sales	4,020	3,966	54	--
Research and development	--	--	--	--
General and administrative	961	190	16	755
Depreciation and amortization	12	12	--	--
Total costs and expenses	<u>4,993</u>	<u>4,168</u>	<u>70</u>	<u>755</u>
Loss from operations	(634)	105	16	(755)
Interest income	--	--	--	--
Interest expense	(350)	--	--	(350)
Net loss on embedded derivative	(8,651)	--	--	(8,651)
Income taxes	--	--	--	--
Net Income (Loss)	<u>\$ (9,635)</u>	<u>\$ 105</u>	<u>\$ 16</u>	<u>\$ (9,756)</u>
Total assets	\$ 2,574	\$ 2,466	\$ 86	\$ 22
Expenditures for long-lived assets	\$ 72	\$ 70	\$ --	\$ 2

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Three Months Ended June 30, 2004  
(Dollars in Thousands)

	Total	ASI	Solution	Corporate Overhead and Other
Contract revenues	\$ 112	\$ 112	\$ --	\$ --
Costs and expenses				
Cost of sales	255	166	89	--
Research and development	1	--	1	--
General and administrative	472	19	71	382
Depreciation and amortization	65	11	54	--
	-----	-----	-----	-----
Total costs and expenses	793	196	215	382
	-----	-----	-----	-----
Loss from operations	(681)	(84)	(215)	(382)
Interest income	--	--	--	--
Interest expense	(97)	--	--	(97)
Income taxes	--	--	--	--
	-----	-----	-----	-----
Net loss	\$ (778)	\$ (84)	\$ (215)	\$ (479)
	=====	=====	=====	=====
Total assets	\$ 168	\$ 143	\$ 11	\$ 14
Expenditures for long-lived assets	\$ --	\$ --	\$ --	\$ --

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Six Months Ended June 30, 2004  
(Dollars in Thousands)

	Total	ASI	Solution	Corporate Overhead and Other
Contract revenues	\$ 294	\$ 254	\$ 40	\$ --
Costs and expenses				
Cost of sales	507	244	263	--
Research and development	7	--	7	--
General and administrative	918	121	151	646
Depreciation and amortization	129	20	109	--
	-----	-----	-----	-----
Total costs and expenses	1,561	385	530	646
	-----	-----	-----	-----
Loss from operations	(1,267)	(131)	(490)	(646)

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Interest income	--	--	--	--
Interest expense	(180)	--	--	(180)
Income taxes	--	--	--	--
	-----	-----	-----	-----
Net Loss	\$ (1,447)	\$ (131)	\$ (490)	\$ (826)
	=====	=====	=====	=====
Total assets	\$ 168	\$ 143	\$ 11	\$ 14
Expenditures for long-lived assets	\$ --	\$ --	\$ --	\$ --

### Note F - Net loss per common share

Basic net loss per common share ("Basic EPS") excludes dilution and is computed by dividing net loss available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted net loss per common share ("Diluted EPS") reflects the potential dilution that could occur if stock options or other contracts to issue common stock were exercised or converted into common stock. The computation of Diluted EPS does not assume exercise or conversion of securities that would have an anti-dilutive effect on net loss per common share.

Options and warrants to purchase 6,100,297 and 6,168,515 shares of common stock and preferred stock convertible into shares of common stock as of June 30, 2005 and 2004, respectively, were not included in the computation of Diluted EPS. Common stock equivalents from preferred stock convertible into shares of common stock were also not included in the computation of Diluted EPS. The inclusion of the options, warrants and convertible preferred stock would have been anti-dilutive, thereby decreasing net loss per common share.

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### Note G - 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.

### Note H - Derivative Liability Expense

On April 11, 2005, Applied, through the issuance of the Series I Preferred and the Amended and Restated Shaar Note, recorded an embedded derivative liability due to the conversion feature of these financial instruments pursuant to EITF 00-19. Applied recorded a loss of (\$8,651,000) and (\$8,651,000) of non-cash income (expense) for the three and six month periods ended June 30, 2005, respectively. The fair value of the embedded derivatives consisting of conversion features included in a note payable and in the Series I Convertible Preferred Stock is calculated as of the reporting date using the Black-Scholes options pricing model. See Note B.

### Note I - Subsequent Events

#### Reverse Split of Applied Common Shares

On August 29, 2005, at the close of business, the Company effectuated the previously approved reverse stock split with the established a ratio of 1-for 20. Applied common stock began trading on a reverse-split basis on August

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30, 2005. As a result of the reverse stock split, every 20 shares of Applied common stock was combined into one share of Applied common stock. As a result of the reverse stock split, the issued and outstanding shares of Applied common stock were reduced from approximately 156 million shares to approximately 7.8 million shares. The number of authorized shares will not be reduced.

The Company has retroactively reflected the reverse stock split in its common share and loss per share information.

The reverse stock split affected all shares of common stock, stock options and warrants of Applied outstanding as of immediately prior to the effective time of the reverse stock split. Fractional shares of common stock of the Company were not issued as a result of the reverse stock split, but instead, holders of pre-split shares of common stock who otherwise would have been entitled to receive a fractional share as a result of the reverse split received one whole share. Shares of Applied common stock trade on the Nasdaq Over the Counter Bulletin Board Market under the symbol CXIA.

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

#### Overview

The Company is engaged in providing a range of engineering and technical services to the public and private sectors related to (i) remediating contamination in soils, liquids and other materials and disposing of or reusing certain waste by-products by utilizing SET; and (ii) 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 owns technologies related to the separation and destruction of mixed waste, polychlorinated biphenyls (PCBs) and chlorofluorocarbons (CFCs). The Company is currently working on the commercialization of these technologies through development efforts, licensing arrangements and joint ventures. Through Advanced Sciences, 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 Advanced Sciences' revenues, and such a reduction would materially affect the operations. However, management believes Advanced Sciences' existing client relationships will allow the Company to obtain new contracts in the future.

The Company has identified two reportable segments in which it operates, based on the guidelines set forth in the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 131. These two segments are as follows: Commodore Advanced Sciences, Inc., which primarily provides various engineering, legal, sampling, and public relations services to Government agencies on a cost plus basis; and Commodore Solutions, Inc., which is commercializing technologies to treat mixed and hazardous waste.

On August 29, 2005, at the close of business, the Company effectuated the previously approved reverse stock split with the established a ratio of 1-for 20. Applied common stock began trading on a reverse-split basis on August 30, 2005. As a result of the reverse stock split, every 20 shares of Applied

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common stock was combined into one share of Applied common stock. As a result of the reverse stock split, the issued and outstanding shares of Applied common stock was reduced from approximately 156 million shares to approximately 7.8 million shares. The number of authorized shares is not reduced.

The reverse stock split affected all shares of common stock, stock options and warrants of Applied outstanding as of immediately prior to the effective time of the reverse stock split. Fractional shares of common stock of the Company were not issued as a result of the reverse stock split, but instead, holders of pre-split shares of common stock who otherwise would have been entitled to receive a fractional share as a result of the reverse split received one whole share. Shares of Applied common stock trade on the Nasdaq Over the Counter Bulletin Board Market under the symbol CXIA.

The Company currently requires additional cash to sustain existing operations and to meet current obligations and ongoing capital requirements. The Company's current monthly operating expenses exceed cash revenues by approximately \$80,000. Currently, the Company is addressing this cash shortfall through loans from The Shaar Fund, Ltd., but The Shaar Fund, Ltd. is under no

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obligation to continue to make such advances to the Company. If this lender decided to discontinue advances, the Company would not be able to meet its current obligations. In addition, the Company owes \$818,330 in loans that are currently due or are payable on demand. Although the lenders on these loans have not yet called the loans, the Company does not currently have the ability to pay these loans absent additional financing.

The Company's report of independent registered public accounting firm on our fiscal 2002, 2003 and 2004 financial statements contains a "going concern" qualification in which they express substantial doubt about the Company's ability to continue in business, absent additional financing. The Company currently requires additional cash to sustain existing operations and to meet current obligations and ongoing capital requirements.

### CRITICAL ACCOUNTING POLICIES

We prepare our financial statements in conformity with U.S. generally accepted accounting principles. As such, we are required to make certain estimates, judgments and assumptions that we believe are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented.

Our accounting policies that are the most important to the portrayal of our financial condition and results, and which require the highest degree of management judgment relate to the reserves for doubtful accounts receivable and the valuation of stock and options issued for services.

#### Reserves for Doubtful Accounts

Management estimates the amount of required reserves for the potential non-collectibility of accounts receivable based upon the customer's financial condition, age of the customer's receivables, changes in payment histories, and consideration of other relevant factors. Because the reserve for doubtful accounts is an estimate of events that have not yet occurred, we could incur additional charges or benefits in the future to reflect differences between estimated and actual collections.

#### Valuation of Stock, Options and Embedded Derivatives

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We value and account for the issuance of equity instruments, embedded or otherwise, to non-employees to acquire goods and services based on the fair value of the goods and services or the fair value of the equity instrument at the time of issuance, whichever is more reliably measurable. The fair value of stock issued for goods or services is determined based on the quoted market price on the date the commitment to issue the stock has occurred. The fair value of stock options, warrants, and embedded derivatives granted to non-employees for goods or services is calculated on the date of grant using the Black-Scholes options pricing model.

### Revenue Recognition

Substantially all the Company's current revenues consist of engineering and scientific services performed for the U.S. Government and prime contractors that serve the U.S. Government under a variety of contracts, most of which provide for unit prices. Revenue under unit price contracts are recorded when the services are provided.

Most of the Company's historical contracts provided for reimbursement of costs plus fixed fees. Direct and indirect contract costs incurred in reimbursement plus cost contracts are subject to audit by the Defense Contract Audit Agency ("DCAA"). Management does not expect these audits to materially

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affect the financial statements and have established appropriate allowances to cover potential audit disallowances. Contract revenues have been recorded in amounts which are expected to be realized upon final settlement. The DCAA has audited the Company's contracts through 1996. An allowance for doubtful accounts and potential disallowances has been established based upon the portion of billed and unbilled receivables that management believes may be uncollectible.

### RESULTS OF OPERATIONS

Three and Six Months Ended June 30, 2005 Compared to Three and Six Months Ended June 30, 2004

Revenues were \$2,733,000 and \$4,359,000 for the three and six months ended June 30, 2005 compared to \$112,000 and \$294,000 for the three and six months ended June 30, 2004. Such revenues were primarily from the Company's subsidiary ASI.

In the case of ASI, revenues were \$2,664,000 and \$4,273,000 respectively for the three and six months ended June 30, 2005 as compared with \$112,000 and \$254,000 for the three and six months ended June 30, 2004. Advanced Sciences has experienced a significant increase in revenue as the result of the September 2004 award of the eDAM contract in Oak Ridge, TN and overall, more work being performed by Advanced Sciences. The revenues from Advanced Sciences 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. Advanced Sciences has three major customers, two of which represent more than 10% of total revenue each. The combined revenue for these three customers was \$2,664,000 and \$4,273,000 respectively, (100% of total revenues) for the three and six months ended June 30, 2005. Cost of sales was \$2,578,000 and \$3,966,000 respectively for the three and six months ended June 30, 2005 compared to \$166,000 and \$244,000 respectively for the three and six months ended June 30, 2004. The increase in cost of sales can be attributed to an



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increase in variable costs caused by the eDAM contract and overall, more work being performed by Advanced Sciences.

In the case of Commodore Solution, Inc. ("Solution"), revenues were \$69,000 and \$86,000, respectively, for the three and six months ended June 30, 2005 as compared with \$0 and \$40,000, respectively, for three and six months ended June 30, 2004. Solution had one major customer during the three and six-month periods ended June 30, 2005 which accounted for \$69,000 and \$86,000, respectively, or 100% of the total revenues for the period. Revenues, when recognized, are primarily from remediation services performed for engineering and waste treatment companies in the U.S. under a variety of contracts. Cost of sales was \$53,000 and \$54,000, respectively, for the three and six months ended June 30, 2005 as compared to \$89,000 and \$263,000 respectively for the three and six months ended June 30, 2004. The cost of sales, when incurred, is attributable to sales and marketing expenses for the SET technology. 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, 2005, the Company incurred research and development costs of \$0 and \$0, respectively, as compared to \$1,000 and \$7,000 respectively for the three and six months ended June 30, 2004.

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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 continuing operations for the three and six months ended June 30, 2005 were \$401,000 and \$961,000, respectively, as compared to \$472,000 and \$918,000 respectively for the three and six months ended June 30, 2004. This difference is primarily due to the deferred salaries for the executives of the Company for the three and six-month periods ended June 30, 2005, the addition of a full time accounting employee, and fees associated with a marketing consultant for the SET technology.

In the case of Advanced Sciences, general and administrative costs for the three and six-month periods ended June 30, 2005 were \$19,000 and \$190,000, respectively, compared to \$19,000 and \$121,000 respectively for the three and six months ended June 30, 2004. This increase is primarily due to the additional administrative costs associated with the eDAM contract in Oak Ridge, TN. Solution incurred general and administrative costs of \$0 and \$16,000, respectively, for the three and six-month periods ended June 30, 2005 as compared to \$71,000 and \$151,000 respectively for the three and six-month periods ended June 30, 2004. This decrease was primarily due to the reassignment of a Solution's employee to CASI field work on the eDAM contract in Oak Ridge, TN.

Interest expense for the three and six months ended June 30, 2005 was \$202,000 and \$350,000, respectively, as compared to \$97,000 and \$180,000, respectively, for the three and six month periods ended June 30, 2004. The increase in interest expense of \$105,000 and \$170,000, respectively, for the three and six month periods ended June 30, 2005 is primarily related to an increase in cash interest costs associated with a higher notes payable balance and a higher line of credit balance compared to the prior year.

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On April 11, 2005, Applied, through the issuance of the Series I Preferred and the Amended and Restated Shaar Note, recorded an embedded derivative liability due to the conversion feature of these financial instruments pursuant to EITF 00-19. Applied recorded a loss of (\$8,651,000) and (\$8,651,000) of non-cash income (expense) for the three and six month periods ended June 30, 2005, respectively. The fair value of the embedded derivatives consisting of conversion features included in a note payable and in the Series I Convertible Preferred Stock is calculated as of the reporting date using the Black-Scholes options pricing model.

### LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2005 and December 31, 2004 Advanced Sciences had a \$116,000 and \$17,000 outstanding balance, respectively, on its revolving line of credit.

The Company currently requires additional cash to sustain existing operations and to meet current obligations and ongoing capital requirements. The Company's current monthly operating expenses exceed cash revenues by approximately \$80,000 at June 30, 2005. Currently, the Company is addressing this cash shortfall through loans from The Shaar Fund, Ltd., but The Shaar Fund, Ltd. is under no obligation to continue to make such advances to the Company. If

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this lender decided to discontinue advances, the Company would not be able to meet its current obligations. In addition, the Company owes \$818,330 in loans that are currently due or are payable on demand as of June 30, 2005. Although the lenders on these loans have not yet called the loans, the Company does not currently have the ability to pay these loans absent additional financing.

The Company's report of independent registered public accounting firm on our fiscal 2002, 2003 and 2004 financial statements contains a "going concern" qualification in which they express substantial doubt about the Company's ability to continue in business, absent additional financing. The Company currently requires additional cash to sustain existing operations and to meet current obligations and ongoing capital requirements.

For the three and six month periods ended June 30, 2005, the Company incurred a net loss of \$507,000 and \$984,000 as compared to a net loss of \$778,000 and \$1,447,000 for the three-month period ended June 30, 2004. For the six month period ended June 30, 2005, and for the years ended December 31, 2004, 2003, and 2002, Applied incurred losses of (\$9,635,000), (\$2,404,000), (\$2,957,000), and (\$5,972,000) respectively. The Company has also experienced net cash inflows (outflows) from operating activities of (\$1,532,000), (\$955,000), and (\$123,000) for the years ended December 31, 2004, 2003 and 2002 respectively.

During the three and six month periods ended June 30, 2005, the Company converted (i) 0 and 5,500, respectively, shares of Series E Preferred; (ii) 0 shares of Series F Preferred; and (iii) 5,000 and 5,000, respectively, shares of Series I Preferred, for 310,174 and 601,802, respectively, shares of the Company's common stock for the three and six month periods ended June 30, 2005. For the three and six month periods ended June 30, 2005, the Company converted no shares of Series H Preferred and issued no stock with respect to accrued dividends pertaining to the Series H Preferred.

In November 2000, the Company completed \$500,000 in financing in the form of a loan (the "Weiss Group Note") from a group of four investors. The Weiss Group Note bears interest at 12% per annum and was due and payable on February 12, 2001. All holders of the Weiss Group Note have granted payment extensions to the Company until January 15, 2005 in exchange for warrants for

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125,000 shares of the Company's common stock at an exercise price of \$0.57. The current principal balance of the Weiss Group Note is \$252,397 as of June 30, 2005 and remains unpaid as of August 22, 2005.

Effective February 14, 2004, the members of the Weiss Group Note voluntarily cancelled all issued warrants to purchase 75,000 shares at an exercise price of \$1.00 per share of the Company's common stock in connection with the Weiss Group Note.

Effective February 15, 2004, the Company issued warrants to purchase 125,000 shares of its common stock at an exercise price of \$0.57 per share to all holders of the Weiss Group Note in consideration of the extension of the due date of such loans by such persons from May 31, 2002 to January 15, 2005. The Company believes that this transaction is exempt from the registration requirements of the Securities Act under Section 4(2) thereof as a transaction not involving any public offering of securities.

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 1,973,077 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 25,000

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shares of the Company's common stock at an exercise price of \$4.40 per share. The Company re-priced this warrant in November 2003 to \$0.57 and extended the expiration date of this warrant to November 19, 2005. The Company believes that this transaction is exempt from the registration requirements of the Securities Act under Section 4(2) thereof as a transaction not involving any public offering of securities. The private investor exercised this warrant on April 7, 2004 and received 25,000 shares of the Company's common stock.

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 16,667 shares of the Company's common stock at an exercise price of \$4.40 per share. The Company pledged its equipment and SET related intellectual property as collateral for the Milford/Shaar Bridge Loan Notes.

The Company made all payments on the Milford/Shaar Bridge Loan Notes until November 13, 2001. The Company asked for and received a forbearance of payments on the Milford/Shaar Bridge Loan Notes from November 13, 2001 until December 31, 2005. In connection with the Milford/Shaar Bridge Loan Notes, the Company issued to Milford/Shaar in February 2004, a five-year warrant for 12,500 shares of the Company's common stock at an exercise price of \$0.60 per share. The Shaar Fund, Ltd., through the Shaar Bridge Loan, continues to provide cash installments on a periodic basis in the form of additional principal. The Milford/Shaar Bridge Loan Notes were restructured into the New Shaar Convertible Note as of April 11, 2005. Prior to the New Shaar Convertible Note, the current principal balance of the Milford/Shaar Bridge Loan Notes was \$3,033,741 as of March 31, 2005. Additionally, as of December 31, 2004, there was \$119,073 in accumulated forbearance fees and \$100,000 due in exit fees on the Milford/Shaar Bridge Loan Notes.

On October 2, 2002, Mr. Bentley Blum, a Director of the Company, had previously loaned the Company with \$125,000 of cash installments over the period of one year (the "Blum Loan"). The Company elected to convert the Blum Loan to the Company's common stock using the conversion feature of the 5-day average

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closing price of the Company's common stock prior to October 2, 2002. On October 2, 2002, Blum issued a conversion notice for \$125,000 of the outstanding principal of the Blum Loan into 125,000 shares. Mr. Blum continued to provide cash installments in the form of a loan to the Company through February 2004 (the "Blum Demand Note"). The Blum Demand Note bears interest at 9% per annum and is payable on demand. The current principal balance of the Blum Demand Note is \$312,032 as of June 30, 2005 and remains unpaid as of August 22, 2005.

On November 19, 2003, the Company issued a warrant to purchase 1,367,790 shares of its common stock at an exercise price of \$0.57 per share (the closing price of our common stock on the OTCBB on such date) to the Blum Asset Trust, a company controlled by Bentley Blum, a Director of the Company, in consideration for the loans made to the Company and the usage of office space and personnel of the Blum Asset Trust over the last five years. The Company believes that this transaction is exempt from the registration requirements of the Securities Act under Section 4(2) thereof as a transaction not involving any public offering of securities.

On April 12, 2005, the Company authorized the issuance of 550,000 shares of Series I Convertible Preferred Stock ("Series I Preferred"), par value \$0.001 per share, each such share of Series I Preferred having a stated value of \$10.00 per share.

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The Series I Preferred shall have the following rights, privileges, and limitations:

- a) The conversion feature shall be exercisable immediately.
- b) The conversion price of the Series I Preferred shall be determined by the average closing price of Company's common stock in the previous 10 trading days, but in no event shall the conversion price be more than \$0.57 per share.
- c) If the Company's common stock is not listed on an exchange at the time of the conversion, then the conversion price will be 50% of the market price at that time.
- d) The Series I Preferred shall have a non-cumulative annual dividend of 10%, payable in cash or shares of the Company's common stock at the Company's election.
- e) Dividend will be paid quarterly commencing May 15, 2005, to the Holders of record of shares of the Series I Preferred Stock. Dividends until February 14, 2006 shall accrue but shall not be payable until February 15, 2006.
- f) The Company will reserve 3,750,000 shares of its common stock for the conversion of the Series I Preferred.

On April 12, 2005, the Company entered into an exchange agreement with The Shaar Fund, LTD (the "Shaar Exchange Agreement"). Under terms of the Shaar Exchange Agreement, the Company agreed that Shaar will exchange all of its right, title and interest in and to the remaining outstanding shares of the Series E Preferred and Series F Preferred (including all other accrued and unpaid dividends thereon) for 395,302 shares of the Company's Series I Preferred.

Additionally, under the Shaar Exchange Agreement, the Company issued an Amended and Restated Secured Promissory Note of the Company, amending and restating a note originally issued June 13, 2001, which such Note has an outstanding principal balance as of April 12, 2005 of \$3,251,585.35 ("Old Shaar Note").

On April 12, 2005 Shaar executed a purchase agreement ("Milford Capital

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Purchase Agreement") to Milford Capital & Management ("Milford"). In accordance with the terms of the Milford Capital Purchase Agreement, Shaar purchased a secured promissory note of the Company, initially issued to Milford on June 13, 2001, in the original principal amount of \$500,000, which had an outstanding principal balance on March 31, 2005 of \$188,149 ("Old Milford Note"), together with (i) all interest, additional obligations, forbearance fees, exit fees, penalties and other amounts due and payable from time to time under or in connection with the Old Milford Note, and (ii) the Forbearance Amount in connection with the Forbearance Agreement, dated January 30, 2004, between Milford and the Company, and Shaar in which Shaar agreed to forgive payment from the Company to Shaar of \$300,000 of accrued and unpaid dividends on shares of the Company's Series E Preferred held by Shaar ("Forgiven Dividends") and consented to the transfer of the dollar value of the Forgiven Dividends to Milford as part of the forbearance fee payable to Milford under the Forbearance Agreement of 2004.

Shaar and the Company have agreed that Shaar will exchange the outstanding principal amount of the Old Shaar Note and the Old Milford Note (including all accrued and unpaid interest, unpaid fees and Forgiven Dividends) for the Company's newly issued 10% convertible secured promissory note (the "New Shaar Convertible Note").

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The New Shaar Convertible Note shall have the following rights, privileges, and limitations:

- a) The New Shaar Convertible Note bears an interest rate of 10% per annum, which is payable in cash or shares of the Company's common stock at the Company's election.
- b) Interest shall accrue on the principal amount for a one year period ("Deferral Period"). On March 22, 2006, the Company will make a single lump sum payment to the holder in an amount equal to all interest that accrued during the Deferral Period
- c) Beginning April 15, 2006, and monthly thereafter on the 15th day of each month until March 22, 2009 ("Maturity Date"), the Company shall pay to Shaar all accrued and unpaid interest ("Interest Payments") on the principal balance of the note accruing during the prior month.
- d) On the Maturity Date, the Company shall make a single lump sum payment to Shaar equal to the outstanding principal balance of the New Shaar Convertible Note ("Principal Balance"), together with all accrued and unpaid interest.
- e) At the option of Shaar, the outstanding Principal Balance may be converted, either in whole or in part, into shares of the Company's common stock.
- f) The conversion price of the payment of the Principal Balance, the Deferral Period, and the Interest Payments shall be determined by the average closing price of Company's common stock in the 10 trading days preceding the conversion date,, but in no event shall the conversion price be more than \$0.57 per share ("Conversion Price").
- g) If the Company's common stock is not listed on an exchange at the time of the conversion, then the conversion price will be 50% of the market price at that time.
- h) The New Shaar Convertible Note may not be prepaid by the Company prior to the Maturity Date.

On April 11, 2005, Applied, through the issuance of the Series I Preferred and the Amended and Restated Shaar Note, recorded an embedded

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derivative liability due to the conversion feature of these financial instruments pursuant to EITF 00-19. Applied recorded a loss of (\$8,651,000) and (\$8,651,000) of non-cash income (expense) for the three and six month periods ended June 30, 2005, respectively. The fair value of the embedded derivatives consisting of conversion features included in a note payable and in the Series I Convertible Preferred Stock is calculated as of the reporting date using the Black-Scholes options pricing model.

The current principal balance of the New Shaar Note is \$4,846,233 as of June 30, 2005 and remains unpaid as of August 22, 2005.

The recipient of securities in this transaction represented its intention to acquire the securities for investment only and not with a view to, or for sale in connection with, any distribution thereof, and appropriate restrictive legends were affixed to the warrants and the certificates representing the shares issued in this transaction. The Company made available to The Shaar Fund Ltd., written information about the Company in accordance with Rule 502 of the Securities Act and advised such recipient of the limitations on resale of such securities. In addition, The Shaar Fund Ltd. was offered the opportunity, prior to exchanging and/or purchasing any securities, to ask questions of, and receive answers from, the Company concerning the terms and conditions of the transaction and to obtain additional relevant information about the Company. Based upon the facts above, the Company believed this transaction to be exempt from the registration requirements of the Securities Act in reliance on Section 4 (2) thereof as a transaction not involving any public offering of securities.

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On April 27, 2005, a private investor purchased \$100,000 of the Company's unregistered common stock at the market price. The Company issued the private investor 10,000,000 shares of unregistered 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 3-year warrant for 4,000,000 shares of the Company's common stock at an exercise price of \$0.01 per share. The Company believes that this transaction is exempt from the registration requirements of the Securities Act under Section 4(2) thereof as a transaction not involving any public offering of securities.

On August 29, 2005, at the close of business, the Company effectuated the previously approved reverse stock split with the established a ratio of 1-for 20. Applied common stock began trading on a reverse-split basis on August 30, 2005. As a result of the reverse stock split, every 20 shares of Applied common stock was combined into one share of Applied common stock. As a result of the reverse stock split, the issued and outstanding shares of Applied common stock will be reduced from approximately 156 million shares to approximately 7.8 million shares. The number of authorized shares will not be reduced.

The reverse stock split affected all shares of common stock, stock options and warrants of Applied outstanding as of immediately prior to the effective time of the reverse stock split. Fractional shares of common stock of the Company were not issued as a result of the reverse stock split, but instead, holders of pre-split shares of common stock who otherwise would have been entitled to receive a fractional share as a result of the reverse split received one whole share. Shares of Applied common stock trade on the Nasdaq Over the Counter Bulletin Board Market under the symbol CXIA.

The Company hopes to meet its short-term capital requirements (including its \$80,000 monthly cash shortfall) through continued loans from The Shaar Fund, Ltd., although this lender is under no obligation to continue to make advances to the Company. The Company intends to negotiate a forbearance

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arrangement with other lenders on loans that are currently due. Ultimately, the Company intends to reduce its cash shortfall and 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 (the "NOLs") of approximately \$36,487,000 as of December 31, 2004, which expire in the years 2010 through 2024. The amount of NOLs that can be used in any one year will be limited by the applicable tax laws that are in effect at the time such NOLs can be utilized. The unused NOLs balances may be accumulated and used in subsequent years. 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 NOLs.

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### FORWARD-LOOKING STATEMENTS

Certain matters discussed in this Annual 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 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 and uncertainties that would affect any such forward-looking statements. These risks and uncertainties include, but are not limited to:

- o the Company's critical need for additional cash to sustain existing operations and meet existing obligations and capital requirements (the Company's auditor's opinion on our fiscal 2002, 2003 and 2004 financial statements contains a "going concern" qualification in which they express doubt about the Company's ability to continue in business, absent additional financing);
- o the ability to generate profitable operations from a large scale

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- remediation project;
- o the ability of the Company to renew its nationwide permit to treat PCBs;
- o the ability of the Company to implement its waste processing operations, including obtaining commercial waste processing contracts and processing waste under such contracts in a timely and cost effective manner; the timing and award of contracts by the U.S. Department of Energy for the cleanup of waste sites administered by it;
- o the timing and award of contracts by the U.S. Department of Energy for the cleanup of waste sites administered by it;
- o the acceptance and implementation of the Company's waste treatment technologies in the government and commercial sectors;
- o the Company's ability to obtain and perform under other large technical support services projects; developments in environmental legislation and regulation;
- o the ability of the Company to obtain future financing on favorable terms; and
- o 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.

ITEM 4. Controls and Procedures  
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(a) Evaluation of disclosure controls and procedures

We maintain disclosure controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized, and reported within the required time periods, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure.

We maintain disclosure controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized, and reported within the required time periods, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. As required by Rule 13a-15(b) under the Exchange Act, we conducted an evaluation, under the supervision of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of June 30, 2005. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer, solely for the reason below, concluded that our disclosure controls and procedures were not effective as of June 30, 2005 in alerting them in a timely manner to material information required to be included in our reports filed under the Exchange Act. This evaluation identified a material weakness in our



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disclosure controls and procedures with respect to analyzing debt and equity instruments to identify potential embedded derivatives and any required accounting entries and disclosures pertaining to embedded derivatives. Management is taking steps to implement appropriate corrective action in this regard.

### (b) Changes in internal controls

There were no significant changes in the Company's internal controls over financial reporting or in other factors that could significantly affect these internal controls subsequent to the date of their most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

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## 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 -

1. 31.1 - Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
2. 31.2 - Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
3. 32.1 - Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
4. 32.2 - Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

#### (b) Reports on Form 8-K.

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1. The Company filed a Current Report on Form 8-K, dated May 15, 2005, announcing its March 31, 2005 Quarterly earnings.
2. The Company filed a Current Report on Form 8-K, dated July 27, 2005, announcing it entered into a stock purchase agreement (the "Agreement") and a warrant agreement (the "Warrant") with a private investor, Dr. Marion Danna (the "Investor") on April 27, 2005. The closing of the transactions contemplated by the Agreement took place on July 10, 2005.

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Under the terms of the Agreement the Investor purchased, for a purchase price of \$100,000.00, 10,000,000 shares of the Company's common stock bearing a restrictive legend and a warrant for 4,000,000 shares of the Company's common stock with an exercise price of \$0.01, exercisable immediately with a three year life.

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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: November 22, 2005

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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