BIODELIVERY SCIENCES INTERNATIONAL INC
Form 10KSB/A
November 21, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-KSB/A

(Amendment No. 2)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2006

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ______ to ______

Commission file number 0-28931

BioDelivery Sciences International, Inc.

(Name of small business issuer in its charter)

Delaware	**35-2089858**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
801 Corporate Center Drive, Suite 210	
Raleigh, NC	**27607**

(Address of principal executive offices) **(Zip Code)**

Issuer s telephone number: (919) 582-9050

2501 Aerial Center Parkway Suite 205

Morrisville, NC 27560

(Former name, former address and former fiscal year, if changed since last report)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, $.001 par value; **NASDAQ-Capital Market**

(Title of class)

Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act ¨

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 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 ¨

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of issuer s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Issuer s revenues for fiscal year 2006 were $275,778.

The aggregate market value of the voting and non-voting common equity held by non-affiliates as of April 13, 2007 was approximately $69,831,096 based on the closing sale price of the company s common stock on such date of U.S. $6.03 per share, as reported by the Nasdaq Capital Market.

As of April 13, 2007, there were 16,666,777 shares of the company s common stock outstanding.

Transitional Small Business Disclosure Format: Yes ¨ No x

EXPLANATORY NOTE

This Amendment No. 2 on Form 10-KSB/A (the Amendment) to the Annual Report on Form 10-KSB of BioDelivery Sciences International, Inc. (the Company) for the year ended December 31, 2006, which was filed with the Securities and Exchange Commission on April 17, 2007 (the Original Filing) and amended on May 31, 2007, is being filed for the limited purpose of amending Item 6. Management s Discussion and Analysis of Financial Condition and Results of Operations (only to modify revenue recognition) and Item 7. Financial Statements (only to show deferred revenue) to the Original Filing to reflect the November 9, 2007 reevaluation by the Company s Audit Committee and the Company s independent registered public accounting firm of the accounting for a $2,500,000 milestone payment received by the Company in September 2006 based on criteria of both SEC Staff Accounting Bulletin No. 104 and EITF 00-21 that revenue recognition should have been deferred and recognized over the estimated term of the license.

As a result of these amendments, the certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, as filed as exhibits to the Original Filing, have been re-executed and re-filed as of the date of this Amendment.

Except for the amendments described above, this Amendment does not modify or update other disclosures in, or exhibits to, the Original Filing, as amended. Readers should be aware that certain information contained herein is as of the date of the Original Filing and may therefore not be current as such information is not being amended pursuant to this Amendment. Please see the Company s filings with the Securities and Exchange Commission for more current information.

Item 6. Management s Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes appearing elsewhere in this Report. This discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. The actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but not limited to, those which are not within our control.

Limited Operating History; Background of Our Company

Until 2002, we were a development stage company. Our first license agreement was funded in 2003 in the amount of $2 million, and we had an additional license funded in 2004 for $1 million, as part of our acquisition of Arius. We expect to continue research and development of our drug delivery technologies, and while we are seeking additional license agreements, which may include up-front payments, we anticipate nominal royalty revenues from the sale or commercialization of our products under development (other than license fees) during 2007. We anticipate that funding for the next several years will come primarily from the sale of securities, collaborative research agreements, including pharmaceutical companies, grants from public service entities and government entities, and potential exercises of our warrants.

In 2001, the National Institutes of Health awarded us a three-year $2.7 million Small Business Innovation Research Grant, which was fully funded through 2004, and which was utilized in our research and development efforts. We had an additional grant of approximately $0.6 million which was funded through July 2006. No additional funds are available on this grant.

We have a limited history of operations, and while we have received license revenues in 2003, 2004, 2005 and 2006 for licensing our technology, we anticipate that our quarterly results of operations will fluctuate significantly for the foreseeable future. We believe period-to-period comparisons of our operating results should not be relied upon as predictive of future performance. Our prospects must be considered in light of the risks, expenses and difficulties encountered by companies maturing in commercialization of their technologies, particularly companies in new and rapidly evolving markets such as pharmaceuticals, drug delivery and biotechnology. For the foreseeable future, we must, among other things, seek regulatory approval for and commercialize our proposed drugs, which may not occur. We may not be able to appropriately address these risks and difficulties. We may require additional funds to complete the development of our technology and to fund expected operations in the next several years.

Critical Accounting Policies and Estimates

Revenue Recognition

We recognize revenue in accordance with the SEC s Staff Accounting Bulletin No. 104, Revenue Recognition in Financial Statements. When evaluating multiple element arrangements, we consider whether the components of the arrangement represents separate units of accounting as EITF 00-21. Application of these standards requires subjective determinations and requires management to make judgments about the value of the individual elements and whether it is separable from the other aspects of the contractual relationship. See Note 1 to our condensed consolidated financial statements for further discussion regarding revenue recognition. Ultimately, the objective of our analysis of each customer contract based on the aforementioned criteria is to determine the amount and appropriate accounting period in which revenue should be recognized. To date, our primary source of revenue has been the issuance of European and U.S. licensing rights to BEMA Fentanyl and related formulations. All amounts received have currently been recorded as deferred revenue in our financial statements.

Valuation of Goodwill and Intangible Assets

Our intangible assets include goodwill, product rights, and licenses, all of which are accounted for based on Financial Accounting Standard Statement No. 142 *Goodwill and Other Intangible Assets* (FAS 142). As described below, goodwill is not amortized but is tested at least annually for impairment or more frequently if events or changes in circumstances indicate that the asset might be impaired. Intangible assets with limited useful lives are amortized using the straight-line method over their estimated period of benefit, ranging from eleven to thirteen years.

Our carrying value of goodwill at December 31, 2006 was $2.715 million.

We amortize intangibles with limited useful lives based on their expected useful lives and look to a number of factors for such estimations, including the longevity of our license agreements. Our carrying value of other, amortizing intangible assets at December 31, 2006 was $3.88 million, net of accumulated amortization of $.6 million. We begin amortizing capitalized intangibles on their date of acquisition.

Impairment Testing

Our goodwill impairment testing is calculated at the reporting unit level. Our annual impairment test has two steps. The first identifies potential impairments by comparing the fair value of the reporting unit with its carrying value. If the fair value exceeds the carrying amount, goodwill is not impaired and the second step is not necessary. If the carrying value exceeds the fair value, the second step calculates the possible impairment loss by comparing the implied fair value of goodwill with the carrying amount. If the implied fair value of goodwill is less than the carrying amount, a write-down is recorded. No goodwill impairment charges have resulted from this analysis for 2006 or 2005.

In accordance with SFAS 144, which relates to impairment of long-lived assets other than goodwill (our other amortizing intangibles), impairment exists if the sum of the future estimated undiscounted cash flows related to the asset is less than the carrying amount of the intangible asset or to its related group of assets. In that circumstance, then an impairment charge is recorded for the excess of the carrying amount of the intangible over the estimated discounted future cash flows related to the asset.

In making this assessment, we predominately use a discounted cash flow model derived from internal budgets in assessing fair values for our impairment testing. Factors that could change the result of our impairment test include, but are not limited to, different assumptions used to forecast future net sales, expenses, capital expenditures, and working capital requirements used in our cash flow models. In addition, selection of a risk-adjusted discount rate on the estimated undiscounted cash flows is susceptible to future changes in market conditions, and when unfavorable, can adversely affect our original estimates of fair values. In the event that our management determines that the value of intangible assets have become impaired using this approach, we will record an accounting charge for the amount of the impairment. No impairment charges have been recorded to other amortizing intangible in either 2006 or 2005.

Stock-Based Compensation and other stock based valuation issues (derivative accounting):

We account for stock-based awards to employees and non-employees using the accounting provisions of SFAS 123R *Accounting for Share-Based Payments,* which provides for the use of the fair value based method to determine compensation for all arrangements where shares of stock or equity

instruments are issued for compensation. Fair values of equity securities issued are determined by management based predominantly on the trading price of the Company s common stock. The values of these awards are based upon their grant-date fair value. That cost is recognized over the period during which the employee is required to provide service in exchange for the award.

We use the Black-Scholes options-pricing model to determine the fair value of stock option and warrant grants. In applying the Black-Scholes options-pricing model during 2006, we assumed no dividend yield, risk-free interest rates ranging from 4.5% to 4.7%, expected option terms ranging from 5 to 6 years (for employee options), a volatility factor range between 54.5% to 89.5%, share prices ranging from $2.05 to $2.69, and option exercise prices ranging from $2.05 to $2.69.

We also use the Black Scholes option pricing model as the primary basis for valuing our derivative liabilities at each reporting date (both embedded and free-standing derivatives). The underlying assumptions used in this determination are primarily the same as are used in the determination of stock-based compensation discussed in the previous paragraph except contractual lives of the derivative instruments are utilized rather than expected option terms as discussed in the previous paragraph.

For the Year Ended December 31, 2006 Compared to the Year Ended December 31, 2005

Sponsored Research Revenue. During the year ended December 31, 2006, we recognized sponsored research revenue of $0.08 million, compared to $0.4 million in the prior year.

Milestone and Royalty Revenues. During the year ended December 31, 2005, we recognized milestone revenue of $0.4 million relating to Emezine®. In addition, we recognized $0.07 million and $0.06 million in royalty revenue in 2006 and 2005, respectively, under our license agreement with Accentia relating to CRS.

Research and Development Expenses. During the years ended December 31, 2006 and 2005, research and development expenses totaled $9.3 million and $6.5 million, respectively. Our scientific staff continued to work toward increased development and application of our BEMA and Bioral® cochleate technologies and other drug-related areas. Funding of this research was obtained through sponsored research revenue, exercise of options by directors, sales of securities and funding of an equity line of credit from HCG. Research and development expenses generally include salaries for key scientific personnel, research supplies, facility rent, lab equipment depreciation and a portion of overhead operating expenses and other costs directly related to the development and application of the BEMA and Bioral® drug delivery technologies.

General and Administrative Expenses. During the years ended December 31, 2006 and 2005, general and administrative expenses totaled $5.1 million and $3.6 million, respectively. General and administrative costs include legal and professional fees, office supplies, travel costs, executive personnel costs, consulting fees, and business development costs. Product development cost in 2006 is warrant expense related to a securities purchase agreement. Furthermore, we incurred expenses in 2005 of approximately $0.08 million related to operating activities of our currently inactive Bioral Nutrient Delivery, LLC subsidiary that commenced in 2003. There were no expenses related to this subsidiary in 2006. The increase in general and administrative expenses in 2006 is primarily due to increased professional and legal fees incurred in connection with legal due diligence associated with licensing transactions, increased patent costs, stock-based compensation (related to our adoption of FAS 123R), and investor relations.

Product Development Expense. In 2006, we issued 601,120 warrants valued at $0.7 million in connection with the initial $2.0 million deposit transaction with CDC Clinical Development Licensing Agreement for BEMA Fentanyl. We had no such expense in 2005.

Interest Income (Expense), Net. During the year ended December 31, 2006 we had net interest expense of $1.95 million, compared to $1.35 million in 2005. The increase in net interest expense is primarily due to amortization of debt discount and interest paid to Laurus for the two convertible notes. Interest income for years ending 2006 and 2005 was nominal.

Derivative Gain (loss). Derivative loss in 2006 is related to the adjustment of derivative liabilities to fair value as of December 31, 2005 and subsequent changes in fair value in 2006. These derivatives relate to the Laurus financing (see Notes 1 and 7 to financial statements) and warrants issued to CDC.

Debt extinguishment (loss). During the year ended December 31, 2006, we had a debt extinguishment loss related to the debt modification that arose from the amendments to the Laurus convertible term notes and related deferral warrants.

Income Tax Benefit and sale of state tax loss carryforwards. We incurred net operating losses during both years presented, and we did not recognize any benefit associated with these losses. We had federal net operating loss carryforwards of $33.0 million at December 31, 2006 and $25.5 million of state carryforwards. The federal net operating loss carryforwards expire beginning in 2020, if not utilized. We sold New Jersey state tax credits and net operating losses in 2005 of $4.5 million, which generated cash of $0.5 million in 2005. The state operating loss carryforwards expire beginning in 2008, if not utilized. Financial Accounting Standards Board Statement No.109 provides for the recognition of deferred tax assets if realization is more likely than not. Based upon available data, which includes our historical operating performance and our reported cumulative net losses in prior years, we have provided a full valuation allowance against our net deferred tax assets as the future realization of the tax benefit is not sufficiently assured.

Item 7. Financial Statements.

Our Consolidated Financial Statements and Notes thereto, as amended, and the report of Aidman, Piser & Company, P.A., our independent registered public accounting firm, are set forth on pages F-1 through F-27 of this Report.

Item 13. Exhibits

The following exhibits are filed with this Amendment No. 2.

31.1	Certification of the Company s Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (*)(**)
31.2	Certification of the Company s Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (*)(**)
32.1	Certification of the Company s Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (*)(**)
32.2	Certification of the Company s Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (*)(**)

* Filed herewith

** A signed original of this written statement has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

BIODELIVERY SCIENCES INTERNATIONAL, INC.

Report of Independent Registered Public Accounting Firm Aidman, Piser & Company, P.A.	F-2
Consolidated Balance Sheet as of December 31, 2006 (restated)	F-3
Consolidated Statements of Operations for the years ended December 31, 2006 (restated) and 2005	F-4
Consolidated Statement of Stockholders Equity for the years ended December 31, 2006 (restated) and 2005	F-5
Consolidated Statements of Cash Flows for the years ended December 31, 2006 (restated) and 2005	F-6
Notes to Consolidated Financial Statements	F-7

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors

BioDelivery Sciences International, Inc.

We have audited the accompanying consolidated balance sheet of BioDelivery Sciences International, Inc. and Subsidiaries as of December 31, 2006, and the related consolidated statements of operations, stockholders deficit, and cash flows for each of the two years in the period then ended. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards of the Public Company Accounting Oversight Board (United States of America). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of BioDelivery Sciences International, Inc. and Subsidiaries as of December 31, 2006, and the consolidated results of their operations and their cash flows for each of the two years in the period then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 13 to the consolidated financial statements the accompanying 2006 consolidated financial statements have been restated.

/s/ Aidman, Piser & Company, P.A.

Tampa, Florida

April 16, 2007 except for Notes 1, 8 and 13 as to which the date is November 20, 2007

BIODELIVERY SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

DECEMBER 31, 2006 (Restated)

ASSETS	
Current assets:	
Cash and cash equivalents	$ 2,172,104
Accounts receivable	42,118
Due from related party	8,523
Prepaid expenses and other current assets	180,863
Total current assets	2,403,608
Equipment, net	379,654
Goodwill	2,715,000
Other intangible assets:	
Licenses	2,442,171
Acquired product rights	2,000,000
Accumulated amortization	(561,767)
Total other intangible assets	3,880,404
Other assets	463,268
Total assets	$ 9,841,934
LIABILITIES AND STOCKHOLDERS DEFICIT	
Current liabilities:	
Note payable	1,000,000
Accounts payable and accrued expenses	2,032,765
Due to related party	1,001,177
Deferred revenue	2,570,360
Dividends payable	152,803
Derivative liability	7,795,931
Total current liabilities	14,553,036
Convertible notes payable	4,003,250
Total liabilities	18,556,286
Commitments and contingencies (Notes 6 and 12)	
Stockholders deficit:	
Series A Preferred stock, $.001 par value; 1,647,059 shares designated, issued and outstanding	3,705,883
Series B Preferred stock, $.001 par value, 941,177 shares designated, 341,176 shares issued and outstanding	1,450,000
Common stock, $.001 par value; 45,000,000 shares authorized, 14,048,637 shares issued; 14,033,146 shares outstanding	14,049
Additional paid-in capital	32,132,609
Treasury stock, at cost, 15,491 shares	(47,183)
Accumulated deficit	(45,969,710)

Total stockholders deficit	(8,714,352)
Total liabilities and stockholders deficit	$ 9,841,934

See notes to consolidated financial statements.

BIODELIVERY SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

YEARS ENDED DECEMBER 31, 2006 AND 2005

	2006 (Restated)	**2005**
Sponsored research revenues	$ 75,717	$ 364,225
Milestone and royalty revenues, related parties	65,061	422,342
Research fees	135,000	62,995
	275,778	849,562
Expenses:		
Research and development	6,718,638	5,526,833
Related party research and development	2,550,058	937,029
Product development	746,591	
General and administrative	4,947,506	3,533,286
Related party general and administrative	124,505	66,835
	15,087,298	10,063,983
Loss from operations	(14,811,520)	(9,214,421)
Other income, net	7,663	
Other expense:		
Sale of tax loss carryforwards		451,590
Interest expense, net	(1,948,264)	(1,345,496)
Derivative gain (loss)	(1,013,142)	28,930
Loss on extinguishment of debt	(4,629,946)	
	(7,591,352)	(864,976)
Net loss	(22,395,209)	(10,079,397)
Preferred stock dividends	(65,250)	(65,250)
Loss attributable to common stockholders	$ (22,460,459)	$ (10,144,647)
Per share amounts, basic and diluted:		
Loss attributable to common stockholders	$ (1.67)	$ (1.21)
Weighted average common stock shares outstanding:		
Basic and diluted	13,435,091	8,353,346

See notes to consolidated financial statements.

BIODELIVERY SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

YEARS ENDED DECEMBER 31, 2006 (Restated) AND 2005

	Series A Preferred Stock		**Series B Preferred stock**				**Additional Paid-In**	**Treasury**	**Accumulated**	**Total Stockhold**
	Shares	**Amount**	**Shares**	**Amount**	**Common Stock**		**Capital**	**Stock**	**Deficit**	**Equity**
nces, ary 1, 2005	1,647,059	$ 3,705,883	341,176	$ 1,450,000	7,245,863	$ 7,246	$ 14,619,701	$ (303,894)	$ (13,495,104)	$ 5,983,
k-based pensation							11,724			11,
version of s payable mmon					70,000	70	171,430			171,
nce of ury stock							(99,711)	256,711		157,
es issued ash, net of ing costs					4,512,774	4,513	7,901,253			7,905,
assification uity to ative ity							(624,593)			(624,
assification rivative ity to y							1,610,929			1,610,
nce of ants for cing costs							305,685			305,
s B erred dends							(65,250)			(65,
oss									(10,079,397)	(10,079,
nces, mber 31,	1,647,059	$ 3,705,883	341,176	$ 1,450,000	11,828,637	$ 11,829	$ 23,831,168	$ (47,183)	$ (23,574,501)	$ 5,377,
k-based pensation							576,627			576,
nce of , net of ing costs	&n---------------------------------- RESEARCH AND DEVELOPMENT COSTS Research and development costs are charged to expense as incurred. Certain corporate overhead expenses, such as professional fees, salaries, rent and travel are allocated to research and development based on estimates made by management. STOCK-BASED COMPENSATION The Company measures compensation									

expense related to the grant of stock options and stock-based awards to employees in accordance with the provisions of Accounting Principles Board ("APB") Opinion No. 25, under which compensation expense, if any, is generally based on the difference between the exercise price of an option, or the amount paid for the award and the market price or fair value of the underlying common stock at the date of the award. Stock-based compensation arrangements involving non-employees are accounted for under Statement of Financial Accounting Standards ("SFAS") No. 123, "ACCOUNTING FOR STOCK-BASED COMPENSATION," under which such arrangements are accounted for based on the fair value of the option or award. The Company adopted the disclosure requirements of SFAS No. 148, "ACCOUNTING FOR STOCK-BASED COMPENSATION - TRANSITION AND DISCLOSURE," an amendment of SFAS No. 123 as of January 1, 2003, which require certain disclosures about stock-based employee compensation plans in an entity's accounting policy note. Those disclosures include a tabular format of pro forma net income and, if applicable, earnings per share under the fair value method if the intrinsic value method is used in any period presented. F-7 NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED) The adoption of SFAS No. 148 did not have a material impact to these consolidated financial statements and the disclosure requirements are included below. On November 10, 2003, the Board of Directors adopted the VisiJet, Inc. 2003 Stock Option Plan. The Option Plan provides for the grant of incentive and non-qualified stock options to selected employees, the grant of non-qualified options to selected consultants and to directors and advisory board members. The Option Plan is administered by the Compensation Committee of the Board of Directors and authorizes the grant of options for 3,000,000 shares. The Compensation Committee determines the individual employees and consultants who participate under the Plan, the terms and conditions of options, the option price, the vesting schedule of options and other terms and conditions of the options granted pursuant thereto. During the fourth

quarter of 2003, the Company issued 125,000 stock options to consultants to purchase the Company's common stock in exchange for services rendered. The Company has accounted for these issuances in accordance with SFAS No. 123 and has recorded an expense of $93,427 representing the fair value of the options using a Black-Scholes option-pricing model. The options are exercisable at price of $1.10 per share and have a term of 10 years. Also during the fourth quarter of 2003, the Company issued options to employees and directors to purchase 1,040,000 shares of its common stock, at an exercise price of $1.10. All options granted during the period have a term of ten years and were issued at an exercise price equal to the market value of the underlying stock at the date of grant. As of December 31, 2003 a total of 1,165,000 options to purchase shares of the Company's common stock were outstanding pursuant to the 2003 Plan. A summary of changes in common stock options during 2003 and 2002 follows: Number of Weighted Average Exercisable Shares Exercise Price Shares

----

Outstanding at December 31, 2002 -- -- -- Granted 1,165,000 $ 1.10 390,000 Forfeited -- -- -- Cancelled -- -- -- Outstanding at December 31, 2003 1,165,000 $ 1.10 390,000 SFAS No. 123 requires the Company to provide pro forma information regarding net income (loss) and income (loss) per share as if compensation cost for the Company's stock option issuances had been determined in accordance with the fair value based method prescribed in SFAS No. 123. The Company estimates the fair value of each stock option at the grant date by using the Black-Scholes option-pricing model with the following assumptions used for grants in fiscal 2003: dividend yield of zero percent, risk-free interest rate of 3.29%, expected life of five years, and expected volatility of 83.82%. F-8 NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED) Under the accounting provisions of SFAS No. 123, as amended by SFAS No. 148, the Company's pro forma net loss and loss per share for the years ended December 31, 2003 and 2002 would have been as follows: 2003 2002 Net Loss: As reported $ (4,959,152) $ (1,226,676)

SFAS No. 123 effect (308,724) -- ------------- ------------- Pro forma net loss $ (5,267,876) $ (1,226,676) ============= ============= Loss per share: As reported $ (0.27) $ (0.16) ============= ============= Pro forma $ (0.28) $ (0.16) ============= ============= Basic and diluted weighted average shares outstanding 18,606,352 7,811,809 ============= ============= The following table summarizes information about stock options outstanding at December 31, 2003: Weighted Average Weighted Weighted Remaining Average Average Exercise Number Life in Exercise Number Exercise Price Outstanding Years Price Exercisable Price $1.10 1,165,000 9.83 $1.10 390,000 $1.10 SEGMENT INFORMATION The Company complies with SFAS No. 131, "DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION" that requires public business enterprises to report information regarding reportable operating segments. SFAS No. 131 supersedes SFAS No. 14, "FINANCIAL REPORTING FOR SEGMENTS OF A BUSINESS ENTERPRISE." During 2003 and 2002, the Company had only one primary business unit, the research and development of ophthalmic surgical instruments. Accordingly, separate operating segment information is not being presented. DEPRECIATION Depreciation of property and equipment is computed using the straight-line method over estimated useful lives ranging from three to five years. USE OF ESTIMATES The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. F-9 NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED) IMPAIRMENT OF LONG-LIVED ASSETS 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 the future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. LOSS PER SHARE The Company calculates loss per share in accordance with SFAS No. 128, "EARNINGS PER SHARE," and Securities and Exchange Commission ("SEC") Staff Accounting Bulletin ("SAB") No. 98. Accordingly, basic loss per share is computed using the weighted average number of common shares and diluted loss per share are computed based on the weighted average number of common shares and all common equivalent shares outstanding during the period in which they are dilutive. Common equivalent shares consist of shares issuable upon the exercise of stock options, using the treasury stock method, or warrants; common equivalent shares are excluded from the calculation if their effect is anti-dilutive. INCOME TAXES The Company utilizes the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. RECLASSIFICATIONS Certain reclassifications have been made to the financial statements of the prior year and for the period February 2, 1996 (inception) to December 31, 2003 in order to conform to current year presentation. RECENTLY ISSUED ACCOUNTING

PRONOUNCEMENTS In November 2002, the FASB issued Interpretation No. 45, "GUARANTOR'S ACCOUNTING AND DISCLOSURE REQUIREMENTS FOR GUARANTEES, INCLUDING INDIRECT GUARANTEES OF INDEBTEDNESS OF OTHERS" - an interpretation of SFAS Nos. 5, 57 and 107 and rescission of FASB Interpretation No. 34. This Interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also F-10 NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED) clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and measurement provisions of this Interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. Implementation of these provisions of the Interpretation is not expected to have a material impact on the Company's consolidated financial statements. The disclosure requirements of the Interpretation are effective for financial statements of interim or annual periods ended after December 15, 2002, and have been adopted in the accompanying consolidated financial statements with no additional disclosure required. In December 2002, FASB issued SFAS No. 148, ACCOUNTING FOR STOCK-BASED COMPENSATION, TRANSITION AND DISCLOSURE ("SFAS 148"). SFAS 148 amends the disclosure requirements of SFAS No. 123 "Accounting for Stock-Based Compensation" ("SFAS 123") to require prominent disclosures in both interim and annual financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS 148 also amends SFAS 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. As the Company has decided not to voluntarily adopt the SFAS 123 fair value method of accounting for stock-based employee

compensation, the new transition alternatives of SFAS 148 will not have a material impact on its financial position or results of operations. The Company adopted the quarterly footnote disclosure of the fair value based method of accounting for stock-based employee compensation as of the beginning of fiscal 2003, although no options were issued by the Company until the fourth quarter of 2003. NOTE 3 - PROPERTY AND EQUIPMENT ------------------------------ At December 31, property and equipment consist of the following: 2003 2002 ---------- ---------- Computer and test equipment $ 82,584 $ 21,833 Furniture and fixtures 33,505 16,067 Trade show equipment 47,002 47,002 ---------- ---------- 163,091 84,902 Less: Accumulated depreciation (58,651) (37,459) ---------- ---------- $ 104,440 $ 47,443 ========== ========== Depreciation expense for the years ended December 31, 2003 and 2002 amounted to $21,193 and $13,627, respectively. Depreciation expense for the period from February 2, 1996 (inception) to December 31, 2003 was $309,555. F-11 NOTE 4 - LICENSE AGREEMENT ------------------------- During 2003, the Company entered into a license agreement with the inventor of a patented technology through which the Company obtained exclusive worldwide rights for all medical applications for the technology that provides for the sterile flow of fluid through a surgical water jet apparatus. The purchase price of the license has been capitalized and is being amortized on a straight-line basis over the remaining life of the patent. The license agreement provides for royalty payments based on the sale of products utilizing licensed technology and for minimum annual royalty payments. See Note 6 - Commitments. At December 31, license agreements consist of: 2003 2002 ---------- --------- License agreements $ 100,000 $ -- Less: accumulated amortization (2,756) -- ---------- --------- $ 97,224 $ -- ========== ========= Amortization expense for the years ended December 31, 2003 and 2002 amounted to $2,756 and $0, respectively. Amortization expense for the period from February 2, 1996 (inception) to December 31, 2003 was $2,756. NOTE 5 - NOTES PAYABLE

- RELATED PARTIES

SURGIJET, INC. On October 23, 1998, the Company issued a demand promissory note in the amount of $400,000 in favor of SurgiJet, Inc., a company then related through common shareholders. Interest accrued on the unpaid principal at a variable interest rate based on the prime rate totaled $139,955 on February 11, 2003. In connection with the Merger Agreement, an amendment to the note was executed on February 11, 2003 under which the accrued interest was reduced to $49,652 and scheduled principal and interest payments were established. Under the amended note, the first payment of $30,000 was due on February 11, 2003 with equal monthly installments of $15,000, including interest due on the first of each month, and all outstanding principal and interest is due and payable upon successful completion of the Company's 2002 financial statements. As a result of the amendment, the Company recorded a $90,303 gain based on the difference between the total accrued interest expense included on the amended note and the total interest of $139,955 previously accrued. Through December 31, 2003 payments totaling $45,000 were made by the Company, resulting in an outstanding principal balance of $360,976 at December 31, 2003, of which $87,144 is classified as long-term debt, and accrued interest payable of $43,676. As discussed more fully at Note 11, the validity of the underlying note, as well as the amended note is disputed by the Company, and is a subject of on-going litigation between the Company and SurgiJet. Pending the outcome of the litigation, the Company ceased making scheduled payments on this note. F-12 NOTE 5 - NOTES PAYABLE - RELATED PARTIES (CONTINUED) DENTAJET, INC. During 2002, the Company entered into a promissory note for a principal sum of $91,000, plus interest at the rate of 10% per annum with DentaJet Inc. ("DentaJet"), a Company then related through common shareholders. During 2002, the Company borrowed an additional $70,000 from, and made payments totaling $27,482 to DentaJet, resulting in an outstanding principal balance of $133,518 at December 31, 2002.

Interest expense related to this note totaling $9,567 was recorded by the Company in 2002, and was included in accrued interest payable at December 31, 2002. During 2003, the Company borrowed an additional $2,000 from DentaJet, and recorded interest expense totaling $15,178 related to this note. As of December 31, 2003 the outstanding principal balance and accrued interest payable on this noted totaled $135,518 and $24,745, respectively. Pursuant to the Merger Agreement, the loan is due and payable upon successful completion of an independent audit of the Company's 2002 financial statements. As discussed more fully at Note 11, the validity of this note is being disputed by the Company, and is a subject of on-going litigation between the Company and SurgiJet.

FINANCIAL ENTREPRENEURS, INC. ("FEI") During 2002 the Company entered into a promissory note agreement with FEI, a significant shareholder of the Company. The note was due on demand and was non-interest bearing. In connection with the Merger Agreement, FEI converted the outstanding note balance at the date of the merger, $378,997 into 378,997 shares of the Company's common stock. There was no beneficial conversion feature on this note. In connection with the Merger Agreement, the Company assumed a promissory note during 2003 originally entered into between PNAC and FEI during 2002. The note is payable on demand and bears interest at an annual rate of 7.5%. Upon consummation of the merger in February 2003, the outstanding principal and accrued interest payable balances were $206,649 and $11,462, respectively. During 2003, the Company added net borrowings of $43,476 to the note, and accrued additional interest expense of $17,072, resulting in an outstanding principal balance and accrued interest payable balances at December 31, 2003 of $250,125 and $28,534, respectively.

SHAREHOLDERS During 2002, the Company entered into a promissory note with Lance Doherty, a significant shareholder of the Company, for a principal sum of $19,000 plus interest at the rate of 10% per annum. As of December 31, 2003 the outstanding principal balance of this note was $19,000, and accrued interest payable totaled $3,920. Pursuant to the Merger

Agreement, this note is due and payable upon successful completion of an independent audit of the Company's 2002 financial statements. As discussed more fully at Note 11, the validity of this note is being disputed by the Company, and is a subject of on-going litigation between the Company and Mr. Doherty. F-13 NOTE 5 - NOTES PAYABLE - RELATED PARTIES (CONTINUED) In addition, during 2002 the Company recorded a liability of $2,967 related to expenses paid by Rex Doherty, a significant shareholder of the Company. Pursuant to the Merger Agreement, this liability, plus interest at the rate of 10% per annum, is due and payable upon successful completion of an independent audit of the Company's 2002 financial statements. At December 31, 2003, the outstanding liability and accrued interest payable related to this debt are $2,967 and $298, respectively. As discussed more fully at Note 11, the validity of this liability is being disputed by the Company, and is a subject of on-going litigation between the Company and Mr. Doherty. PONTE NOSSA ACQUISITION CORPORATION ("PNAC") During 2002, the Company entered into various loan agreements with PNAC to provide funding to facilitate transactions contemplated by the then pending merger with the Company. Principal and accrued interest on the notes were due on the earlier of i) the date on which the closing of the transactions of the merger agreement by and between the Company and PNAC, ii) termination of the merger agreement, iii) sale of the Company or iv) the maturity date. The notes were collateralized by a security interest in certain assets and common stock of the Company. At December 31, 2002, notes payable to PNAC consisted of the following: Note payable - PNAC Senior secured promissory notes, interest at 3% per annum, due May 2003 $236,000 Note payable - PNAC Working capital note, interest at 10% per annum, due August 2003 309,752 Note payable - PNAC Milestone note payable, interest at 10% per annum, due August 2003 97,606 --------- $643,358 ========= At December 31, 2002, accrued interest payable on the above notes was $12,354. During 2003, prior to the completion of the Merger Agreement, the Company

borrowed an additional $115,073, pursuant to the working capital note referenced above, and accrued additional interest expense in the amount of $2,495. As a result of the Merger Agreement, the outstanding principal and accrued interest payable balances related to these notes, in the aggregate amount of $773,280 were eliminated, and as of December 31, 2003 there are no remaining outstanding balances. NOTE 6 - COMMITMENTS ------------------- OPERATING LEASES The Company leases approximately 5,100 square feet of office and laboratory space in Irvine, California at a total rent, inclusive of common area charges, of $7,600 per month under a lease that runs through April 20, 2004. Rent expense was $82,398 and $62,160 for the years ended F-14 NOTE 6 - COMMITMENTS (CONTINUED) December 31, 2003 and 2002, respectively. Rent expense for the period from February 2, 1996 (inception) to December 31, 2003 was $376,246. The Company also leases certain office equipment under operating leases. The approximate future minimum annual rental payments under operating leases as of December 31, 2003 are as fo1lows: Year Ending December 31, ----------------------- 2004 $ 31,037 2005 3,168 2006 3,168 2007 3,168 2008 1,188 LICENSE AGREEMENTS Under the terms of the technology license agreements with SurgiJet, the Company is obligated to pay a royalty of 7% of revenues received from sales of the products, up to $400 million of revenues over the course of the agreements, and 5% of revenues thereafter. The license agreements with SurgiJet also provide for a minimum royalty of $60,000 per year that may be used as a credit toward payment future royalties due on product sales. Under the terms of the patent license agreement entered into during 2003, the Company is obligated to pay a royalty of 6% of net sales of products utilizing the licensed patent technology. The license agreement also provides for a minimum royalty of $24,000 per year that may be used as a credit toward payment future royalties due on product sales. NOTE 7 - SHAREHOLDERS' EQUITY (DEFICIT) --------------------------------------

MERGER In connection with the completion of the Merger Agreement in February 2003, the Company agreed to issue a total of 8,600,000 shares of common stock and 1,720,000 warrants to purchase common stock in exchange for all of the outstanding common and preferred stock of Visijet prior to the merger, and in exchange for services rendered by three individuals prior to the merger. In addition, the Company issued an aggregate of 3,528,481 shares of common stock and warrants to purchase 4,528,481 shares of common stock at an initial exercise price of $1.00 per share (with the exercise price increasing by $0.50 per share each year) to certain private investors in connection with the conversion of debt totaling $569,680, and a private placement investment of $564,000, that occurred concurrently with the consummation of the merger. Based on a reconciliation of share activity recorded in connection with the merger, the Company recorded an adjustment during the fourth quarter of 2003 to reduce the number of outstanding shares of common stock by 54,007. Pursuant to the Merger Agreement, PNAC shareholders received a total of 6,084,000 shares of the Company's common stock upon consummation of the F-15 NOTE 7 - SHAREHOLDERS' EQUITY (DEFICIT) (CONTINUED) merger. In a separate agreement entered into in connection with the merger, FEI converted a promissory note held by it into 378,997 shares of common stock at a conversion rate of $1.00 per share. Also, FEI agreed to cancel 7,957,000 shares of the PNAC stock owned by it prior to completion of the Merger Agreement, and the Company issued FEI a five year warrant to purchase 1,543,000 shares of common stock at an exercise price of $5.00 per share. OTHER COMMON STOCK ACTIVITY In February 2003, the Company issued 211,267 shares of common stock to two employees in satisfaction of unpaid salary accrued prior to the merger. See Note 9 - Settlement Agreements and Loan Payable. In September 2003, the Company issued 150,000 shares of common stock to a consultant in connection with services rendered. See Note 13 - Related Party Transactions. During 2003, the Company issued 2,712,500 shares of common stock, and five year warrants to purchase

3,711,000 shares of the Company's common stock at an exercise price of $2.25 per share in connection with private equity placements. In addition, the Company recorded common stock subscriptions in the amount of $918,500 based on proceeds received from private placements for which the stock has not yet been issued, and reclassified $100,000 to common stock subscriptions based on pre-merger private placement funds received for which the stock has not yet been issued. OTHER WARRANT ACTIVITY During 2002 and 2003, PNAC issued common stock warrants to purchase 235,000 shares and 270,000 shares of common stock, respectively, in connection with private equity placements that occurred prior to completion of the Merger Agreement that remained outstanding subsequent to the merger. The warrants are exercisable for a period of five years at an exercise price of $2.50. Pursuant to an agreement entered into in connection with the merger, the Company issued a five-year warrants to purchase 25,000 shares of its common stock at an exercise price of $3.00, each to an officer of the Company and a former officer of PNAC. During 2003, the Company issued 5-year warrants to purchase 3,711,000 shares of its common stock, at an exercise price of $2.25 per share, in connection with private equity placements. In addition, during 2003, the Company issued 5-year warrants to purchase 45,000 shares of its common stock, at an exercise price of $1.23 per share, for services rendered to the Company. In connection with the 45,000 warrants issued for services rendered, the Company recorded consulting expense in the amount of $33,483 based on the fair value of the warrants using a Black-Scholes model valuation. The following table summarizes the number of outstanding common stock warrants in 2003 and 2002: F-16 NOTE 7 - SHAREHOLDERS' EQUITY (DEFICIT) (CONTINUED) Weighted Average Number Exercise Price ----------- ----------------- Outstanding at December 31, 2001 - - Granted 235,000 $2.50 Forfeited - - Exercised - - ----------- ----------------- Outstanding at December 31, 2002 235,000 $2.50 Granted 11,867,480 $2.53 Forfeited - - Exercised - - ----------- ----------------- Outstanding at December 31, 2003

12,102,480 $2.53 The following table summarizes additional information with respect to outstanding common stock warrants at December 31, 2003: Number Weighted Average Life Number Exercise Price Outstanding Remaining in Months Exercisable ------------- ------------ --------------------- ----------- $1.00 4,528,480 49 3,528,480 $1.23 45,000 55 45,000 $2.25 3,711,000 58 3,711,000 $2.50 505,000 46 505,000 $3.00 50,000 49 50,000 $5.00 3,263,000 49 3,263,000 ------------ ----------- 12,102,480 11,102,480 ============ ===========

NOTE 8 - INCOME TAXES --------------------- The provision for income taxes consist of the following for the years ended December 31: 2002 2001 ------------ ------------ Current: Federal $ -- $ -- State 800 800 ------------ ------------ Total provision $ 800 $ 800 ============ ============ The components of the net deferred income tax assets are as follows as of December 31: 2003 2002 ------------ ------------ Deferred income tax assets: Net operating loss carry forward $ 4,192,639 $ 2,398,000 Other temporary timing adjustments 400,764 257,000 ------------ ------------ 4,593,403 2,655,000 Deferred tax liability: State taxes (37,585) (191,000) ------------ ------------ Deferred income tax asset, net before Valuation allowance 4,555,818 2,464,000 Less: valuation allowance (4,555,818) (2,464,000) ------------ ------------ Deferred income tax asset, net $ -- $ -- ============ ============ F-17

NOTE 8 - INCOME TAXES (CONTINUED) Since 1996, the company has generated a net operating loss (NOL) of approximately $5,404,011. The total carry forward amounts are available to offset future taxable income and expire in various years through 2022. The ability to use some or all of this carryforward is limited by future events such as a failure to generate positive taxable income or a change in ownership as stated under the rules of Internal Revenue Code Section 382. The net deferred tax asset is primarily associated with its net operating loss carryforwards, state taxes and other timing adjustments. The Company has recorded a valuation allowance for the entire amount due to the uncertainty surrounding the likelihood of the

Company generating sufficient taxable income in the future. NOTE 9 - SETTLEMENT AGREEMENTS AND LOAN PAYABLE -- On November 4, 2002, the Company entered into settlement agreements with Randal A. Bailey, its President and Chief Executive Officer, and Larry Hood, its Director of Engineering, related to accrued, but unpaid fees for consulting services previously rendered by them in the aggregate of $700,000. Under the agreements a total of $450,000 was converted into 211,267 shares of the Company's common stock based upon the closing price on the effective date the merger, of which Mr. Bailey received 164,319 shares and Mr. Hood received 46,948 shares. The balance owed of $250,000 was converted into two-year notes payable, that bear interest at an annual rate of 3.5% and provide for the principal to be paid over twenty-four equal installments. At December 31, 2003, the balance on these notes was $104,166, of which $17,458 is classified as long-term, and accrued interest payable was $6,330. NOTE 10 - SELECTED QUARTERLY DATA ------ Quarter Ended ------ 2003 March 31 June 30 September 30 December 31 Total ---------------------- ------------- ------------- -------------- -------------- -------------- Expenses $ 814,387.00 $ 885,338.00 $1,239,737.00 $2,053,401.00 $4,992,863.00 ------------- ------------- -------------- -------------- -------------- Operating loss (814,387) (885,338) (1,239,737) (2,053,401) (4,992,863) Interest Expense (14,336) (17,037) (5,944) (18,930) (56,247) Other income (expense) 26 361 90,303 (732) 89,958 ------------- ------------- -------------- -------------- -------------- Net loss $ (828,697) $ (902,014) $ (1,155,378) $ (2,073,063) $ (4,959,152) ============= ============= ============== ============== ============== Loss per share $ (0.06) $ (0.046) $ (0.056) $ (0.10) $ (0.27) ============= ============= ============== ============== ============== Weighted average shares Outstanding 14,171,631 19,533,294 20,468,856 21,179,696 18,606,352 ============= ============= ==============

============== ============== F-18 NOTE 10 - SELECTED QUARTERLY DATA (CONTINUED) Quarter Ended Quarter Ended Quarter Ended Quarter Ended 2002 March 31 June 30 September 30 December 31 Total ----------------------- ------------- ------------- -------------- -------------- -------------- Expenses 142,008 353,344 253,573 297,528 1,046,453 ------------- ------------- -------------- -------------- -------------- Operating loss (142,008) (353,344) (253,573) (297,528) (1,046,453) Interest Expense (17,754) (22,944) (68,681) (131,319) (21,940) Other income (expenses) -- -- -- (48,904) (48,904) ------------- ------------- -------------- -------------- -------------- Net loss $ (159,762) $ (376,288) $ (275,513) $ (415,113) $ (1,226,676) ============= ============= ============== ============== ============== Loss per share $ (0.020) $ (0.048) $ (0.040) $ (0.052) $ (0.16) ============= ============= ============== ============== ============== Weighted average shares Outstanding 7,713,943 7,817,735 7,817,735 7,916,811 7,811,809 ============= ============= ============== ============== ============== NOTE 11 - CONTINGENCIES ----------------------- During 2003, the Company initiated litigation against SurgiJet, Inc., its former parent company, and certain directors, officers and shareholders of SurgiJet. The action was initially filed by the Company for a judicial determination that a $400,000 Promissory Note issued by the Company and payable to SurgiJet "SurgiJet Note"), prior to the completion of the Merger Agreement, is not enforceable, and for recovery of payments previously made on the note. Subsequently, a challenge of the validity of other notes payable carried on the Company's books at the effective date of the Merger Agreement, including notes to Dentajet, Lance Doherty (former President of VisiJet and beneficial owner of more than 5% of its outstanding Common Stock) and Rex Doherty was added to the litigation. SurgiJet and its principals filed a cross-action against the Company, and its directors and certain

officers, seeking damages of approximately $800,000, rescission of the Merger Agreement, other specified damages, interest and attorney's fees. In the cross-complaint, SurgiJet and its principals allege breach of the Merger Agreement between the Company and SurgiJet, breach of an Assumption of Liabilities Agreement (including Notes Payable to DentaJet, Lance Doherty and Rex Doherty) entered into in connection with the Merger Agreement, and breach of the SurgiJet Note, along with fraud and unfair business practices. The Company's management believes that the cross-complaint is merely a diversionary effort by SurgiJet to draw attention away from the main action. The Company believes the allegations to the cross-complaint are wholly without merit and plans to vigorously pursue its claims and contest the cross-complaint. F-19 NOTE 11 - CONTINGENCIES (CONTINUED) The Company is also a defendant in an action filed by an individual claiming entitlement to a finder's fee arising out of the merger between Ponte Nossa and Visijet. The complaint alleges that the plaintiff is entitled to 105,000 shares of the Company's common stock. In January 2004 the Company and plaintiff reached a settlement in this matter whereby the Company agreed to issue plaintiff 45,000 shares of the Company's common stock as full settlement of the claim. The Company is also a defendant in a breach of contract claim from an outside provider of accounting services for work performed for the Company prior to the effective date of the Merger Agreement for $43,500, plus interest. The Company has denied the allegations of the complaint and is vigorously contesting the action. In December 2003, a former consultant who had performed services for the Company prior to the effective date of the Merger Agreement obtained a judgment award in the amount of $40,398 from the Labor Commissioner of the State of California in an action related to claimed unpaid wages and expenses previously filed against the Company. Although the Company has filed an appeal in the California Superior Court contesting the action taken by the Labor Commissioner, an accrual for the awarded amount has been recorded as of December 31, 2003 pending the

outcome of the appeal. In January 2004, the Company was served a summons which named the Company and certain of its officers as defendants in an action filed by a corporation claiming it was owed fees related to professional employment placement services in the approximate amount of $114,500. The Company denies the allegations of the complaint and plans to vigorously contest the action. NOTE 12 - RESTATEMENT -------------------- During the 2002 audit, it was discovered that certain accounting matters related to the financial statements for the year ended December 31, 2001 required restatement. The Company's prior management overstated expenses in 2001 by recording $93,595 of accrued personal expense of the Company's prior management, as general and administrative and research and development expenses. The financial statements for the year ended December 31, 2001 have been restated to decrease operating expenses by $93,595. In addition, it was discovered that certain general and administrative expenses and research and development expenses related to the period ended December 31, 2001 were included in the financial statements for the year ended December 31, 2002. The financial statements for the year ended December 31, 2001 have been restated for this error by increasing operating expenses by $129,166. The net effect of these adjustments was to increase net loss $35,571 for the year ended December 31, 2001 as shown below: F-20 NOTE 12 - RESTATEMENT (CONTINUED) As Reported As Restated ----------- ----------- General and administrative expenses $ 436,122 $ 458,773 Research and development expenses 944,745 957,665 ----------- ----------- Total operating expenses 1,380,867 1,416,438 =========== =========== Net loss $1,439,602 $1,475,173 =========== =========== NOTE 13 - RELATED PARTY TRANSACTIONS ---------------------------------- During 2003, the Company began making consulting payments of $2,500 per month to a corporation owned by a director of the Company. In June of 2003, the payments were increased to $5,000 per month. Through December 31, 2003 consulting fees and related expenses totaling $41,250 and $2,604,

respectively, were expensed, of which $2,500 is included in accounts payable at December 31, 2003. In addition, in September 2003, the Company issued 150,000 shares of common stock to the corporation for services provided by in connection with the finalization of the Merger Agreement. In connection with the issuance of these shares, the Company recorded consulting expenses of $225,000, based on the fair market value of the common stock at the date of issuance. In February 2003, the Company entered into a consulting agreement with director of the Company. Pursuant to this agreement, the director receives a monthly retainer of $5,000 per month plus a fee of $1,500 per day for consulting work performed. Through December 31, 2003 consulting fees and related expenses totaling $118,000 and $24,581, respectively, were recorded pursuant to this agreement, of which $14,721 is included in accounts payable at December 31, 2003. In February 2003, the Company paid consulting fees in the amount of $110,000 to a corporation controlled by the two shareholders, each of whom own beneficially in excess of 5% of the outstanding shares of common stock of the Company, related to services provided in connection with the finalization of the Merger Agreement. In April 2003, the Company entered into a consulting agreement with this corporation pursuant which, the Corporation is entitled to receive a monthly fee of $15,000, provided however that payment of accrued fees is not payable by the Company until such time as the Company has a minimum cash balance of $2.5 million. Through December 31, 2003 a total of $135,000 in fees has been expensed and accrued pursuant to this agreement. During 2003, the Company recorded finders fee expenses totaling $30,000 for amounts earned by one of these shareholders and the corporation, in connection with private equity placements by the Company. Of the total finders fees earned, $15,000 was paid during the year and $15,000 is included in accrued expenses at December 31, 2003. During 2003, the Company paid finders fee expenses in the amount of $52,500, to a corporation controlled by an individual who beneficially owns in excess of 5% of the outstanding shares of common

stock of the Company. In addition, during 2003, the Company recorded consulting expenses totaling $75,000 that were added to an outstanding note payable with the corporation, and reimbursed the corporation for travel expenses related to business of the Company totaling $19,279. F-21 NOTE 14 - SUBSEQUENT EVENTS -------------------------- In February 2004, the Company entered into a bridge financing agreements with five (5) accredited investors pursuant to which the Company issued a total of $500,000 of secured subordinated debentures and received net proceeds of $447,500 after subtracting related placement agent fees and legal expenses totaling $52,500. The debentures bear interest at an annual rate of 24%, which is payable monthly beginning April 1, 2004. In addition, the debenture holders received an aggregate of 250,000 warrants to purchase shares of the Company's common stock, through March 1, 2009, at an exercise price of $1.10 The principal balance of the debentures is due and payable on the earlier of (i) thirty (30) days from the date the Company's registration statement filed on Form SB-2 is declared effective by the Securities and Exchange Commission, provided that SBI (as defined in the Registration Statement) has not defaulted in its obligation to purchase shares of the Company's common stock or (ii) twelve (12) months from the date the Registration Statement is declared effective or (iii) eighteen (18) months from the date of the date of the debenture agreement. In April 2004, the Company entered into stock purchase agreements with two (2) private equity investment funds pursuant to which the funds agreed to purchase an aggregate of 4,750,000 shares of the Company's common stock for a total amount of $9,500,000. In addition, under the agreements, one of the funds would receive 5-year warrants to purchase up to 1,900,000 shares of the Company's common stock at a price of $2.00 per share. Completion of this financing and related funding is contingent on the effectiveness of a registration statement filed with the Securities and Exchange Commission covering the resale of the shares of common stock and the shares of common stock underlying the warrants. F-22 SIGNATURES In

accordance with the requirements of the Exchange Act, the registrant caused this Amendment to report to be signed on its behalf by the undersigned, thereunto duly authorized. VisiJet, Inc. Dated: April 14, 2004 /s/ Randal A. Bailey ------------------------------ Randal A. Bailey, President /s/ Laurence Schreiber ------------------------------ Laurence Schreiber, Secretary In accordance with the Exchange Act, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the dates indicated. Signature Title Date -------------- ---- /s/ Randal A. Bailey ----------------------- Randal A. Bailey President (Principal Executive Officer) April 14, 2004 and a Director /s/ Laurence Schreiber ----------------------- Laurence Schreiber Treasurer (Principal Financial Officer) and a Director April 14, 2004 /s/ Richard H. Keates ----------------------- Richard H. Keates, M.D. Director April 14, 2004 ----------------------- Adam Krupp Director April 14, 2004 /s/ Norman Schwartz ----------------------- Norman Schwartz Director April 14, 2004 F-23