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AIRTECH INTERNATIONAL GROUP INC  
Form 10QSB  
June 03, 2002

QUARTERLY REPORT FOR SMALL BUSINESS ISSUERS SUBJECT  
TO THE 1934 ACT REPORTING REQUIREMENTS

FORM 10-QSB

U.S. SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

(Mark One)

/x/ QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934

For the quarterly period ended February 28, 2002

/ / TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

0-19796

-----  
Commission File No.

AIRTECH INTERNATIONAL GROUP, INC.

-----  
(Exact name of registrant as specified in its charter)

WYOMING

98-0120805

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

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

4695 MacArthur Court, Suite 1450 Newport Beach, CA 92660

-----  
(Address of principal executive offices)

Registrant's telephone number, including area code: (949) 475 6755

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

Yes [ X ] No [ ]

As of February 28, 2002, approximately 68,834,180 shares of Common Stock,  
\$.05 par value, were outstanding.

Traditional Small Business Disclosure Format

Yes [ X ] No [ ]

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ITEM	TABLE OF CONTENTS	PAGE NUMBER
PART I FINANCIAL INFORMATION		
1. Independent Accountants' Report.....		3
Airtech International Group, Inc.		
Financial Statements, Unaudited:		
Balance Sheet as of February 28, 2002.....		4
Statement of Operations for the nine months ended February 28, 2002 and 2001.....		6
Statement of Operations for the three months Ended February 28, 2002 and 2001.....		7
Statement of Cash Flows for the three months ended February 28, 2002 and 2001.....		8
Notes to the Financial Statements.....		9
2. Management's Discussion and Analysis.....		18
PART II OTHER INFORMATION		
1. Legal Proceedings.....		21
2. Changes in Securities.....		22
3. Defaults upon Senior Securities.....		22
4. Submission of Matters to a Vote of Security Holders.....		22
5. Other Information.....		22
6. Exhibits and Reports on Form 8-K.....		23
Signature Page.....		25

TURNER, STONE & COMPANY  
12700 Park Central Drive  
Suite 1610  
Dallas, Texas 75251

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INDEPENDENT ACCOUNTANTS' REPORT

Board of Directors and Stockholders  
Airtech International Group, Inc. and subsidiaries  
Dallas, Texas

We have reviewed the accompanying consolidated balance sheet of Airtech International Group, Inc. and subsidiaries as of February 28, 2002 and the related consolidated statements of operations and cash flows for the three months and nine months then ended. These consolidated financial statements are the responsibility of the Company's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statement taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying February 28, 2002 consolidated financial statements for them to be in conformity with generally accepted accounting principles.

/s/ Turner, Stone & Company, LLP  
-----  
Certified Public Accountants  
May 22, 2002  
Dallas, Texas

PART 1--Financial Information

Item I Financial Statements

Airtech International Group, Inc. and Subsidiaries  
Consolidated Balance Sheets  
February 28, 2002 and 2001

2002

2001

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ASSETS

CURRENT ASSETS

Cash	\$ 9,285	\$ 53,368
Trade accounts receivables, net of allowance for doubtful accounts of \$150,000 and \$40,000 respectively	521,527	731,315
Notes receivable, current portion	437,250	437,250
Inventory	0	1,305,559
Prepaid expenses and other assets	47,132	113,257
	-----	-----
Total current assets	1,015,194	2,640,749
	-----	-----

PROPERTY AND EQUIPMENT--net of accumulated  
depreciation of \$16,222  
and \$198,159 respectively

8,534 112,740

NOTES RECEIVABLE--net of current portion, net of  
allowance for Doubtful accounts of \$0  
and \$0, respectively

1,078,312 1,078,312

OTHER ASSETS

Investment in Joint Venture	0	0
Goodwill, net of \$134,291 and \$45,810 of accumulated amortization, respectively	44,763	92,432
Intellectual properties, net of \$337,095 and \$167,300 of acc. amortization, respectively	750,302	919,597
Other, Prepaid Royalties	0	294,988
	-----	-----

Total other assets 795,065 1,307,017

\$2,897,105 \$5,138,818  
=====

The accompanying notes are an integral part of the financial statements.

Airtech International Group, Inc. and Subsidiaries  
Consolidated Balance Sheets  
February 28, 2002 and 2001

LIABILITIES AND STOCKHOLDERS' DEFICIT

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	2002	2001
	-----	-----
CURRENT LIABILITIES		
Notes payable	\$ 829,044	\$ 277,185
Accounts payable, trade	403,521	750,526
Note payable-officers	0	210,338
Accrued payroll and payroll taxes	4,194	507,753
Convertible debentures	2,305,284	0
Other accrued expenses	899,872	608,843
	-----	-----
Total current liabilities	4,441,915	2,354,645
	-----	-----
LONG-TERM LIABILITIES		
Deferred revenue	340,000	340,000
Product Marketing Obligation		430,000
Convertible Debentures	0	2,350,000
	-----	-----
Total long-term liabilities	340,000	3,120,000
	-----	-----
Total liabilities	4,781,915	5,474,645
	-----	-----
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' DEFICIT		
Series M cumulative, convertible preferred, 990,625 Shares outstanding, liquidation preference of \$1.00 per share	991	991
Series B cumulative preferred, 5,000,000 shares Authorized, 1,000,000 shares outstanding	10,000	0
Outstanding, liquidation preference of \$2.00 per share		
Common stock--\$.05 par value, 100,000,000 shares authorized; 68,834,180 and 27,958,641 shares issued and outstanding, respectively	3,441,709	1,397,932
Additional paid-in capital	10,208,330	8,251,966
Retained deficit	(15,545,840)	(9,986,716)
	-----	-----
Total stockholders' deficit	(1,884,810)	(335,827)
	-----	-----
	\$ 2,897,105	\$ 5,138,818
	=====	=====

The accompanying notes are an integral part of the financial statements.

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	2002	2001
	-----	-----
REVENUES		
Product sales	\$ 961,426	\$ 1,412,607
Other Revenue		25,000
	-----	-----
Total revenues	961,426	1,437,607
	-----	-----
COSTS AND EXPENSES		
Salaries and wages	453,311	787,490
Research and Development	92,622	283,927
Cost of sales	652,775	780,235
Advertising	98,345	241,358
Depreciation and amortization	288,468	233,188
Other general & administrative expense	3,089,388	639,544
	-----	-----
Total costs and expenses	4,674,909	2,965,742
	-----	-----
LOSS FROM OPERATIONS	(3,713,483)	(1,528,135)
Interest expense	(445,572)	(175,114)
	-----	-----
NET LOSS BEFORE INCOME TAXES	(4,159,055)	(1,703,249)
Income taxes		
	-----	-----
NET LOSS	\$ (4,159,055)	\$ (1,703,249)
	=====	=====
LOSS PER COMMON SHARE--BASIC	\$ ( 0.06)	\$ ( 0.07)
	=====	=====
LOSS PER COMMON SHARE--DILUTED	\$ ( 0.06)	\$ ( 0.07)
	=====	=====

The accompanying notes are an integral part of the financial statements.

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	2002	2001
	-----	-----
REVENUES		
Product sales	\$ 8,845	\$ 418,034
Other Revenue		15,000
	-----	-----
Total revenues	8,845	433,034
	-----	-----
COSTS AND EXPENSES		
Salaries and wages	126,996	285,375
Research and Development	7,372	52,677
Cost of sales	7,674	220,845
Advertising	20,804	55,963
Depreciation and amortization	75,160	72,716
Other general & administrative expense	2,191,991	208,006
	-----	-----
Total costs and expenses	2,429,997	895,582
	-----	-----
LOSS FROM OPERATIONS	(2,421,152)	(462,548)
Interest expense	(134,368)	(62,404)
	-----	-----
NET LOSS BEFORE INCOME TAXES	(2,555,520)	(514,952)
Income taxes	0	0
	-----	-----
NET LOSS	\$ (2,555,520)	\$ (514,952)
	=====	=====
LOSS PER COMMON SHARE--BASIC	\$ ( 0.037)	\$ ( 0.02)
	=====	=====
LOSS PER COMMON SHARE--DILUTED	\$ ( 0.037)	\$ ( 0.02)
	=====	=====

The accompanying notes are an integral part of the financial statements.

7

Airtech International Group, Inc. and Subsidiaries  
Consolidated Statements of Cash Flows  
For the Nine Months Ended February 28, 2002 and 2001

2002	2001
-----	-----

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CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Loss	\$ (4,159,055)	\$ (1,703,249)
Adjustments to reconcile net income to cash		
Depreciation and amortization	288,468	233,188
Stock payments for interest on convertible debentures, payroll etc	1,119,000	0
Changes in operating assets and liabilities		
Accounts receivable	280,557	(461,344)
Inventory	983,148	(766,607)
Accounts payable	129,414	490,424
Accrued expenses and Prepaid Expenses	(370,222)	294,436
Other receivables	0	(75,045)
	-----	-----
Net cash used in operating activities	(1,728,690)	(1,988,197)
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES		
Expenditures for other assets, Equipment	161,948	(60,085)
Repayment of Note Payable		(500,000)
Redemption of Marketable Securities		1,000,000
	-----	-----
Net cash provided by investing activities	161,948	560,685
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of convert. debentures	172,000	0
Proceeds from issuance of Notes Payable	551,859	0
Proceeds from issuance of common stock	313,258	993,834
Conversion of Convertible Debentures to Stock	236,786	0
	-----	-----
Net cash provided by financing activities	1,273,303	993,834
	-----	-----
DECREASE IN CASH	(293,439)	(1,434,278)
CASH, BEGINNING OF PERIOD	302,724	1,487,646
	-----	-----
CASH, END OF PERIOD	\$ 9,285	\$ 53,368
	=====	=====

The accompanying notes are an integral part of the financial statements.

8

### Airtech International Group, Inc. and Subsidiaries Notes to Consolidated Financial Statements

#### 1. Summary of Significant Accounting Policies

##### Organization

Airtech International Group, Inc. (the Company), formerly Interactive Technologies Corporation (ITC), was incorporated in the state of Wyoming on

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August 8, 1991. As of May 31, 1998, in connection with the acquisition discussed below, the Company manufactures and sells air purification products.

On May 31, 1998, the Company acquired all of the outstanding common stock shares of Airtech International Corporation (AIC), which through its subsidiaries, manufactures and sells various air filtration and purification products. The total purchase price of \$22,937,760 was funded through the issuance of 10,500,000 shares of common stock valued at \$.625 per share, the issuance of 11,858,016 shares of Series A convertible preferred stock shares valued at \$.625 per share and the issuance of \$9,000,000 of convertible debentures.

However, because these convertible securities were converted into common stock within two months following acquisition, the shareholders of AIC obtained control of the Company. As a result, AIC became the acquirer for financial reporting purposes.

The transaction was accounted for using the purchase method of accounting with AIC for accounting and reporting purposes the acquirer. Accordingly, the purchase price of the net assets acquired has been allocated among the net assets based on their relative fair value of zero.

The Company sold its interest in its dormant wholly owned subsidiary, Airspure International Group, Inc. to Humitech, Inc. All the stock received from Humitech, Inc. was disbursed as a stock dividend to the shareholders of record November 30, 2001.

### Principles of consolidation

The accompanying consolidated financial statements include the general accounts of the Company and its subsidiaries, AIC, Airspure, Inc., Airspure International Group, Inc. thru November 30, 2001 (dormant) and McCleskey Sales and Service, Inc. (dormant) and the joint venture AirSecure, LLC (start up phase company) each of which has a fiscal year ended May 31. All material intercompany accounts and balances have been eliminated in the consolidation. Turner, Stone & Company, the Company's independent accountants, has performed limited reviews of the interim financial information included herein. Their report on such reviews accompanies this filing.

### Amortization

Intellectual property is allocated to the Company's air filtration products based on expected sales as a percent of total sales by product. The Company records amortization beginning when the product is initially inventoried for sale. Amortization is recorded ratably over a ten-year term.

9

### Airtech International Group, Inc. and Subsidiaries Notes to Consolidated Financial Statements

Goodwill acquired and recorded in the financial acquisition of ITC, is being amortized under the straight line method over 5 years.

A prepaid royalty fee, paid pursuant to a December 1995 agreement and related to the Company's portable medical unit, was amortized using the straight-line method over 24 months beginning January 2000 and ending December 2001.

### Inventories

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Inventories are carried at the lower of cost or net realizable value (market) and include component parts used in the assembly of the Company's line of air purification units, filters and finished goods comprised of completed products. The costs of inventories are based upon specific identification of direct costs and allocable costs of direct labor, packaging and other indirect costs.

### Property and equipment

Property and equipment are stated at cost less accumulated depreciation. Depreciation of property and equipment is currently being provided by straight line and accelerated methods for financial and tax reporting purposes, respectively, over estimated useful lives of five to seven years.

### Product marketing obligation

Property marketing obligations pursuant to Statement of Financial Accounting Standards, "SFAS" No. 68, the Company has recorded funds raised in an arrangement to develop, produce and market the Model S-999 as a product marketing obligation. As of June 2001, the partnership has been dissolved with the conversion of all limited partners into common stock of the Company.

### Revenue recognition

Revenues from the Company's operations are recognized at the time products are shipped or services are provided. Revenue from franchise sales are recognized at the time all material services relating to the sale of a franchise have been performed by the Company.

### Management estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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.

### Cash flow

For purposes of the statement of cash flows, cash includes demand deposits, short term cash equivalent investments and time deposits with maturates of less than three months.

10

Airtech International Group, Inc.  
and Subsidiaries  
Notes to Consolidated Financial Statements

None of the Company's cash is restricted.

### Loss per share

The basic and diluted loss per share are based upon 68,834,180 and 25,269,142 respectively, weighted average shares of common stock outstanding over the three and nine month period ending February 28, 2002 and 2001. No effect has been given to the assumed conversion of convertible preferred stock, convertible debentures, product market obligation guarantees (for the quarter ended February 28, 2001) and the assumed exercise of stock options and warrants,

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as the effect would be antidilutive.

### Research and Development

The Company's research and development activities consists of retooling and developing its Model S-12 and S-30 products, including applying the Company's technology in photo-catalytic conversion to the other air purification products. The costs of research and development are charged to expense when incurred.

### 2. Liabilities

The Company's notes payable consist of loans from various corporations and individuals. The notes \$277,185 contain no significant restrictions, bear interest at rates from 10% to 18%. The notes are in default since May 1999.

The Company also entered into a note payable agreement with a private placement group. The terms are for a two year repayment on a monthly basis of principle and interest at 12%. The notes totaling \$551,859 are in default as of April 19, 2002.

### 3. Commitments and Contingencies

#### Operating Leases

The company is currently obligated under an operating leases for its Dallas office and warehouse facility, which expires in September 2004. The Company is no longer occupying the space.

Minimum future rental payments under the above operating lease is as follows:

Year ending May 31	
2002.....	21,600
2003.....	43,200
2004.....	47,500
	-----
	\$112,300

### 4. Financial instruments

The Company's financial instruments consist of its cash, marketable securities accounts and notes receivable, and trade payables.

11

Airtech International Group, Inc.  
and Subsidiaries  
Notes to Consolidated Financial Statements

#### Cash and Marketable Securities

The Company maintains its cash in bank deposit and other accounts, which, at times, may exceed federally insured limits. The Company invests excess cash not required for operations in US Treasury repurchase agreements in connection with its cash management account with its primary bank. The Company has not experienced any losses in such accounts, and does not believe it is subject to any credit risks involving its cash.

#### Accounts and notes receivable, trade

The Company accounts and notes receivables are unsecured and represent sales not collected to date. Management believes these accounts and notes

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receivables are fairly stated at estimated net realizable amounts.

### 5. Stock options and warrants

Through the quarter ended February 28, 2002 and 2001, the Company has issued various stock options and warrants to employees and others and uses the intrinsic value method of accounting for these stock options. Compensation cost for options granted has not been recognized in the accompanying financial statements because the amounts are not material and its exercise price exceeded the common stock fair market value at the date of option. The options and warrants expire between May 2002 and January 2007 and are exercisable at prices from \$0.05 to \$10.00 per option or warrant. Exercise prices were set at or above the underlying common stock's fair market value on the date of grant.

### 6. DESCRIPTION OF CONVERTIBLE SECURITIES

We have summarized below the material provisions of our securities which are convertible into shares of our common stock.

#### SERIES "M" CONVERTIBLE PREFERRED STOCK AND RELATED WARRANTS

We have 990,625 shares of Series "M" Convertible preferred stock outstanding at February 28, 2002. Holders of Series "M" preferred have the right to convert their shares into shares of our common stock on a one-for-one basis at any time. The Series "M" preferred were to automatically convert to shares of common stock on December 31, 2001. This has been extended monthly since December. The holders of Series "M" preferred are entitled to receive quarterly dividend distributions equal to 4.57% of the gross revenues generated from the sales of our Series 950 units until January 31, 2002. The dividends are to be paid on or before the sixtieth day of each calendar quarter based upon the gross revenues from our Series 950 unit from the previous quarter. Airtech has not paid dividends on the preferred stock and is in default under the stock certificate.

#### AIRSOPURE 999 LIMITED PARTNERSHIP INTERESTS

We had \$430,000 of limited partnership interests outstanding in Airsopure 999, L.P. ("Airsopure LP"). Airsopure, Inc., at May 31, 2001 our wholly-owned subsidiary ("Airsopure"), is the sole general partner of Airsopure LP. Under the limited partnership agreement, the limited partners were entitled to receive 1.7% of the gross revenues generated from sales of our Model S-999

12

Airtech International Group, Inc.  
and Subsidiaries  
Notes to Consolidated Financial Statements

automobile air purification system. The limited partners were entitled to receive distributions until December 31, 2003. All limited partners were converted to common stock in June 2001 by the issuance of 2,639,926 shares of our common stock. The Limited Partnership was dissolved at May 31, 2001.

#### 12% CONVERTIBLE DEBENTURES DUE 2004 AND ATTACHED WARRANTS

In January 2000, our board of directors authorized the issuance of up to \$5,000,000 of our 12% Convertible Debentures Due 2004 under a private placement memorandum. As of February 28, 2001, we sold \$300,000 in principal amount of our 12% debentures. At any time after one year from the date of issuance, holders of our 12% debentures are entitled to convert our 12% debentures on a dollar for

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dollar basis into shares of our common stock. Semi-annual interest payments are due and payable on our 12% debentures commencing September 1, 2000. The interest due thru May 31, 2001 was paid by the issuance of common stock and subsequent interest payments have not been made. Under the terms of the debenture the Company is in default for the principle and interest amount of the debenture. Each 12% debenture in the principal amount of \$25,000 includes a warrant to purchase shares of our common stock at an exercise price of \$2.00 per share. The warrants expire two years from the date of issuance. At our option, our 12% debentures may be converted on a dollar for dollar basis into shares of our common stock or paid in cash at face value on the maturity date. Prior to maturity, we may with the consent of the debenture holder, redeem our 12% debentures in cash at a premium together with accrued interest to date.

### 6% CONVERTIBLE DEBENTURES DUE 2002 AND ATTACHED WARRANTS

On February 22, 2000, we sold \$2,500,000 in principal amount of our 6% Convertible Debentures Due 2002 to PK Investors, LLC. Our 6% debentures have a maturity date of February 22, 2002 at which time the principal amount and all accrued interest is due and payable. No interest payments are due prior to maturity of the 6% debentures. Interest was paid through October 2001, through the issuance of shares of common stock. As of February 22, 2002 the Company is in default for failure to repay the note and interest when due. We may, at our option, pay the accrued interest at maturity by issuing shares of our common stock to the debenture holder at a price equal to the conversion price of our common stock as described below. Our 6% debentures are convertible at any time at the option of the holder into shares of our common stock. The conversion price of our common stock used in calculating the number of shares issuable upon conversion (or in payment of interest) is the lesser of:

- 110% of the average closing bid price of our common stock for the five trading days prior to the date of initial payment; and

- the product obtained by multiplying 0.80 by the average of the three lowest closing bid prices of our common stock during the thirty trading days prior to the date we receive a conversion notice from a debenture holder.

13

Airtech International Group, Inc.  
and Subsidiaries  
Notes to Consolidated Financial Statements

In the event we have a "change of control", the holders of our 6% debentures may require us to redeem the 6% debentures at a redemption price equal to 125% of the aggregate outstanding principal and accrued interest on the 6% debentures. A "change of control" includes:

- acquisition by an entity or group of more than 50% of our voting stock; - merger or consolidation; - a change in a majority of our existing board of directors; or - a sale of substantially all of our assets.

The holders of our 6% debentures also have attached warrants to purchase 250,000 shares of our common stock at an exercise price of \$2.6124 per share. The warrants expire on February 22, 2005. The 6% Convertible Debenture due 2002 was not paid at maturity and is in default.

### 12% CONVERTIBLE DEBENTURES DUE MARCH 30, 2003 and ATTACHED WARRANTS

On March 29, 2001, we entered into a securities purchase agreement with AJW Partners, LLC and New Millennium Partners II, LLC to raise up to \$1,000,000

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through the sale to these investors of our 12% Convertible Debentures Due 2003 with attached warrants to purchase up to 600,000 shares of our common stock. Upon execution of the securities purchase agreement, the investors purchased \$800,000 in principal amount of 12% debentures with attached warrants to purchase 500,000 shares of our common stock. The purchase price paid by the investors for our 12% debentures and attached warrants was \$800,000 which represents the total amount we have received under the purchase agreement through April 30, 2001. Under the terms of our purchase agreement, the investors are obligated and did purchase the remaining \$200,000 in principal amount of our 12% debentures with attached warrants to purchase 100,000 shares of common stock for a purchase price of \$200,000. The investors purchased \$200,000 of the convertible debentures July 20, 2001. The holders of the debentures made a demand for conversion of a portion of the Debentures in November 2001, the Company did not convert and the Debentures are in default at February 28, 2002.

Our 12% debentures have a maturity date of March 30, 2003 at which time the principal amount and all accrued interest on the 12% debentures is due and payable. Interest payments on the 12% debentures are due and payable quarterly commencing June 1, 2001 or at the option of the debenture holder upon conversion of the 12% debentures into shares of our common stock. If the debenture holder elects, we will pay any accrued interest on conversion by issuing shares of our common stock to the debenture holder at a price equal to the conversion price of our common stock as described below. The 12% debentures are secured by a security agreement under which we pledged substantially all of our assets, including our goods, fixtures, equipment, inventory, contract rights, and receivables.

The 12% debentures are convertible at any time at the option of the holder into shares of our common stock, provided at no time may a holder of our 12% debentures and its affiliates own more than 4.9% of our outstanding common stock without giving us 30 days prior written notice of the debenture holder's intent to waive the 4.9% ownership limitation. The conversion price of our common stock used in calculating the number of shares issuable upon conversion, or in payment of interest on the 12% debentures, is the lesser of 50% of the average of the lowest three trading prices of our common stock for the twenty trading days

14

Airtech International Group, Inc.  
and Subsidiaries  
Notes to Consolidated Financial Statements

ending one trading day prior to the date we receive a conversion notice from a debenture holder; and a fixed conversion price of \$0.25.

Also, under the terms of the 12% debentures, if we at any time distribute any shares of our common stock in a consolidation, exchange of shares, re-capitalization or reorganization, the 12% debenture holders are entitled to participate in the distribution as if the debenture holders had converted the 12% debentures; distribute any of our assets to our stockholders as a dividend, stock repurchase, return of capital, or otherwise, the 12% debenture holders are entitled to participate in the distribution as if the debenture holder had converted the 12% debentures; or issue or sell any shares of our common stock for no consideration or at a price less than \$0.25 per share, then the fixed conversion price of \$0.25 described above shall be reduced to the price per share we receive on the issuance or sale.

Our 12% debentures have an imbedded beneficial conversion feature which enables the debenture holders to convert the 12% debentures at the lesser of a 50% discount to the market price of our common stock and \$0.25 per share. As of

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the date of sale of the 12% debentures, the imbedded discount attributable to the 12% debentures was \$900,000. We have reflected this discount in our financial statements by writing off \$146,700 of the discount as of the date of sale of the 12% debentures. We will amortize the remaining \$753,300 of the discount over the three year term of the 12% debentures. If a 12% debenture is converted prior to the expiration of the three year term, we will write off to interest expense any remaining discount attributable to the converted 12% debenture.

### Description of Warrants

The warrants purchased by the investors on March 29, 2001 entitle the investors to purchase 500,000 shares of our common stock at an exercise price equal to the lesser of 90% of the average of the lowest three trading prices of our common stock for the twenty trading days ending one trading day prior to the date of exercise of the warrant; and \$0.102 per share.

The warrants expire on March 29, 2004. The warrants are subject to exercise price adjustments upon the occurrence of certain events including stock dividends, stock splits, mergers, reclassifications of stock or our re-capitalization. The exercise price of the warrants is also subject to reduction if we issue any rights, options or warrants to purchase shares of our common stock at a price less than the market price of our shares as quoted on the OTC Bulletin Board. Also, if at any time, we declare a distribution or dividend to the holders of our common stock in the form of cash, indebtedness, warrants, rights or other securities, the holders of the warrants are entitled to receive the distribution or dividend as if the holder had exercised the warrant.

The warrants attached to our 12% debentures have an imbedded beneficial exercise feature which enables the warrant holders to exercise the warrants at the lesser of a 10% discount to the market price of our common stock and \$0.102

15

### Airtech International Group, Inc. and Subsidiaries Notes to Consolidated Financial Statements

per share. As of the date of sale of the warrants, the imbedded discount allocable to the warrants was \$100,000. The discount was determined from the Black-Scholes option pricing method. In our financial statements, we will amortize and write-off to interest expense the \$100,000 discount over the three year term of the warrants. If a warrant is exercised prior to the expiration of the three year term, we will write off to interest expense any remaining discount attributable to the exercised warrant.

See Litigation Section for description of claims of 12% debenture holders that the debenture is in default.

### Consent and Standstill Agreement of 6% Debenture Holders

Our 6% debenture holders consented to the sale of our 12% debentures. The 6% debenture holders also agreed that neither they nor their affiliates would for a period beginning March 29, 2001 and ending 8 months from the date the registration statement relating to the securities offered by this prospectus is declared effective by the SEC offer to sell, contract to sell, pledge, grant any rights or otherwise dispose of any shares of our common stock held by the 6% debenture holders without the prior consent of the 12% debenture holders; or engage in any hedging transactions which are designed or reasonably expected to

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lead to or result in a disposition of the shares of our common stock held by the 6% debenture holders.

The 6% debenture holders may however; convert the 6% debentures into a maximum of 200,000 shares of our common stock per month on a non-cumulative basis; and sell up to 100,000 shares per month of common stock converted after March 29, 2001 or 200,000 shares if the selling price is at least \$0.75 per share, with any unsold converted shares held in escrow by our legal counsel.

### CONVERTIBLE PREFERRED STOCK

The Company has authorized 5,000,000 shares of Series B Preferred Stock that is senior to Common Stock and junior to Series M Preferred stock and carries liquidation redemption of \$2.00 per share. The shares have the same voting rights as Common Stock shares on a twenty-for-one basis. The stock is entitled to receive dividends when and if declared by the Directors of the Company at the rate of \$0.20 per share and can be converted to Common Stock at the option of the holder into thirty two and 65/100th shares of Common per share of Preferred. The Company has issued one million shares of Series B Preferred Stock.

### Joint Venture

The Company has entered into an Agreement with BioSecure Corp. to form a joint venture. The joint venture is a Nevada limited liability corporation, AirSecure, LLC. The Company has a 49% ownership in the venture with BioSecure Corp. owning the remaining 51%. The joint venture will focus on the bioterrorism protection market for various products and services, including the air cleaning and air filtration products of the Company. The Company will account for its investment in the Joint Venture using the Equity Method of

16

Airtech International Group, Inc.  
and Subsidiaries  
Notes to Consolidated Financial Statements

accounting. However, as of February 28, 2002, the joint venture did not have any reportable activity, no assets or liabilities or company value.

### Subsequent Event.

The Company was in default under a settlement agreement with a creditor, Carlo Gavazzi Mupac, Inc. This creditor seized certain of the Company's assets in March 2002. The effect of the seizure and subsequent creditor sale of assets is reflected in the Financial Statements as of February 28, 2002.

17

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

### FORWARD LOOKING STATEMENTS

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Certain statements contained in this report that are not historical fact are "forward-looking statements" as that term is defined in the Private Securities Litigation Reform Act of 1995. The words or phrases "will likely result," "are expected to," "will continue," "is anticipated," "believes," "estimates," "projects" or similar expressions are intended to identify these forward-looking statements. These statements are subject to risks and uncertainties beyond our reasonable control that could cause our actual business and results of operations to differ materially from those reflected in our forward-looking statements. The safe harbor provisions provided in the Securities Litigation Reform Act do not apply to forward-looking statements we make in this report. Forward-looking statements are not guarantees of future performance. Our forward-looking statements are based on trends which we anticipate in our industry and our good faith estimate of the effect on these trends of such factors as industry capacity, product demand and product pricing. The inclusion of projections and other forward-looking statements should not be regarded a representation by us or any other person that we will realize our projections or that any of the forward-looking statements contained in this prospectus will prove to be accurate.

### BACKGROUND AND GENERAL

On May 31, 1998, Interactive Technologies acquired all of the outstanding shares of common stock of Airtech Corporation for a purchase price of \$22,937,760. The financial statements reflect the combination as a reverse merger with Airtech Corporation as the acquiring entity for accounting and reporting purposes and Interactive Technologies as the surviving entity for legal purposes. Interactive Technologies effectively issued shares of common stock for the outstanding shares of Airtech Corporation, with the stockholders of Airtech Corporation ultimately acquiring control of Interactive Technologies. For this reason, Airtech Corporation is considered the acquiring entity for purposes of our financial statements.

### RESULTS OF OPERATIONS

FOR THE THREE AND NINE MONTHS ENDED FEBRUARY 28, 2002  
COMPARED TO THE THREE AND NINE MONTHS ENDED FEBRUARY 28, 2001

#### REVENUES

Our consolidated total revenues decreased \$43,147 or 5.2% from \$1,004,573 for the nine months ended February 28, 2002 compared to the nine months ended February 28, 2001 of \$1,004,573. This decrease in sales is due to the cessation of sales from the consumer direct sale franchise group. In the first nine months, starting in August 2000 the Company had opened four retail outlets for sale of the portable unit. These stores were closed in March 2001. Similarly, the revenue for the three months ended February 28, 2001 of \$485,936 included the direct sale program which is no longer in operation in the current quarter ended February 28, 2002. Therefore the sales from on going operations decreased \$477,091 to \$8,845 from \$485,936 for the three month period in 2001. In addition, there was an additional \$300,000 in bulk sales for the nine months ended February 28, 2002 from the sale of the auto unit at a near cost basis. There were no similar bulk sales for the nine months ended February 28, 2001. This bulk sale was reflected in the quarter ended November 30, 2002.

18

#### COSTS AND EXPENSES

Our consolidated total costs and expenses increased \$1,709,167 or 157% from \$2,965,742 to \$4,674,909 in the nine months ended February 28, 2002 and 2001, respectively. The costs and expenses increased \$1,534,415 or 271% from \$895,582 for the three months ended February 28, 2001 to \$2,429,997 for the three months

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ended February 28, 2002. The major components of this \$1,709,167 and \$1,534,415 increase were:

Salaries and wages for the nine months decreased \$334,179 or 42% from \$787,490 in 2001 to \$453,311 for 2002. This decrease is the result of many factors including decreased commissions on sales of our products through the retail direct sale stores. Also, we have decreased the total number of employees (outside of the decrease from the retail store group) by thirteen individuals. The salaries decreased from \$285,375 for the three months ended February 28, 2001 to \$126,996 for the three months ended February 28, 2002. The reason for the \$158,379 decrease in expenses was the same as for the nine months comparison.

Cost of sales decreased for the nine months by \$127,460 or 16% to \$652,775 for 2001 as compared to \$780,235 for 2001. This decrease is due to the change in product mix of units sold in the quarters. For the 2001 period the sales were in the retail direct sale market where the margins were higher than the current sales into the non retail market. In addition, in the nine months ended February 28, 2002 the Company sold \$300,000 of the auto units at a cost of \$300,000 in a lump sum sale. Therefore, the percentage cost of sales are not comparable. For the nine and three months ended February 28, 2001 and 2002 the percentage cost of sales was 68% and 67% respectively. The \$220,845 cost of sales or 53% compares to \$7,674 or 87% for the three months ended February 28, 2002. The percentage for the three months due to the low volume of sales.

Depreciation and amortization increased \$55,279 to \$288,468 for the nine months ended February 28, 2002 compared to \$233,188 for the nine months of 2001. This increase is primarily due to increased amortization of prepaid royalties. The increased amortization of royalties is also the reason for the \$2,444 increase in costs from \$72,716 to \$75,160 for the three month periods ended February 28, 2002 and 2001

General and administrative expenses increased \$2,449,844 to \$3,089,388 for the nine months ended February 28, 2002 from \$639,544 in 2001. This 483% increase is due to increases in litigation expenses of legal fees and expected settlement costs. The increase is also due to a \$700,000 write off of receivables and the loss of \$700,000 in inventory and equipment due to the creditor seizure of assets. In addition, outside consultant fees and investment bankers fees increased during 2001, due to the additional consultants used in lieu of full time employees as a result of the decrease in salaries over the period. The general and administrative costs increased, primarily due to the seizure of assets, a total of \$1,983,985, resulting in the \$2,191,991 in expenses for the quarter ended November 30, 2002 compared to \$208,006 for the three months ended November 30, 2001.

19

Interest expense of \$445,572 for 2002 is \$270,458 higher or 254% than the \$175,114 interest expense in 2001, due to the interest accrual on the outstanding 6% debentures issued in February 2000, the 12% debentures issued in March and the \$500,000 issued in September 2001. In addition, the 12% convertible debentures sold in March and July 2001 contained an imbedded beneficial conversion feature, wherein an additional \$142,115 in interest was charged as interest expense and as a discount to the debentures.

The result of these revenues and costs and expenses is a net loss of \$(4,159,055) or (\$0.06) per share of common stock (basic and diluted) for the nine months ended February 28, 2002 compared to a net loss of \$(1,703,249) or (\$0.07) per share of common stock for the nine months ended February 28, 2001. This represents a \$2,455,806 or 244% increase in our net loss and a \$0.01 decrease in loss per share of our common stock compared to 2001. The average

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number of shares of our common stock increased from 2001 to 2002 so the loss per share on our common stock is not comparable. The net loss for the three months ended February 28, 2002 of \$2,555,520 is \$2,040,568 or 496% higher than the loss of \$514,952 for the three months ended February 28, 2001. The loss per share increased to \$(0.037) for the three months ended February 28, 2002 despite the increase in the number of shares outstanding compared to the three months in 2001.

### CAPITAL EXPENDITURES

We do not have any large capital expenditures planned for fiscal year 2002. Any minor capital expenditures will be met with cash on hand. In the event our product sales increase beyond current out-sourced manufacturing capacities, then additional capital expenditures will be required to increase production capacity. We anticipate, however, that any additional capital expenditures to increase production capacity would not exceed \$150,000. These capital expenditures would also be offset by increased product sales which created the need to increase our current out-sourced manufacturing capacities. The Company will be outsourcing the assembly of the products to a number of vendors.

### LIQUIDITY AND CAPITAL RESOURCES

In March 2002, a creditor Carlo Gavazzi Mupac, Inc. executed a writ of execution based upon the failure to pay a settlement payment and seized certain of the assets of the Company. The result of the seizure is reflected in the Financial Statements. The loss of inventory and assets has resulted in a decrease in the ability of the Company to manufacture and sell products.

The Company is in default with all of its creditors. The Company does not have sufficient assets to either pay the creditors or to fund manufacturing and sales activity. The only means to continue operations is for a third party to negotiate workout settlements with the creditors and fund sales activities. The Company entered into Agreements with various third parties to negotiate with the creditors and to fund a downsized operations budget. As of this date the third parties have not been successful with the creditors and have failed to support operations. Therefore, unless the third parties perform, We do not expect to have sufficient funds necessary to finance the production, by outside manufacturers, distribution, by the Company and its Joint Venture and sale of our products including management and advertising support for fiscal year 2002. In addition, general and administrative expenses have been reduced during the first nine months of fiscal 2002. We also expect that our cash balance and operations are inadequate to sustain our continued operations during fiscal year 2002, on a lower basis and based on the venture and third party agreements.

20

Our sales projections are based upon our good faith estimates of the marketability of our products and we cannot assure you that we will achieve these results during fiscal year 2002.

If our current lack of cash and lack of revenues from product sales and the effects of the venture agreement are insufficient to fund our requirements, we will rely on new external funding sources to provide liquidity, however, due to the position of the Company the possibility of new external funding is not likely and can not be assured.

If our current and new product sales, distributor/franchise sales, new areas of distribution sales and funds from our external sources are not sufficient to maintain operations, the resulting lack of capital could force us to substantially curtail or cease our operations. Any curtailment of operations would have a material adverse effect on our ability to manufacture and

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distribute our products and our profitability.

### Part II- Other Information

#### ITEM 1. LEGAL PROCEEDINGS

In 1997, we were named as a defendant in a cause of action styled LLB Realty, L.L.C. v. Interactive Technologies Corp., Cause No. MER-L-1535-97, in the Superior Court of New Jersey, Mercer County. The complaint alleges damages relating to a lease agreement entered into with the plaintiff's for office facilities in New Jersey. We never occupied the space based upon the plaintiff (lessor) failing to finish-out the space pursuant to our specifications. The complaint alleges damages of approximately \$250,000 for remaining lease payments, finish-out costs and lost revenues. The Court ruled in favor of the plaintiffs and will hold a hearing to determine damages. Although we are in negotiations for a settlement relating to the complaint, the outcome of these negotiations is uncertain. We have established a reserve in our consolidated financial statements in the amount of \$200,000 in anticipation of a settlement.

21

We have been named as a defendant in a case Number 01 CV 1084 in the United States District Court for the Southern District of New York alleging damages of \$1,500,000 to the holders of the 12% debentures due March 2003. The complaint states that the Company is in default of the Debenture Agreements. The Company will defend the allegations. The possible adverse result has been reserved in the Company's liabilities. This action is in the early stages of litigation.

The Company settled a law suit titled H.A.A. Inc. v Airtech International Group, Inc. during the first quarter 2002. The Company is in default under this settlement agreement.

The Company has been found due and owing a former employee in a County Court action in Michigan. The Company will negotiate a settlement with offset amounts due the Company. The net liability of \$25,000 has been reserved in the Company's liabilities.

The Company settled a law suit Carlo Gavazzi Mupac, Inc. v Airtech International Group, Inc. in 2000. The Company paid approximately \$400,000 to the plaintiff since that time. The Company was in default for approximately \$225,000 at February 28, 2002. The creditor seized certain of the Company's assets in March 2002. The remaining amount due was not satisfied by the creditor sale of these assets. The \$225,000 due is reflected in the liabilities of the Company.

We have been named as a defendant in a number of lawsuits arising in the ordinary course of our business, generally from a failure to pay creditors. There are approximately ten such lawsuits and numerous threatened suits. In some of these cases a judgment was rendered against us. We have answered these routine causes of action where appropriate, negotiated settlements where appropriate and agreed to a payment schedule with respect to others. We are in default with all creditors. We have fully reserved for these claims and causes of action in our consolidated financial statements in the aggregate amount of approximately \$235,000.

The United States Securities and Exchange Commission is informally investigating the Company's press releases in October and November 2001 and has requested document production of various kinds from the Company. The Company has produced some information for the SEC and is in the process of producing the remaining requested information. The Company can not predict the outcome of the investigation.

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### ITEM 2. CHANGES IN SECURITIES

On July 20, 2001, issuance of \$200,000 in 12% Convertible Debentures in a Private Placement. On June 10, 2001, issued a Private Placement of 2,639,926 shares of Common Stock to convert the limited partners in the Airsopure 999 L.P., reflected in the Financial Statements as Product Marketing Obligation of \$430,000. Issued in a Private Placement in June 2001 335,000 shares of Common Stock to the 12% Convertible Debenture holders (Private Placement) for interest owed under the Debenture. Partial conversion of 6% and 12% Convertible Debentures and payment of accrued interest owing into 12,384,000 shares of Common Stock, issued under SB-2 Registration Statements. The Company issued a new Series B Preferred Stock in January 2002 and issued one million shares. The company issued shares of stock to the Company employees for services performed during this period, under a S-8 Registration Statement.

### ITEM 3. DEFAULT UPON SENIOR SECURITIES

The Company has been named in a cause citing a default of the 12% Convertible Debentures, due March 2003. The Company is contesting this default allegation and will answer the complaint. In addition, the Company is in default under the 6% Convertible Debentures due 2002, is in default for failing to pay interest to the 12% Convertible Debenture due 2003 and the monthly principal and interest due the 12% Note holders.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

### ITEM 5. OTHER INFORMATION

#### DIVIDENDS

We have paid no dividends on our shares of common stock and we have no current intention to pay dividends on our shares of common stock in the future. Holders of our Series "M" Convertible Preferred Stock have a preferred dividend right to receive dividend distributions equal to 4.57% of the gross revenues

22

generated from sales of our Series 950 units until January 31, 2002. Except for required dividend payments on the Series "M" convertible preferred stock, we intend to retain any future earnings for reinvestment in our business. As of November 28, 2001, no dividends have been paid on the Series "M" Convertible preferred stock. Future dividends will be dependent upon our financial condition, results of operations, capital requirements and other relevant factors. In August 2001, we announced that the Company would be issuing a dividend to shareholders of record November 30, 2001. This dividend was one share of Humitech, Inc. common stock, for every ten shares of Airtech International Group, Inc. common stock owned at November 30, 2001. Humitech, Inc. purchased, in August, 2001, one hundred per cent of the outstanding common stock of our dormant subsidiary, Airsopure International Group, Inc. in a stock exchange whereby we received approximately ten percent of the combined company stock in Humitech. We issued one hundred per cent of our ownership in Humitech in the dividend to shareholders. This dividend has been substantially completed as of this date.

### ITEM 6. (a) EXHIBITS AND (b) REPORTS ON FORM 8-K.

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### (a) Exhibits

- 3.1\* Restated Articles of Incorporation filed December 27, 1991 of the Company's predecessor in name, Interactive Technologies Corporation, Inc.
- 3.2\* Articles of Amendment dated filed May 14, 1997 of the Company's predecessor in name Interactive Technologies Corporation, Inc.
- 3.3\* Articles of Amendment of the Company filed October 16, 1998
- 3.4 Bylaws of the Company's predecessor in name, Interactive Technologies Corporation, Inc. (incorporated by reference to the Company's Form 10 filed on January 14, 1992)
- 4.1\* Specimen Common Stock Certificate
- 4.2\* Specimen Series "M" Preferred Stock Certificate
- 4.3\* Form of Warrant to purchase shares of Common Stock granted to holders of Series "M" Convertible Preferred Stock
- 4.4\* Form of Securities Purchase Agreement dated February 22, 2000 by and between the Company and PK Investors LLC
- 4.5\* Form of 6% Convertible Debenture Due 2002
- 4.6\* Form of Warrant to purchase shares of Common Stock granted to holders of 6% Convertible Debentures Due 2002
- 4.7\* Registration Rights Agreement dated February 22, 2000 by and between the Company and PK Investors LLC relating to the registration of the Common Stock and Warrants related to Exhibits 4.4 and 4.5
- 4.8\* Form of Conditional Warrant to Purchase 6% Convertible Debentures and Warrants to Purchase Common Stock
- 4.9\*\* Form of 12% Convertible Debenture Due 2005
- 4.10\*\* Form of Warrant to purchase shares of Common Stock granted to holders of 12% Convertible Debentures Due 2005
- 10.1 Stock Purchase Agreement dated May 5, 1997 by and between Interactive Technologies Corporation, Inc. and Airtech International Corporation (incorporated by reference to Exhibit 10.5 to Company's Annual Report filed on August 28, 1997 for the year ended May 31, 1997, file No. 19796)
- 10.2\* Employment Agreement dated May 1, 1997 between the Company and C.J. Comu
- 10.3\* Employment Agreement dated May 1, 1997 between the Company and John Potter
- 10.4\* Form of Franchise Agreement relating to franchises offered by Airsopure International Group, Inc., a wholly-owned subsidiary of the Company

23

- 10.5\* Form of Development Agreement offered to franchisees by Airsopure International Group, Inc., a wholly-owned subsidiary of the Company
- 10.6\* Form of Offering Circular presented to franchisees by Airsopure International Group, Inc., a wholly-owned subsidiary of the Company
- 21\*\* Subsidiaries of the Registrant

- o Incorporated by reference to the Company's Registration Statement on Form SB-2 filed on May 8, 2000, Registration No. 333-36554.

- \*\* Incorporated by reference to the Company's Form 10-K/SB filed September 14, 2000.

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

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

A Form 8-K was filed to reflect the change in address of the Company to Newport Beach California.

SIGNATURES

In accordance with the requirements of the Securities Act of 1934, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized and in the capacity as the registrant's Chief Executive Officer and Chief Financial and Accounting Officer, respectively.

Dated: May 22, 2002

AIRTECH INTERNATIONAL GROUP, INC.

By: /s/ R. JOHN HARRIS

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R. John Harris,  
Chief Executive Officer and Chairman

By: /s/ James R. Halter

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James R. Halter,  
Chief Financial, Accounting Officer  
and Director