ENCORE ACQUISITION CO
Form 424B5
June 09, 2004

Table of Contents

Filed Pursuant to Rule 424(b)(5)
Registration No. 333-106943

Prospectus Supplement to Prospectus dated August 25, 2003.

2,000,000 Shares

Encore Acquisition Company

Common Stock

The common stock is listed on the New York Stock Exchange under the symbol EAC . The last reported sales price of our common stock on June 7, 2004 was $28.30 per share.

See Risk Factors beginning on page 1 of the accompanying prospectus to read about factors you should consider before buying shares of the common stock.

Neither the Securities and Exchange Commission nor any other regulatory body has approved or disapproved of these securities or passed on the accuracy or adequacy of this prospectus supplement or the accompanying prospectus. Any representation to the contrary is a criminal offense.

	Per Share	Total
Initial price to public	$26.95	$53,900,000
Underwriting discount(1)	$ 0.30	$ 600,000
Proceeds, before expenses, to Encore	$26.65	$53,300,000

(1) In addition, Goldman, Sachs & Co. may receive from purchasers of the shares normal brokerage commissions in amounts agreed upon with such purchasers.

Goldman, Sachs & Co. expects to deliver the shares against payment in New York, New York on June 10, 2004.

Goldman, Sachs & Co.

Prospectus Supplement dated June 7, 2004.

Table of Contents

ABOUT THIS PROSPECTUS SUPPLEMENT

This document is in two parts. The first part is this prospectus supplement, which describes the terms of this offering of shares of common stock and includes information about us. The second part is the accompanying prospectus, which provides more general information. Generally, when we refer to the prospectus, we are referring to both parts of this document combined.

We incorporate important information into this prospectus by reference. You may obtain the information incorporated by reference into this prospectus without charge by following the instructions under Where You Can Find More Information on page 25 of the accompanying prospectus or by contacting us at our address provided on page S-12.

If the description of this offering varies between this prospectus supplement and the accompanying prospectus, you should rely on the information in this prospectus supplement. Additionally, you should rely only on the information contained in this prospectus supplement, the accompanying prospectus and the documents incorporated therein by reference. We have not, and the underwriter has not, authorized anyone to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not making an offer of these securities in any jurisdiction where an offer or sale of these securities is not permitted. The information in this prospectus supplement and the accompanying prospectus is accurate as of the dates shown in these documents. The information we have incorporated by reference is accurate as of the date of such document. Our business, financial condition, results of operations and prospects may have changed since that date.

You should read this prospectus supplement along with the accompanying prospectus carefully before you invest. Both documents contain important information you should consider when making your investment decision. The prospectus supplement contains information about the common stock offered in this offering and may add, update or change information in the accompanying prospectus.

FORWARD-LOOKING STATEMENTS

This prospectus supplement, including the information we incorporate by reference, includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, or the Exchange Act. You can identify our forward-looking statements by words such as estimate, project, predict, believe, expect, anticipate, plan, forecast, bud other words that convey the uncertainty of future events or outcomes. When considering these forward-looking statements, you should keep in mind the risk factors and other cautionary statements contained in this prospectus supplement, the accompanying prospectus and the documents we have incorporated by reference.

The forward-looking statements are not guarantees of future performance, and we caution you not to rely unduly on them. We have based many of these forward-looking statements on expectations and assumptions about future events that may prove to be inaccurate. While our management considers these expectations and assumptions to be reasonable, they are inherently subject to significant business, economic, competitive, regulatory and other risks, contingencies and uncertainties, most of which are difficult to predict and many of which are beyond our control. These risks, contingencies and uncertainties relate to, among other matters, the following:

- the risks associated with generating significant revenue from a limited number of geographic areas;
- the risks associated with the drilling of oil and natural gas wells in our exploitation efforts;
- the risks associated with implementing capital intensive secondary and tertiary recovery projects;
- our ability to find, acquire, market, develop and produce new properties;

our ability to complete the Overton Field acquisition;

oil and natural gas price volatility;

uncertainties in the estimation of proved reserves and in the projection of future rates of production and timing of exploitation expenditures;

operating hazards attendant to the oil and natural gas business;

drilling and completion risks that are generally not recoverable from third parties or insurance;

potential mechanical failure or underperformance of significant wells;

climatic conditions;

availability and cost of material, equipment and electricity;

derivative instruments;

actions or inactions of third-party operators of our properties;

our ability to find and retain skilled personnel;

availability of capital;

the strength and financial resources of our competitors;

regulatory developments;

environmental risks; and

general economic and business conditions and industry trends.

We have discussed some of these factors in more detail in the section entitled Risk Factors beginning on page 1 of the accompanying prospectus. These factors are not necessarily all the important factors that could affect us. We advise you that you should (1) be aware that important factors we do not refer to above could affect the accuracy of our forward-looking statements and (2) use caution and common sense when considering our forward-looking statements. We do not intend to update these statements unless the securities laws require us to do so.

Table of Contents

PROSPECTUS SUPPLEMENT SUMMARY

This summary highlights information contained elsewhere in this prospectus supplement and the accompanying prospectus. This summary does not contain all of the information that you should consider before investing in our common stock. You should read the entire prospectus supplement and the accompanying prospectus carefully, including the section entitled Risk Factors beginning on page 1 of the accompanying prospectus and the documents incorporated by reference, before making an investment decision. The terms we, our, us, Encore, and the Company used herein refer to Encore Acquisition Company and its subsidiaries unless otherwise indicated or as the context so requires. All references to production and reserve volumes in this prospectus represent amounts net to Encore. The estimates of proved oil and natural gas reserves at December 31, 2003 included in this prospectus supplement and in the documents incorporated by reference are based upon the report of Miller and Lents, Ltd., an independent engineering firm. Such estimates do not give effect to our acquisition of Cortez Oil & Gas, Inc. or the pending acquisition of natural gas properties in the Overton Field in Smith County, Texas.

Our Business

We are a growing independent energy company engaged in the acquisition, development, exploitation and production of onshore North American oil and natural gas reserves. Since our inception in 1998, we have sought to acquire high-quality assets with potential for upside through low-risk development drilling projects. Our properties are currently located in four core areas: the Cedar Creek Anticline, or CCA, of Montana and North Dakota; the Permian Basin of West Texas and Southeastern New Mexico; the Mid Continent area, which includes the Arkoma and Anadarko Basins of Oklahoma, the North Salt Basin of Louisiana and the Barnett Shale near Fort Worth, Texas; and the Rocky Mountains.

As of December 31, 2003, our estimated proved reserves were 141 million barrels of oil equivalent, or MMBOE, approximately 84% of which were oil. The proved developed reserves as of that date were 110 MMBOE, or 78% of total proved reserves. In April 2004, we completed the acquisition of Cortez Oil & Gas, Inc., which, based on our internal estimates, added approximately 15 MMBOE of proved reserves, which are not reflected in the table below. In April 2004, we announced that we had entered into an agreement to purchase certain natural gas properties in the Overton Field. We expect this acquisition to close in the second quarter of 2004 and, based on our internal estimates, to add approximately 46 Bcfe (8 MMBOE) of proved reserves. The following table sets forth our total proved reserves, average daily production and reserve-to-production ratio, or R/ P index, in our principal areas of operation as of December 31, 2003 and for the year then ended.

	Proved Reserves at December 31, 2003 (MBOE)	Percent of Total	Average Daily Production for 2003 (BOE/d)	Percent of Total	R/P Index
Cedar Creek Anticline(1)	103,601	73%	13,490	61%	21.0
Permian Basin(2)	22,424	16%	4,554	20%	13.5
Rockies(3)	6,620	5%	2,935	13%	6.2
Mid Continent(4)	8,245	6%	1,239	6%	11.2
Total	140,890	100%	22,218	100%	17.4

(1) Our CCA properties, which produce mainly from porous dolomites drilled on 40 to 80 acre spacing intervals, have longer reserve lives than our other properties because the low permeability level encountered within those producing intervals require a longer time to produce the reserves in place. This results in a lower production decline rate.

(2) Permian Basin includes the Central Permian, Indian Basin and Crockett properties.

(3) Rockies includes the Paradox Basin, Lodgepole and Bell Creek properties.

(4) Mid Continent includes the Elm Grove and Verden properties. The Elm Grove properties were acquired on July 31, 2003, and the R/ P index shown in the table is calculated by annualizing our production since the acquisition.

In 2003, our reserve growth was achieved through acquisitions, high-pressure air injection, or HPAI, and organically through the drill bit by developing a portion of our inventory of drilling projects that we expect will extend over the next several years. We continue to pursue high-quality assets and to replenish our drilling inventory through acquisitions. During 2003, we added 20.7 MMBOE of oil and natural gas reserves for finding, development, and acquisition, or FD&A, replacement costs of $7.42 per barrel of oil equivalent, or BOE, which replaced 255% of the 8.1 MMBOE we produced in 2003. Including downward revisions of 3.5 MMBOE, the development program added 14.4 MMBOE (178% of our production) at an average FD&A cost of $6.86 per BOE. Included in our reserve additions are 12.5 MMBOE of HPAI in the CCA of Montana and North Dakota. Our three-year average FD&A cost, including revisions, is $5.60 per BOE, with a reserve replacement ratio of 329%.

Business Strategies

Our primary business objective is to maximize internally generated cash flow and shareholder value by executing the following strategies:

Maintain an Active Low-Risk Development Drilling Program. Our technological expertise, combined with our proficient field operations and reservoir engineering, have allowed us to increase production and reserves on our properties through development drilling, workovers, waterflood enhancements, tertiary projects, and recompletions. Our plan is to maintain an inventory of low-risk exploitation and development projects that provide us ongoing drilling activity. Each year, we budget a portion of internally generated cash flow to secondary and tertiary recovery projects whose results will not be seen until future years. Our conventional development budget for 2004, exclusive of spending on high-pressure air injection, is $128.3 million, revised for the Cortez acquisition and our pending Overton acquisition.

Maximize Existing Reserves and Production Through High-Pressure Air Injections. In addition to conventional development drilling, we utilize high-pressure air injection techniques on certain properties to enhance our growth. HPAI involves utilizing compressors to inject air into previously produced oil and natural gas formations in order to displace remaining resident hydrocarbons and force them under pressure to a common lifting point for production. We believe that the HPAI programs on our CCA properties will generate a higher rate of return than other tertiary processes and can be applied throughout our CCA properties. The zone of our initial focus for HPAI, the Red River U4 zone, is the same zone where HPAI has been successfully implemented by other operators in adjacent areas and on our Pennel unit of the CCA. Response from HPAI investments is not expected until ten to eighteen months from the time of first injection. Our HPAI budget for 2004 is $34.3 million.

Expand Our Reserves, Production, and Drilling Inventory Through a Disciplined Acquisition Program. We will continue to pursue acquisitions of properties with similar upside potential to our current producing properties portfolio. Using the experience of our management team, we have developed and refined an acquisition program designed to increase our reserves and to complement our core properties, while providing upside potential. We have a staff of engineering and geoscience professionals who manage our core properties and use their experience and expertise to target attractive acquisition opportunities. Following an acquisition, our technical professionals seek to enhance the value of the new assets through a proven development and exploitation program. For the year ended

2003, we evaluated over $1.0 billion of potential acquisitions. We will continue to aggressively evaluate acquisition opportunities in 2004 with the same disciplined commitment to acquire assets that fit our portfolio and continue to create value for our shareholders.

Focus on Cost Control Through Efficient and Safe Operations. As of December 31, 2003, we operated properties representing approximately 84% of our proved reserves, which allows us to control capital allocation and expenses. We strive to operate our properties not only efficiently but also safely. The total recordable incident rate, or TRIR, averaged 2.5 per 200,000 man hours for the industry in 2003. We are very proud to have a perfect TRIR of zero for our employees in 2003.

Challenges to Implementing Our Strategy. We face a number of challenges to implementing our strategy and achieving our goals. Our primary challenge is to generate superior rates of return on our investments in a volatile commodity pricing environment, while replenishing our drilling inventory. Changing commodity prices affect the rate of return on a property acquisition, internally generated cash flow, and, in turn, can affect our capital budget. In addition to the changing commodity price risk, we face strong competition from independents and major oil companies. For more information on the challenges to implementing our strategy and achieving our goals, please read Risk Factors beginning on page 1 of the accompanying prospectus.

Recent Developments

Cortez Acquisition. On April 14, 2004, we acquired all of the outstanding capital stock of Cortez Oil & Gas, Inc., a privately held, independent oil and natural gas company, for a cash purchase price of $122.6 million, which included the repayment of $39.4 million of Cortez s debt. We have also agreed to pay Cortez s former securityholders up to $2.9 million in aggregate additional cash consideration if specified leases associated with Cortez s properties are obtained by June 30, 2004 (subject to 30 day extension) and other conditions are met. We funded the acquisition with a portion of the net proceeds from the issuance of the 6 1/4% Senior Subordinated Notes due 2014 described below.

The acquired oil and natural gas properties are located primarily in the Cedar Creek Anticline of Montana, the Permian Basin of West Texas and Southeastern New Mexico, and in the Mid Continent area, including the Anadarko and Arkoma Basins of Oklahoma and the Barnett Shale north of Fort Worth, Texas.

Issuance of 6 1/4% Senior Subordinated Notes. On April 2, 2004, we issued $150.0 million of 6 1/4% Senior Subordinated Notes maturing April 15, 2014. The offering was made through a private placement and the notes were then resold pursuant to Rule 144A and Regulation S. We estimate net proceeds of approximately $146.2 million after paying all costs associated with the offering. The net proceeds were used to fund the acquisition of Cortez and repay amounts outstanding under our revolving credit facility.

Overton Acquisition. On April 26, 2004, we announced an agreement to acquire natural gas properties in the Overton Field located in Smith County, Texas, for $82 million from a group of private sellers. Our internal engineers estimate that the Overton Field properties have approximately 46 Bcfe of natural gas equivalent of total proved reserves. The Overton Field properties currently produce approximately 7 million cubic feet of natural gas equivalent per day, primarily from multiple tight sandstone reservoirs in the Travis Peak and Cotton Valley formations at depths ranging between 8,000 and 11,500 feet. Production from the Overton Field properties is 94% natural gas and the properties will be operated by us. Subject to due diligence and other customary closing conditions, we expect to close the transaction in June 2004 with an effective date of June 1, 2004.

Table of Contents

The Offering

Common stock offered by Encore	2,000,000 shares.
Common stock outstanding after this offering	32,502,464 shares.
Use of proceeds	We intend to use the net proceeds from this offering to repay indebtedness under our revolving credit facility and for general corporate purposes, including the planned Overton acquisition. You should read the discussion under the heading Use of Proceeds for more information.
Risk Factors	Please read the section entitled Risk Factors beginning on page 1 of the accompanying prospectus for a discussion of some of the factors you should carefully consider before deciding to invest in shares of our common stock.
New York Stock Exchange Symbol	EAC

The number of shares of our common stock outstanding after this offering is based upon 30,502,464 shares of common stock outstanding as of June 7, 2004, and excludes:

- an aggregate of 1,108,634 shares of common stock issuable upon the exercise of outstanding stock options, of which 629,731 options were exercisable as of June 7, 2004 with a weighted average exercise price of $14.08 and

- 1,418,863 shares of common stock reserved for additional grants under our incentive stock plan.

Table of Contents

Summary Historical Consolidated Financial Data

The following table shows summary historical financial data for the periods and as of the dates indicated. The summary historical financial data as of and for the years ended December 31, 2001, 2002 and 2003 are derived from our audited consolidated financial statements. The summary historical financial data as of and for the three months ended March 31, 2003 and 2004 are derived from our unaudited consolidated financial statements. Our summary historical financial data should be read in conjunction with the consolidated financial statements, related notes and other financial information incorporated by reference in this prospectus supplement. All amounts are in thousands except per share data.

	Year Ended December 31,			Three Months Ended March 31,	
	2001	2002	2003	2003	2004
				(unaudited)	
Consolidated Statement of Operations Data:					
Revenues:(1)					
Oil	$105,768	$134,854	$176,351	$46,432	$46,764
Natural gas	30,149	25,838	43,745	9,355	12,527
Total revenues	135,917	160,692	220,096	55,787	59,291
Expenses:					
Production					
Lease operations	25,139	30,678	37,846	8,953	10,242
Production, ad valorem, and severance taxes	13,809	15,653	22,013	6,169	5,839
Depletion, depreciation, and amortization	31,721	34,550	33,530	7,783	9,263
General and administrative (excluding non-cash stock based compensation)	5,053	6,150	8,680	2,450	2,228
Non-cash stock based compensation	9,587		614	145	310
Derivative fair value (gain) loss	680	(900)	(885)	(1,260)	158
Bad debt expense	7,005				
Impairment of oil and natural gas properties	2,598				
Other operating expense	934	2,045	3,481	170	1,002
Total expenses	96,526	88,176	105,279	24,410	29,042
Operating income	39,391	72,516	114,817	31,377	30,249
Other income (expenses):					
Interest	(6,041)	(12,306)	(16,151)	(4,171)	(3,906)
Other	46	91	214	47	51
Total other income (expenses)	(5,995)	(12,215)	(15,937)	(4,124)	(3,855)
Income before income taxes and cumulative effect of accounting change	33,396	60,301	98,880	27,253	26,394
Current income tax benefit (provision)	(1,919)	745	(991)	(767)	(1,085)
Deferred income tax provision	(14,414)	(23,361)	(35,111)	(9,371)	(8,407)
Income before cumulative effect of accounting change	17,063	37,685	62,778	17,115	16,902
Cumulative effect of accounting change, net of income taxes	(884)		863	863	

Net income	$ 16,179(2)	$ 37,685	$ 63,641(3)	$ 17,978(3)	$ 16,902
Net income per common share:					
Basic	$ 0.56	$ 1.25	$ 2.11	$ 0.60	$ 0.56
Diluted	0.56	1.25	2.10	0.59	0.55
Weighted average number of common shares outstanding:					
Basic	28,718	30,031	30,102	30,037	30,179
Diluted	28,723	30,161	30,333	30,221	30,567

Table of Contents

	Year Ended December 31,			Three Months Ended March 31,	
	2001	2002	2003	2003	2004
				(unaudited)	
Consolidated Statement of Cash Flows Data:					
Cash provided by (used by)					
Operating activities	$ 80,212	$ 91,509	$ 123,818	$ 25,708	$ 31,073
Investing activities	(89,583)	(159,316)	(153,747)	(23,132)	(31,012)
Financing activities	8,610	80,749	17,303	(7,267)	237

	As of December 31,			As of March 31,	
	2001	2002	2003	2003	2004
				(unaudited)	
Consolidated Balance Sheet Data:					
Working capital	$ 1,107	$ 12,489	$ (52)	$ 17,683	$ (777)
Total assets	402,000	549,896	672,138	572,898	702,056
Total debt	79,107	166,000	179,000	158,000	179,000
Stockholders equity	269,302	296,266	358,975	316,259	369,390

(1) For the years ended December 31, 2001, 2002 and 2003, we reduced revenue for the payments of the net profits interests by $2.8 million, $2.0 million and $5.8 million, respectively. For the quarters ended March 31, 2003 and 2004, we reduced revenue for the payments of the net profits interests by $1.4 million and $1.8 million, respectively.

(2) Net income for the year ended December 31, 2001 includes $9.6 million of non-cash compensation expense, $4.3 million of bad debt expense, $1.6 million impairment of oil and gas properties, and a ($0.9) million cumulative effect of accounting change, which affects its comparability with other periods presented.

(3) Net income for the year ended December 31, 2003 and for the quarter ended March 31, 2003 includes a $0.9 million cumulative effect of accounting change, which affects its comparability with other periods presented.

Table of Contents

Summary Oil and Natural Gas Reserve Information

The following table sets forth summary information with respect to our estimated proved oil and natural gas reserves as of the dates indicated. The following estimates of our net proved oil and natural gas reserves are based on estimates prepared by Miller and Lents, Ltd., independent petroleum engineers, in accordance with guidelines established by the SEC.

Reserve engineering is a subjective process of estimating underground accumulations of oil and natural gas that cannot be measured in an exact way. The accuracy of any reserve estimate is a function of the quality of available data and the interpretation of that data by petroleum engineers. In addition, the results of drilling, testing, and production activities may require revisions of estimates that were made previously. Accordingly, reserve estimates are often materially different from the quantities of oil and natural gas that are ultimately recovered.

	As of December 31,		
	2001	**2002**	**2003**
Proved Reserves:			
Oil (MBbls)	91,369	111,674	117,732
Natural Gas (MMcf)	75,687	99,818	138,950
Combined (MBOE)	103,983	128,310	140,890
Proved developed reserves (MBOE)	83,296	107,648	109,838
Annual reserve replacement ratio(1)	306%	429%	255%
Estimated reserve life (years)(2)	16.6	17.3	17.4

(1) The annual reserve replacement ratio is a percentage determined by dividing the estimated reserves added during a year from extensions and discoveries, improved recovery, acquisitions of minerals in place and revisions of previous estimates, excluding property sales, by the oil and natural gas volumes produced during that year.

(2) Estimated reserve life is calculated by dividing the estimated proved reserves at year end by the total production during the year. The resultant number of years can be affected by the timing of major acquisitions and dispositions.

Table of Contents

Summary Operating Data

The following table sets forth summary operating data for the periods indicated.

	Year Ended December 31,			Three Months Ended March 31,	
	2001	2002	2003	2003	2004
Production Volume:					
Oil (MBbls)	4,935	6,037	6,601	1,666	1,611
Natural gas (MMcf)	8,078	8,175	9,051	1,933	2,524
Combined (MBOE)	6,281	7,399	8,110	1,988	2,031
Average Sales Price:					
Oil ($/Bbl)	$21.43	$22.34	$26.72	$27.87	$29.03
Natural gas ($/Mcf)	3.73	3.16	4.83	4.84	4.96
Combined ($/BOE)	21.64	21.72	27.14	28.06	29.19
Costs per BOE:					
Lease operations	$ 4.00	$ 4.15	$ 4.67	$ 4.50	$ 5.04
Production, ad valorem and severance taxes	2.20	2.12	2.71	3.10	2.87
Depletion, depreciation and amortization	5.05	4.67	4.13	3.92	4.56
General and administrative (excluding non-cash stock based compensation)	0.80	0.83	1.07	1.23	1.10

Table of Contents

USE OF PROCEEDS

We expect the net proceeds from this offering to be approximately $53.0 million, after deducting underwriting discounts and the estimated expenses of the offering. We intend to use the net proceeds from this offering to repay indebtedness under our revolving credit facility and for general corporate purposes, including the planned Overton acquisition. As of June 7, 2004, we have $28.0 million outstanding under our revolving credit facility, which was incurred to finance acquisitions and for general corporate purposes. The facility matures in June 2006, and of the amount outstanding, $10.0 million currently bears interest at 4.0% and the remaining $18.0 million currently bears interest at LIBOR plus 1.0%.

PRICE RANGE OF COMMON STOCK

Our common stock is listed on the New York Stock Exchange under the symbol EAC. The following table sets forth quarterly high and low sales prices of our common stock on the New York Stock Exchange for each of the periods indicated:

	High	Low
2004		
Quarter ended June 30 (through June 7, 2004)	$31.50	$24.81
Quarter ended March 31	28.85	23.65
2003		
Quarter ended December 31	$25.28	$19.60
Quarter ended September 30	22.15	17.80
Quarter ended June 30	20.01	17.00
Quarter ended March 31	19.35	16.63
2002		
Quarter ended December 31	$20.40	$13.51
Quarter ended September 30	17.55	15.00
Quarter ended June 30	17.35	14.60
Quarter ended March 31	15.00	12.40

On June 7, 2004, there were 30,502,464 shares of common stock outstanding, which were held by approximately 194 shareholders of record.

Table of Contents

UNDERWRITING

Encore and Goldman, Sachs & Co. have entered into an underwriting agreement with respect to the shares being offered. Subject to certain conditions, Goldman, Sachs & Co. has agreed to purchase all of the 2,000,000 shares offered hereby.

Shares sold by Goldman, Sachs & Co. to the public will initially be offered at the initial price to public set forth on the cover of this prospectus supplement. In addition, Goldman, Sachs & Co. may receive from purchasers of the shares normal brokerage commissions in amounts agreed with such purchasers. If all the shares are not sold at the initial price to public, Goldman, Sachs & Co. may change the offering price and the other selling terms.

Encore has agreed with Goldman, Sachs & Co. not to dispose of or hedge any of its common stock or securities convertible into or exchangeable for shares of common stock during the period from the date of this prospectus supplement continuing through the date 90 days after the date of this prospectus supplement, except with the prior written consent of Goldman, Sachs & Co. This agreement does not apply to (1) the grant of options and issuance of shares of common stock upon exercise of Encore s options pursuant to its existing incentive stock plan, (2) the issuance of shares of restricted common stock granted to its officers and employees as contemplated under its existing incentive stock plan, (3) the issuance of shares of common stock in connection with any business combination to be consummated after such 90-day period and (4) the filing of a universal shelf registration statement on Form S-3, with Encore remaining subject to the 90-day lock-up provision with respect to any issuance thereunder of common stock or securities convertible into or exchangeable for shares of common stock. Encore s directors and executive officers have entered into similar agreements with Goldman, Sachs & Co., except that the period is 60 days for Mr. I. Jon Brumley and Mr. Jon S. Brumley and 45 days for Encore s remaining executive officers and directors.

In connection with the offering, Goldman, Sachs & Co. may purchase and sell shares of common stock in the open market. These transactions may include short sales, stabilizing transactions and purchases to cover positions created by short sales. Shorts sales involve the sale by Goldman, Sachs & Co. of a greater number of shares it is required to purchase in the offering. Goldman, Sachs & Co. will need to close out any short sale by purchasing shares in the open market. Goldman, Sachs & Co. is likely to create a short position if it is concerned that there may be downward pressure on the price of the common stock in the open market after pricing that could adversely affect investors who purchase in the offering. Stabilizing transactions consist of various bids for or purchases of common stock made by Goldman, Sachs & Co. in the open market prior to the completion of the offering.

Purchases to cover a short position and stabilizing transactions may have the effect of preventing or retarding a decline in the market price of Encore s stock, and may stabilize, maintain or otherwise affect the market price of the common stock. As a result, the price of the common stock may be higher than the price that otherwise might exist in the open market. If these activities are commenced, they may be discontinued at any time. These transactions may be effected on the NYSE, in the over-the-counter market or otherwise.

Goldman, Sachs & Co. has represented, warranted and agreed that: (i) it has not offered or sold and, prior to the expiry of a period of six months from the closing date, will not offer or sell any shares to persons in the United Kingdom except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995; (ii) it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000 (FSMA)) received by it in connection with the issue or sale of any shares in circumstances in which section 21(1) of the FSMA does not apply to the Issuer and (iii) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the shares in, from or otherwise involving the United Kingdom.

The shares may not be offered or sold, transferred or delivered, as part of their initial distribution or at any time thereafter, directly or indirectly, to any individual or legal entity in the Netherlands other than to individuals or legal entities who or which trade or invest in securities in the conduct of their profession or trade, which includes banks, securities intermediaries, insurance companies, pension funds, other institutional investors and commercial enterprises which, as an ancillary activity, regularly trade or invest in securities.

The shares may not be offered or sold by means of any document other than to persons whose ordinary business is to buy or sell shares, whether as principal or agent, or in circumstances which do not constitute an offer to the public within the meaning of the Companies Ordinance (Cap. 32) of Hong Kong, and no advertisement, invitation or document relating to the shares may be issued, whether in Hong Kong or elsewhere, which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to shares which are or are intended to be disposed of only to persons outside Hong Kong or only to professional investors within the meaning of the Securities and Futures Ordinance (Cap. 571) of Hong Kong and any rules made thereunder.

This prospectus has not been registered as a prospectus with the Monetary Authority of Singapore. Accordingly, this prospectus and any other document or material in connection with the offer or sale, or invitation or subscription or purchase, of the shares may not be circulated or distributed, nor may the shares be offered or sold, or be made the subject of an invitation for subscription or purchase, whether directly or indirectly, to persons in Singapore other than under circumstances in which such offer, sale or invitation does not constitute an offer or sale, or invitation for subscription or purchase, of the shares to the public in Singapore.

Goldman, Sachs & Co. has acknowledged and agreed that the securities have not been registered under the Securities and Exchange Law of Japan and are not being offered or sold and may not be offered or sold, directly or indirectly, in Japan or to or for the account of any resident of Japan, except (1) pursuant to an exemption from the registration requirements of the Securities and Exchange Law of Japan and (ii) in compliance with any other applicable requirements of Japanese law.

Encore estimates that its share of the total expenses of the offering, excluding underwriting discounts and commissions, will be approximately $300,000.

Encore has agreed to indemnify Goldman, Sachs & Co. against certain liabilities, including liabilities under the Securities Act of 1933.

Goldman, Sachs & Co. and its affiliates have, from time to time, performed, and may in the future, perform, various financial advisory and investment banking services for Encore, for which they received or will receive customary fees and expenses.

LEGAL OPINIONS

The legal validity of the common stock offered under this prospectus supplement will be passed upon for us by Baker Botts L.L.P., Houston, Texas. Certain legal matters in connection with the common stock offered under this prospectus supplement will be passed upon for the underwriter by Andrews Kurth LLP, Houston, Texas.

Table of Contents

INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE

The SEC allows us to incorporate by reference information filed with the SEC. This means that we can disclose important information to you, without actually including the specific information in this prospectus supplement, by referring you to those documents. The following documents which we have previously filed with the SEC pursuant to the Exchange Act are incorporated into this prospectus supplement by reference:

- our Annual Report on Form 10-K for the fiscal year ended December 31, 2003;
- our Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2004;
- our Current Reports on Form 8-K filed with the SEC on March 30, 2004, March 31, 2004, April 20, 2004 and April 30, 2004; and
- the description of our common stock contained in our Form 8-A filed on December 12, 2000.

All documents we file pursuant to Section 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of this prospectus supplement and before all of the common stock offered by this prospectus supplement is sold are incorporated by reference in this prospectus supplement from the date of filing of the documents. Information that we file with the SEC will automatically update and may replace information in this prospectus supplement and information previously filed with the SEC.

You may request a copy of the filings incorporated by reference in this prospectus supplement, at no cost, by writing or calling us at: Encore Acquisition Company, 777 Main Street, Suite 1400, Ft. Worth, Texas 76102; Attention: Corporate Secretary (telephone: (817) 877-9955).

Table of Contents

PROSPECTUS

$400,000,000

Encore Acquisition Company

777 Main Street, Suite 1400

Fort Worth, Texas 76102
(817) 877-9955

Senior Debt Securities

Subordinated Debt Securities

Preferred Stock

Common Stock

We may offer from time to time senior debt securities, subordinated debt securities, preferred stock and common stock. Our subsidiaries may guarantee the senior or subordinated debt securities offered by this prospectus.

We will provide additional terms of our securities in one or more prospectus supplements to this prospectus. You should read this prospectus and the related prospectus supplement carefully before you invest in our securities.

Our common stock is listed on the New York Stock Exchange under the symbol EAC.

You should consider carefully Risk Factors beginning on page 1 before investing in the notes.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is August 25, 2003.

Table of Contents

TABLE OF CONTENTS

ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we have filed with the Securities and Exchange Commission under a shelf registration process. Using this process, we may offer the securities this prospectus describes in one or more offerings with a total initial offering price of up to $400,000,000. This prospectus provides you with a general description of the securities we may offer. Each time we use this prospectus to offer securities, we will provide a prospectus supplement and, if applicable, a pricing supplement. The prospectus supplement and any pricing supplement will describe the specific terms of that offering. The prospectus supplement and any pricing supplement may also add to, update or change the information contained in this prospectus. Please carefully read this prospectus, the prospectus supplement and any pricing supplement, in addition to the information contained in the documents we refer to under the heading Where You Can Find More Information.

Table of Contents

ABOUT ENCORE ACQUISITION COMPANY

We are a growing independent energy company engaged in the acquisition, development, exploitation and production of onshore North American oil and natural gas reserves. Since inception in 1998, we have sought to acquire high quality assets with potential for upside through low-risk development drilling projects.

Our properties are currently located in the Williston Basin of Montana and North Dakota, the Permian Basin of Texas and New Mexico, the Anadarko Basin of Oklahoma, the Powder River Basin of Montana, the Paradox Basin of Utah and the North Louisiana Salt Basin of Louisiana. Our growth has come primarily from the acquisition of producing oil and natural gas properties and subsequent development of these properties. Since our inception through June 30, 2003, we have invested $379.6 million in acquiring producing oil and natural gas properties. Through June 30, 2003, we have invested another $249.1 million for development and exploitation of these properties.

Our principal executive offices are located at 777 Main Street, Suite 1400, Fort Worth, Texas 76102. Our main telephone number is (817) 877-9955. We maintain a website on the Internet at http://www.encoreacq.com. The information on our website is not incorporated by reference into this prospectus.

RISK FACTORS

You should carefully consider the following matters, in addition to the other information we have provided in this prospectus, the accompanying prospectus supplement and the documents we incorporate by reference, before reaching a decision regarding an investment in our securities.

Risks Related to Our Business

Oil and natural gas prices are volatile and sustained periods of low prices could materially and adversely affect our financial condition and results of operations.

Historically, the markets for oil and natural gas have been volatile, and these markets are likely to continue to be volatile in the future. Our revenues, profitability and future growth depend substantially on prevailing oil and natural gas prices. Lower oil and natural gas prices may reduce the amount of oil and natural gas that we can economically produce. Prevailing oil and natural gas prices also affect the amount of internally generated cash flow available for repayment of indebtedness and capital expenditures. In addition, the amount we can borrow under our revolving credit facility is subject to periodic redetermination based in part on changing expectations of future oil and natural gas prices.

The factors that can cause oil and natural gas price volatility include:

- the supply of domestic and foreign oil and natural gas;
- the ability of members of the Organization of Petroleum Exporting Countries (OPEC) to agree upon and maintain oil prices and production levels;
- political instability or armed conflict in oil or natural gas producing regions;
- the level of consumer demand;
- weather conditions;
- the price and availability of alternative fuels;
- domestic and foreign governmental regulations and taxes;
- domestic political developments; and

worldwide economic conditions.

The volatile nature of markets for oil and natural gas makes it difficult to reliably estimate future prices. Any decline in oil and natural gas prices adversely affects our financial condition. If oil or natural gas prices

Table of Contents

decline significantly for a sustained period of time, we may, among other things, be unable to meet our financial obligations, make planned expenditures or raise additional capital.

Reserve estimates depend on many assumptions that may prove to be inaccurate. Any material inaccuracies in our reserve estimates or underlying assumptions could cause the quantities and net present value of our reserves to be overstated.

Estimating quantities of proved oil and natural gas reserves is a complex process that requires interpretations of available technical data and numerous assumptions, including certain economic assumptions. Any significant inaccuracies in these interpretations or assumptions or changes in conditions could cause the quantities and net present value of our reserves to be overstated.

To prepare estimates of economically recoverable oil and natural gas reserves and future net cash flows, we must analyze many variable factors, such as historical production from the area compared with production rates from other producing areas. We must also analyze available geological, geophysical, production and engineering data, and the extent, quality and reliability of this data can vary. The process also involves economic assumptions relating to commodity prices, production costs, severance and excise taxes, capital expenditures and workover and remedial costs. Actual results most likely will vary from our estimates. Any significant variance could reduce the estimated quantities and present value of our reserves.

You should not assume that the present value of future net cash flows from our proved reserves referred to or incorporated by reference in this prospectus is the current market value of our estimated oil and natural gas reserves. In accordance with SEC requirements, we base the estimated discounted future net cash flows from our proved reserves on prices and costs in effect on the date of the estimate, holding the prices and costs constant throughout the life of the properties. Actual future prices and costs may differ materially from those used in the net present value estimate, and future net present value estimates using then current prices and costs may be significantly less than the current estimate.

If oil and natural gas prices decrease, we may be required to take write downs.

We may be required to write down the carrying value of our oil and natural gas properties when future estimated oil and gas prices are low or if we have substantial downward adjustments to our estimated proved reserves or increases in our estimates of operating expenses or development costs.

We capitalize the costs to acquire, find and develop our oil and natural gas properties under the successful efforts accounting method. The net capitalized costs of our oil and gas properties may not exceed their estimated fair value. If net capitalized costs of our oil and gas properties exceed their fair value, we must charge the amount of the excess to earnings. We review the carrying value of our properties quarterly, based on changes in expectations of future oil and natural gas prices, expenses and tax rates. Once incurred, a write down of oil and gas properties is not reversible at a later date even if oil or gas prices increase.

Our acquisition strategy subjects us to numerous risks that could adversely affect our results of operations.

Acquisitions are an essential part of our growth strategy, and our ability to acquire additional properties on favorable terms is important to our long-term growth. Depending on conditions in the acquisition market, it may be difficult or impossible for us to identify properties for acquisition or we may not be able to make acquisitions on terms that we consider economically acceptable. Even if we are able to identify suitable acquisition opportunities, our acquisition strategy depends upon, among other things, our ability to obtain debt and equity financing and, in some cases, regulatory approvals.

The successful acquisition of producing properties requires an assessment of several factors, including:

- recoverable reserves;
- future oil and natural gas prices;

- operating costs; and

- potential environmental and other liabilities.

The accuracy of these assessments is inherently uncertain. In connection with these assessments, we perform a review of the subject properties that we believe to be generally consistent with industry practices. Our review will not reveal all existing or potential problems nor will it permit us to become sufficiently familiar with the properties to fully assess their deficiencies and capabilities. Inspections may not always be performed on every well, and structural and environmental problems are not necessarily observable even when an inspection is undertaken. Even when problems are identified, the seller may be unwilling or unable to provide effective contractual protection against all or part of the problems. We are often not entitled to contractual indemnification for environmental liabilities and acquire properties on an as is basis.

Possible future acquisitions could result in our incurring additional debt, contingent liabilities and expenses, all of which could have a material adverse effect on our financial condition and operating results. Furthermore, our financial position and results of operations may fluctuate significantly from period to period based on whether significant acquisitions are completed in particular periods. Competition for acquisitions is intense and may increase the cost of, or cause us to refrain from, completing acquisitions.

The failure to properly manage growth through acquisitions could adversely affect our results of operations.

Growing through acquisitions and managing that growth will require us to continue to invest in operational, financial and management information systems and to attract, retain, motivate and effectively manage our employees. Pursuing and integrating acquisitions involves a number of risks, including:

- diversion of management attention from existing operations;

- unexpected losses of key employees, customers and suppliers of the acquired business;

- conforming the financial, technological and management standards, processes, procedures and controls of the acquired business with those of our existing operations; and

- increasing the scope, geographic diversity and complexity of our operations.

The process of integrating acquired operations into our existing operations may result in unforeseen operating difficulties and may require significant management attention and financial resources that would otherwise be available for the ongoing development or expansion of existing operations.

A substantial portion of our producing properties is located in one geographic area.

We have extensive operations in the Williston Basin of Montana and North Dakota. As of December 31, 2002, our Cedar Creek Anticline properties in the Williston Basin represented approximately 75% of our proved reserves and 61% of our 2002 production. Any circumstance or event that negatively impacts production or marketing of oil and natural gas in the Williston Basin could reduce our earnings and cash flow.

Derivative instruments expose us to risks of financial loss in a variety of circumstances.

We use derivative instruments in an effort to reduce our exposure to fluctuations in the prices of oil and natural gas and to reduce our cash outflows related to interest. Our derivative instruments expose us to risks of financial loss in a variety of circumstances, including when:

- a counterparty to our derivative instruments is unable to satisfy its obligations;

- production is less than expected; or

- there is an adverse change in the expected differential between the underlying price in the derivative instrument and actual prices received for our production.

Derivative instruments may limit our ability to realize increased revenue from increases in the prices for oil and natural gas.

3

We adopted Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133), on January 1, 2001. SFAS 133 generally requires us to record each hedging transaction as an asset or liability measured at its fair value. Each quarter we must record changes in the fair value of our hedges, which could result in significant fluctuations in net income and stockholders equity from period to period. Please read our most recently filed annual report on Form 10-K and quarterly report on Form 10-Q for a more detailed discussion of our hedging program.

Drilling oil and natural gas wells is a high-risk activity.

Drilling oil and natural gas wells, including development wells, involves numerous risks, including the risk that no commercially productive oil or natural gas reservoirs will be discovered. We often are uncertain as to the future cost or timing of drilling, completing and producing wells. We may not recover all or any portion of our investment in drilling oil and natural gas wells.

Our drilling operations may be curtailed, delayed or canceled as a result of a variety of factors, including:

- unexpected drilling conditions or miscalculations;
- title problems;
- pressure or irregularities in formations;
- equipment failures or accidents;
- adverse weather conditions;
- compliance with environmental and other governmental requirements, which may increase our costs or restrict our activities; and
- cost of, or shortages or delays in the availability of, drilling rigs and equipment.

The failure to replace our reserves could adversely affect our financial condition.

Our future success depends upon our ability to find, develop or acquire additional oil and natural gas reserves that are economically recoverable. Our proved reserves generally decline when reserves are produced, unless we conduct successful exploitation or development activities or acquire properties containing proved reserves, or both. We may not be able to find, develop or acquire additional reserves on an economic basis.

Substantial capital is required to replace and grow reserves. If lower oil and natural gas prices or operating difficulties result in our cash flow from operations being less than expected or limit on our ability to borrow under our revolving credit facility, we may be unable to expend the capital necessary to find, develop or acquire new oil and natural gas reserves.

We have limited control over the activities on properties we do not operate.

Other companies operate some of the properties in which we have an interest. We have limited ability to influence or control the operation or future development of these non-operated properties or the amount of capital expenditures that we are required to fund with respect to them. Our dependence on the operator and other working interest owners for these projects and our limited ability to influence or control the operation and future development of these properties could materially adversely affect the realization of our targeted returns on capital in drilling or acquisition activities and lead to unexpected future costs.

Table of Contents

Our business involves many operating risks that can cause substantial losses; insurance may be unavailable or inadequate to protect us against these risks.

Our operations are subject to hazards and risks inherent in drilling for, producing and transporting oil and natural gas, such as:

- fires;
- natural disasters;
- explosions;
- formations with abnormal pressures;
- blowouts;
- collapses of wellbore, casing or other tubulars;
- failure of oilfield drilling and service tools;
- uncontrollable flows of oil, natural gas, formation water or drilling fluids;
- pressure forcing oil or natural gas out of the wellbore at a dangerous velocity coupled with the potential for fire or explosion;
- changes in below-ground pressure in a formation that cause surface collapse or cratering;
- pipeline ruptures or cement failures;
- environmental hazards, such as oil spills, natural gas leaks and discharges of toxic gases; and
- weather.

If any of these events occur, we could incur substantial losses as a result of:

- injury or loss of life;
- damage to and destruction of property, natural resources and equipment;
- pollution and other environmental damage;
- regulatory investigations and penalties;
- suspension of our operations; and
- repair and remediation costs.

We do not maintain insurance against the loss of oil or natural gas reserves as a result of operating hazards, nor do we maintain business interruption insurance. In addition, pollution and environmental risks generally are not fully insurable. We may experience losses for uninsurable or uninsured risks or losses in amounts in excess of existing insurance coverage. The occurrence of an event that is not fully covered by insurance could harm our financial condition and results of operations.

Terrorist activities and the potential for military and other actions could adversely affect our business.

The threat of terrorism and the impact of military and other action have caused instability in world financial markets and could lead to increased volatility in prices for oil and natural gas, all of which could adversely affect the markets for our operations. Future acts of terrorism could be directed against companies operating in the United States. The U.S. government has issued public warnings that indicate that energy assets might be specific targets of terrorist organizations. These developments have subjected our operations to increased risk and, depending on their ultimate magnitude, could have a material adverse affect on our business.

Our development and exploitation operations require substantial capital, and we may be unable to obtain needed financing on satisfactory terms.

We make and will continue to make substantial capital expenditures in development and exploitation projects. We intend to finance these capital expenditures through a combination of cash flow from operations and external financing arrangements. Additional financing sources may be required in the future to fund our capital expenditures. Financing may not continue to be available under existing or new financing arrangements, or on acceptable terms, if at all. If additional capital resources are not available, we may be forced to curtail our drilling and other activities or be forced to sell some of our assets on an untimely or unfavorable basis.

The loss of key personnel could adversely affect our business.

We depend to a large extent on the efforts and continued employment of I. Jon Brumley, our Chairman of the Board and Chief Executive Officer, Jon S. Brumley, our President, and other key personnel. The loss of the services of Mr. I. Jon Brumley or Mr. Jon S. Brumley or other key personnel could adversely affect our business, and we do not have employment agreements with, and do not maintain key man insurance on the lives of, any of these persons. Our drilling success and the success of other activities integral to our operations will depend, in part, on our ability to attract and retain experienced geologists, engineers and other professionals. Competition for experienced geologists, engineers and some other professionals is extremely intense. If we cannot retain our technical personnel or attract additional experienced technical personnel, our ability to compete could be harmed.

The marketability of our oil and natural gas production is dependent upon transportation facilities over which we have no control.

The marketability of our oil and natural gas production depends in part upon the availability, proximity and capacity of pipelines, oil and natural gas gathering systems and processing facilities. Any significant change in market factors affecting these infrastructure facilities could harm our business. We deliver oil and natural gas through gathering systems and pipelines that we do not own. These facilities may not be available to us in the future.

Competition in the oil and natural gas industry is intense, and many of our competitors have greater financial, technological and other resources than we do.

We operate in the highly competitive areas of oil and natural gas acquisition, development, exploitation and production. The oil and natural gas industry is characterized by rapid and significant technological advancements and introductions of new products and services using new technologies. We face intense competition from independent, technology-driven companies as well as from both major and other independent oil and natural gas companies in each of the following areas:

- acquiring desirable producing properties or new leases for future exploration;
- marketing our oil and natural gas production;
- integrating new technologies; and
- acquiring the equipment and expertise necessary to develop and operate our properties.

Many of our competitors have financial, technological and other resources substantially greater than ours, which may adversely affect our ability to compete with these companies. These companies may be able to pay more for development prospects and productive oil and natural gas properties and may be able to define, evaluate, bid for and purchase a greater number of properties and prospects than our financial or human resources permit. Further, these companies may enjoy technological advantages and may be able to implement new technologies more rapidly than we can. Our ability to develop and exploit our oil and natural gas properties and to acquire additional properties in the future will depend upon our ability to successfully conduct operations, implement advanced technologies, evaluate and select suitable properties and consummate transactions in this highly competitive environment.

We are subject to complex federal, state and local laws and regulations that could adversely affect our business.

Exploration, development, production and sale of oil and natural gas in North America are subject to extensive federal, state, provincial and local laws and regulations, including complex tax and environmental laws and regulations. We may be required to make large expenditures to comply with applicable laws and regulations, which could adversely affect our results of operations and financial condition. Matters subject to regulation include:

- discharge permits for drilling operations;
- drilling bonds;
- spacing of wells;
- unitization and pooling of properties;
- environmental protection;
- reports concerning operations; and
- taxation.

Under these laws and regulations, we could be liable for:

- personal injuries;
- property damage;
- oil spills;
- discharge of hazardous materials;
- reclamation costs;
- remediation and clean-up costs; and
- other environmental damages.

We do not believe that full insurance coverage for all potential environmental damages is available at a reasonable cost, and we may need to expend significant financial and managerial resources to comply with environmental regulations and permitting requirements. We could incur substantial additional costs and liabilities in our oil and natural gas operations as a result of stricter environmental laws, regulations and enforcement policies.

Failure to comply with these laws and regulations also may result in the suspension or termination of our operations and subject us to administrative, civil and criminal penalties. Further, these laws and regulations could change in ways that substantially increase our costs. Any of these liabilities, penalties, suspensions, terminations or regulatory changes could make it more expensive for us to conduct our business or cause us to limit or curtail some of our operations.

The cessation of operations by Arthur Andersen LLP will limit our ability to use the consolidated financial statements audited by Arthur Andersen LLP and could impact our ability to access public capital markets as well as our investors ability to seek potential recoveries from

Arthur Andersen LLP.

Our consolidated financial statements as of and for the years ended December 31, 2001 and 2000 were audited by Arthur Andersen LLP, independent public accountants, as indicated in their reports with respect thereto, and are incorporated in this prospectus in reliance upon the authority of said firm as experts in giving said reports. Subsequent to Arthur Andersen LLP s completion of our 2001 audit, the firm was convicted of obstruction of justice charges relating to a federal investigation of Enron Corporation, has ceased practicing before the SEC and has lost the services of the material personnel responsible for our audit. As a result, it is not possible to obtain Arthur Andersen LLP s consent to the incorporation by reference of their report in this prospectus, and we have dispensed with the requirement to file their consent in reliance upon Rule 437a of the Securities Act of 1933. Because Arthur Andersen LLP has not consented to the incorporation by reference of their report in this prospectus, you will not be able to recover against Arthur Andersen LLP under Section 11 of the Securities Act for any untrue statements of a material fact contained in the consolidated financial statements audited by Arthur Andersen LLP or any omissions to state a material fact required to be stated therein.

We may issue preferred stock whose terms could adversely affect the voting power or value of our common stock.

Our certificate of incorporation authorizes us to issue, without the approval of our stockholders, one or more classes or series of preferred stock having such preferences, powers and relative, participating, optional and other rights, including preferences over our common stock respecting dividends and distributions, as our board of directors generally may determine. The terms of one or more classes or series of preferred stock could adversely impact the voting power or value of our common stock. For example, we might grant holders of preferred stock the right to elect some number of our directors in all events or on the happening of specified events or the right to veto specified transactions. Similarly, the repurchase or redemption rights or liquidation preferences we might assign to holders of preferred stock could affect the residual value of the common stock. Please read Description of Capital Stock Preferred Stock beginning on page 20.

Risks Related to Our Indebtedness

Our leverage and debt service obligations may adversely affect our cash flow and have other important and potentially adverse consequences to you.

We had total indebtedness of $150.0 million as of June 30, 2003. Our debt level could have several important consequences to you, including:

- it may be more difficult for us to satisfy our obligations;
- we may have difficulties borrowing money in the future for acquisitions, to meet our operating expenses or for other purposes;
- the amount of our interest expense may increase because certain of our borrowings not subject to interest rate protection hedges are at variable rates of interest, which, if interest rates increase, could result in higher interest expense;
- we will need to use a portion of the money we earn to pay principal and interest on our debt, which will reduce the amount of money we have to fund working capital, capital expenditures and other business activities;
- we may be more vulnerable to economic downturns and adverse developments in our industry; and
- our debt level could limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate.

Our ability to meet our expenses and debt obligations will depend on our future performance, which will be affected by financial, business, economic, regulatory and other factors, many of which are beyond our control. Our earnings may not be sufficient to allow us to pay the principal and interest on our debt and meet our other obligations. If we do not have enough money, we may need to refinance all or part of our existing debt, sell assets, borrow more money or raise equity, which we may not be able to do on terms acceptable to us, if at all.

Table of Contents

Our revolving credit facility and other debt instruments have restrictive covenants that could affect our financial condition.

Our revolving credit facility and the indenture related to the 8 3/8% senior subordinated notes, which we refer to as the 8 3/8% notes, contain financial and other restrictive covenants that limit our ability to engage in activities that may be in our long-term best interests. The covenants under our revolving credit facility are similar but generally more restrictive than the covenants under the indenture.

Our ability to borrow under our revolving credit facility is subject to financial covenants, including leverage, interest and fixed charge coverage ratios. Our revolving credit facility limits our ability to effect mergers, asset sales and change of control events. These covenants also contain restrictions regarding our ability to incur additional indebtedness in the future. In some cases, our subsidiaries are subject to similar restrictions that may restrict their ability to make distributions to us.

The indenture related to our 8 3/8% notes also contains limitations on our ability to effect mergers and change of control events, as well as other limitations, including:

- limitations on incurring additional indebtedness;
- limitations on the sale of assets;
- limitations on the declaration and payment of dividends or other restricted payments;
- limitations on transactions with affiliates; and
- limitations on liens.

If we do not comply with these or other covenants and restrictions contained in our revolving credit facility, the indenture or the other agreements governing our other indebtedness, we could be in default under those agreements, and the debt, together with accrued interest, could then be declared due and payable. If we were unable to repay any borrowings when due, the lenders under our revolving credit facility could proceed against their collateral, which includes most of the assets we own, including the stock and assets of our subsidiaries. In addition, a default under our revolving credit facility or agreements governing our other indebtedness could lead to an acceleration of debt under other debt instruments that contain cross-acceleration or cross-default provisions. We do not have sufficient working capital to satisfy our debt obligations in the event of an acceleration of all or a significant portion of our outstanding indebtedness.

In addition to our current indebtedness, we may incur substantially more debt. This could exacerbate the risks described above.

Together with our subsidiaries, we may incur substantially more debt in the future. Our revolving credit facility and the indenture governing the 8 3/8% notes contain restrictions on our incurrence of additional indebtedness. However, these restrictions are subject to qualifications and exceptions, and under certain circumstances, indebtedness incurred in compliance with these restrictions could be substantial. Also, these restrictions do not prevent us from incurring obligations that do not constitute indebtedness. As of June 30, 2003, we had approximately $220.0 million additional borrowing capacity under our revolving credit facility, subject to specific requirements, including compliance with financial covenants. To the extent new debt is added to our current debt levels, the risks described above could substantially increase.

Any failure to meet our debt obligations could harm our business, financial condition and results of operations.

If our cash flow and capital resources are insufficient to fund our debt obligations, we may be forced to sell assets, seek additional equity or debt capital or restructure our debt. In addition, any failure to make scheduled payments of interest and principal on our outstanding indebtedness would likely result in a reduction of our credit rating, which could harm our ability to incur additional indebtedness on acceptable terms. Our cash flow and capital resources may be insufficient for payment of interest on and principal of our debt in the future, and any such alternative measures may be unsuccessful or may not permit us to meet scheduled debt service obligations, which could cause us to default on our obligations and impair our liquidity.

We may not have the ability to raise the funds necessary to finance the change of control offer required by the indenture related to the 8 3/8% notes.

Upon the occurrence of a change of control, as defined in the indenture for our 8 3/8% notes, we will be required to offer to repurchase all outstanding 8 3/8% notes. We may not have sufficient funds available to us to make the required repurchase of the 8 3/8% notes. In addition, our revolving credit facility provides that the occurrence of any change of control event constitutes an event of default, which could require that we repay all unpaid and outstanding indebtedness under the revolving credit facility and may limit the funds available for us to make any payments with respect to the 8 3/8% notes, including for the repurchase of the 8 3/8% notes. Our failure to purchase tendered 8 3/8% notes would constitute a default under the indenture governing the 8 3/8% notes which, in turn, could constitute a further event of default under our revolving credit facility.

FORWARD-LOOKING INFORMATION

This prospectus, including the information we incorporate by reference, includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. You can identify our forward-looking statements by words such as estimate, project, predict, believe, expect, anticipate, plan, forecast, budget, goal or other words t uncertainty of future events or outcomes. When considering these forward-looking statements, you should keep in mind the risk factors and other cautionary statements contained in this prospectus, any prospectus supplement and the documents we have incorporated by reference.

The forward-looking statements are not guarantees of future performance, and we caution you not to rely unduly on them. We have based many of these forward-looking statements on expectations and assumptions about future events that may prove to be inaccurate. While our management considers these expectations and assumptions to be reasonable, they are inherently subject to significant business, economic, competitive, regulatory and other risks, contingencies and uncertainties, most of which are difficult to predict and many of which are beyond our control. These risks, contingencies and uncertainties relate to, among other matters, the following:

- the risks associated with operating in one or two major geographic areas;
- the risks associated with drilling of oil and natural gas wells in our exploitation efforts;
- our ability to find, acquire, market, develop and produce new properties;
- oil and natural gas price volatility;
- uncertainties in the estimation of proved reserves and in the projection of future rates of production and timing of exploitation expenditures;
- operating hazards attendant to the oil and natural gas business;
- drilling and completion risks that are generally not recoverable from third parties or insurance;
- potential mechanical failure or underperformance of significant wells;
- climatic conditions;
- availability and cost of material and equipment;
- derivative instruments;
- actions or inactions of third-party operators of our properties;

our ability to find and retain skilled personnel;

availability of capital;

Table of Contents

- the strength and financial resources of our competitors;
- regulatory developments;
- environmental risks; and
- general economic and business conditions and industry trends.

We have discussed some of these factors in more detail in the Risk Factors section of this prospectus. These factors are not necessarily all the important factors that could affect us. We advise you that you should (1) be aware that important factors we do not refer to above could affect the accuracy of our forward-looking statements and (2) use caution and common sense when considering our forward-looking statements. We do not intend to update these statements unless the securities laws require us to do so.

Table of Contents

USE OF PROCEEDS

Unless we inform you otherwise in the prospectus supplement, we will use the net proceeds from the sale of the offered securities for general corporate purposes. These purposes may include funding working capital requirements, capital expenditures, repayment and refinancing of indebtedness and repurchases and redemptions of securities. Pending any specific application, we may initially invest those funds in short-term marketable securities or apply them to the reduction of short-term indebtedness.

RATIO OF EARNINGS TO FIXED CHARGES

Our ratio of earnings to fixed charges for each of the periods shown is as follows:

	Six Months Ended	Year Ended December 31,	Period from April 22, 1998

Our near term revenue growth is dependent on continued sales from (i) more seasoned independent sales representatives, (ii) a greater number of independent sales representatives (iii) fulfilling the ventilation needs of the growing energy consultant marketplace which work to lower their client s energy costs and emissions, and (iv) from the Company s own customer direct sales activities, all of which focus on the sale of product primarily into the commercial user marketplace with a growing emphasis on low rise structures (small commercial buildings, multi-purpose structures, and residences). In addition, the Company and its independent sales representative sales force will work to secure orders for ConsERV core only sales (i) from HVAC equipment manufacturers, (ii) from distribution firms servicing the equipment needs of the HVAC installer community, and (iii) creating license/supply relationships with HVAC or ERV OEMs preferably having a dominant presence in existing direct related sales channels.

COST OF SALES

Our cost of sales consists primarily of materials (including freight), direct labor, and outsourced manufacturing expenses incurred to produce our ConsERV products.

We are dependent on third parties to manufacture the key components needed for our nano-structured based materials and value added products made with these materials. Accordingly, a supplier s failure to supply components in a timely manner, or to supply components that meet our quality, quantity and cost requirements or our technical specifications, or the inability to obtain alternative sources of these components on a timely basis or on terms acceptable to us, would create delays in production of our products or increase our unit costs of production. Certain of the components contain proprietary products of our suppliers, or the processes used by our suppliers to manufacture these components are proprietary. If we are required to replace any of our suppliers, while we should be able to obtain comparable components from alternative suppliers at comparable costs, it would create a delay in production.

Our cost of sales may fluctuate due to a number of factors, including, but not limited to:

A change in key suppliers or the prices that they charge for the fundamental components of our ConsERV products;

An increase in the labor resources needed to expand the production of our ConsERV products;

Commercialization of new product applications of our polymer technology;

Continued technological improvements in key materials or configuration(s) to reduce our per unit cost structure; and

Additional outsourcing of our manufacturing and assembly processes with strategic partners to reduce our per unit cost structure.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Our selling, general and administrative expenses consist primarily of payroll and related benefits, share-based compensation, professional fees, marketing and channel support costs, and other infrastructure costs such as insurance, information technology and occupancy expenses.

Table of Contents

Our selling, general and administrative expenses may fluctuate due to a variety of factors, including, but not limited to:

Additional expenses as a result of becoming a reporting company including, but not limited to, director and officer insurance, director fees, SEC reporting and compliance expenses, transfer agent fees, additional staffing, professional fees and similar expenses;

Additional infrastructure needed to support the expanded commercialization of our ConsERV products and/or new product applications of our polymer technology for, among other things, administrative personnel, physical space, marketing and channel support and information technology; and

The fair value of new share-based awards, which is based on various assumptions including, among other things, the volatility of our stock price

RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, certain data derived from our Statements of Operations:

	Year Ended December 31, 2010	2009
Revenues	$ 3,342,468	$ 1,531,215
Percentage of revenues	100.0%	100.0%
Cost of goods sold	$ 2,290,041	$ 1,071,098
Percentage of revenues	68.5.%	70.0%
Research and development expenses, net grant revenue	$ 238,182	$ 6,600
Percentage of revenues	7.1%	.4%
Selling, general and administrative expenses	$ 2,693,092	$ 3,217,992
Percentage of revenues	80.6%	210.2%
Interest expense	$ 209,550	$ 621,574
Percentage of revenues	6.3%	40.6%
Change in fair value of warrant liability	$ (618,801)	$ 3,731,694
Percentage of revenues	18.5%	243.7%
Net loss	$ (1,433,593)	$ (7,117,076)
Percentage of revenues	(42.9)%	(464.8)%

DECEMBER 31, 2010 COMPARED TO DECEMBER 31, 2009

REVENUES: Total revenues for the year ended December 31, 2010 and 2009 were $3,342,468 and $1,531,215 respectively, an increase of $1,811,253, or 118.3%. The increase in revenues for 2010 is primarily attributable to the Company increasing the sales price by 6% on the ConsERV products, introducing new products (C-series and semi-custom units) to the ConsERV line, generating additional sales in new price categories and an increase in the number and size of its sales transactions in 2010 compared to 2009. The Company also attributes the sales increase to a realignment of and an increase in the number of its independent sales representatives. During the year ended December 31, 2010 and 2009, seven and five customers accounted for approximately 61% and 66% of revenues, respectively.

COST OF GOODS SOLD: Cost of goods sold was $2,290,041 and $1,071,098 or 68.5% and 70.0% of revenues for the years ended December 31, 2010 and 2009, respectively. The increase in 2010 of $1,218,943 is primarily due an increase in sales. Gross profit margin increased from 30% in 2009 to 31.4% in 2010. The increase in the gross profit margin was due to a decrease in the cost of materials due to improved production processes, volume pricing and new suppliers. The Company also was able to reduce labor costs by approximately 10% through the implementation of lean manufacturing and QRM processes. The effect of these cost savings that were achieved through these measures was partially offset by an increase in contract labor of approximately $80,000 and an overall increase in freight costs by approximately $100,000.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES: Selling, general and administrative expenses were $2,693,092 for the year ended December 31, 2010, compared to $3,217,992 for the year ended December 31, 2009, a decrease of $524,900 or 16.3%. This decrease is primarily due to a decrease in stock based compensation of approximately $785,000 which was partially offset by an increase in professional fees of approximately $174,000 which was due to hiring an investor relations firm in 2010 and additional consultants. The Company also had an increase in payroll expenses of approximately $106,700 for the addition of two new employees in management.

INTEREST EXPENSE: Interest expense was $209,550 for the year ended December 31, 2010 compared to $621,574 for the same period of 2009, a decrease of $412,024 or 66.3%. During the year ended December 31, 2009, interest expense was primarily related to convertible notes issued from December 2007 to January 2008, and comprised of approximately $172,000 of stated interest expense on the notes, approximately $413,000 in expense relating to warrants issued to induce conversion of principal and $30,100 in expense related to the amortization of the discount and embedded beneficial conversion feature. The decrease in interest expense is due to the fact that the beneficial conversion feature and discount on the notes payable became fully amortized in January 2009 and the convertible debt has been reduced by $275,000 in 2010.

CHANGE IN FAIR VALUE OF WARRANT LIABILITY: The change in the fair value of warrant liability increased by $4,350,495 for the year ended December 31, 2010 to income of ($618,801) from expense of $3,731,694 in the prior year due to the change in the fair value of the underlying warrant liability based on the Black-Scholes option pricing model. See Note 12 in the Financial Statements for further explanation.

NET LOSS: Net loss for the year ended December 31, 2010 decreased by $5,683,483 to $1,433,593 from $7,117,076 for the year ended December 31, 2009. The decrease in net loss is primarily due to the increases in sales and the change in fair value of the warrant liability net of decreases in interest expense and selling, general and administrative expenses.

LIQUIDITY AND CAPITAL RESOURCES

The Company finances its operations primarily through sales of its ConsERV products, sales of its common stock, the issuance of convertible promissory notes, unsecured promissory notes and license agreements.

Our historical revenues have not been sufficient to sustain our operations. We have not achieved profitability in any year since inception and we expect to continue to incur net losses and negative cash flow from operations until we can produce sufficient revenues to cover our costs, which are not expected for several years. Furthermore, even if we achieve our goal of selling a greater number of ConsERV units, we anticipate that we will continue to incur losses until we can cost-effectively produce and sell our products to a wider market. Our profitability will require the successful commercialization of our ConsERV products and any future products we develop. No assurances can be given when this will occur.

We have filed a registration statement on Form S-1 with the SEC for a contemplated public offering of common stock for gross proceeds of up to fifteen million dollars. We have engaged MDB Capital Group LLC to be the underwriter of this public offering. However, we have not entered into an underwriting agreement with MDB Capital Group LLC, and we may not be able to consummate a public offering. As disclosed in our registration statement, we intend to use the proceeds of the public offering for working capital, general corporate purposes and repayment of certain outstanding indebtedness.

During the year ended December 31, 2009 eighteen holders converted their Convertible Notes, having an aggregate outstanding principal balance of $2,350,000 plus accrued interest of $361,600, into 13,553,822 shares of common stock. Some of the holders converted during periods in which we were offering an additional warrant as an inducement to convert. In accordance with said offers we issued additional warrants to purchase 1,665,000 shares of common stock, exercisable immediately at $0.25 per share and valued at $126,367, and 575,000 warrants, exercisable immediately at $0.75 per share valued at $286,641 which was recorded as interest expense during the twelve months ended December 31, 2009.

During 2009, four investors holding Convertible Notes with an aggregate outstanding principal balance of approximately $450,000 at December 31, 2008 notified the Company that they were asserting their rights to receive payment of the principal and interest pursuant to the terms of the Convertible Notes. In June of 2009, three of these investors, holding an aggregate principal note balance of $250,000, entered into a confession of judgment with the

Table of Contents

Company. Under that agreement, the three investors had the right, should the Company fail to pay all principal and interest due pursuant to their Convertible Notes on or before September 11, 2009, to file the confession of judgment with the court and seek to secure a judgment against the Company in the amount of all principal and interest due under their Convertible Notes together with the reasonable cost and expense of collection. All accrued interest and principal related to the three Convertible Notes, $289,600 in the aggregate, was paid in full by the Company on or before September 11, 2009. In July 2009, the fourth investor, holding a Convertible Note in the principal amount of $200,000, agreed to extend said note to September 2009. In November 2009, this investor and the Company modified the Convertible note to extend the maturity date of said note to July 2010, pay the principal amount due in eight monthly installments commencing December of 2009, end the accrual of interest as of November 20, 2009 and convert the $34,861 in interest due under the Convertible Note as of November 20, 2009 into 170,137 shares of Company s common stock. During the year ended December 31, 2010, $75,000 of the outstanding balance was repaid and $75,000 was converted into 325,000 shares of common stock.

As of December 31, 2010, $50,000 of principal on the Convertible Notes was outstanding, in default and due and payable in full. On March 23, 2011 this note was paid in full by Company. As of the date of this filing all Convertible Notes issued under the Financing have been paid in full or converted.

In July 2009, we secured a loan of $300,000 from an investor. Pursuant to the terms of the note, we are to pay the note holder simple interest at the rate of seven percent per annum commencing on July 17, 2009 with all interest and principal due there under payable in cash on or before January 16, 2011. On December 30, 2010, the investor elected to apply all of the proceeds due and payable under the Note, including all accrued interest, to purchase the Company s Common Stock. Pursuant to this transaction, the investor subscribed for and purchased 1,268,472 shares of Common Stock at a purchase price of $0.26 per share resulting in an aggregate purchase price of $329,803.

In December 2009, we secured a loan in the principal amount of $1,000,000 from an investor. Pursuant to the terms of the note, we are to pay the holder simple interest at the rate of ten percent per annum commencing on the date of issuance with all interest and principal due and payable in cash on or before June 17, 2010 the note s maturity date was extended to April 30, 2011. On March 22, 2011, the Company entered into a Securities Amendment and Exchange Agreement and an Amended and Restated Convertible Promissory Note (2011 Convertible Note , collectively Exchange Agreements) with the this investor. Pursuant to the terms and subject to the conditions set forth in the Exchange Agreements, the Company and the Investor amended and restated the $1,000,000 unsecured promissory note issued by the Company to Investor on or about December 17, 2009 (Original Note) to, among other things, extend the term to March 22, 2012. Interest in the amount of 10% per annum, commencing on December 17, 2009 and calculated on a 365 day year, and the principal amount of $1,000,000 will be paid on March 22, 2012. Subject to the terms and conditions of the 2011 Convertible Note, including limitations on conversion, the outstanding principal and interest under the 2011 Convertible Note will automatically convert into shares of the Company s common stock at the then-effective conversion price upon the closing of a qualified firm commitment underwritten public offering or may be voluntarily converted by the investor at anytime during the term. The initial conversion price is $0.26 per share. Any principal or interest which is not converted will be repaid by the Company at the earlier of a qualified offering, (as defined in the 2011 Convertible Note which is filed as an exhibit to the Form 8K filed with the Securities and Exchange Commission on March 28, 2011 and is incorporated by reference to this annual report on Form 10K), or March 22, 2012. Pursuant to and during the term of the 2011 Convertible Note, the Company will not issue or allow to exist any obligation for borrowed money, except for subordinate indebtedness in payment and priority, trade payables incurred in the ordinary course of business, purchase money secured indebtedness for equipment or inventory, unsecured and subordinate, or unsecured and subordinate working capital guarantees provided by, the Export Import Bank of the United States (the EXIM Bank), and indebtedness evidenced by the promissory note dated February 19, 2010 issued to RBC Capital Markets- Custodian of Leonard Samuels IRA (as amended) in the principal amount of $620,000.

On March 22, 2011, in connection with the above Exchange Agreements, the Company entered into Amendment to 2007 Warrant and Amendment to 2009 Warrant to extend the terms of the Stock Purchase Warrant, dated on or about December 31, 2007, and Stock Purchase Warrant, dated on or about March 12, 2009, respectively, to March 22, 2016 and to provide for cashless exercise unless such warrant shares are registered for resale under a registration statement. In addition, on March 22, 2011, the Company issued a Stock Purchase Warrant to the Investor to purchase 1,000,000 shares of the Company s common stock at $0.45 per share, exercisable commencing on the earliest of the consummation of the qualified offering (as defined in the Exchange Agreements), the date of conversion of the 2011 Convertible Note in full, or the date of conversion of the 2011 Convertible Note by the Investor in the greatest number of shares of the Company s common stock not to exceed 9.99% beneficial ownership of Company outstanding common stock and terminating on March 22, 2016.

Table of Contents

Also, on March 22, 2011, the Company entered into a Note and Warrant Purchase Agreement, Secured Convertible Promissory Note and Patent Security Agreement (Financing Agreements) with the Investor. Pursuant to the terms and subject to the conditions set forth in the Financing Agreements, the Investor has provided a bridge loan in the amount of $1,500,000 (Loan) to the Company, which will be secured in all patents, patent applications and similar protections of the Company and all rents, royalties, license fees and accounts with respect to such intellectual property assets. Pursuant to the Secured Convertible Promissory Note (Secured Note), interest in the amount of 10% per annum, calculated on a 365 day year, and the principal amount of $1,500,000 will be paid on March 22, 2012, but repayment is accelerated upon a qualified offering (as defined in the note). In the event of such qualified offering, and subject to the terms and conditions of the Secured Note, the outstanding principal and interest under the Secured Note will automatically convert, subject to the limitations on conversion described in the note, into shares of the Company s common stock at the then-effective conversion price upon the closing of such qualified offering. The initial conversion price is $0.26 per share. Any principal or interest which is not converted will be repaid by the Company at the earlier of a qualified offering or March 22, 2012. No cash fees were paid to any party to the transaction in exchange for lending the money. On March 22, 2011, in connection with the Financing Agreements, the Company issued a Stock Purchase Warrant to the Investor to purchase 3,000,000 shares of the Company s common stock at $0.45 per share, exercisable until March 22, 2016.

Pursuant to and during the term of the Secured Note, the Company will not issue or permit to exist any obligation for borrowed money, except for trade payables incurred in the ordinary course of business, purchase money secured indebtedness for equipment or inventory, unsecured and subordinate indebtedness to, or unsecured and subordinate working capital guarantees provided by, the EXIM Bank, the promissory note dated February 19, 2010 issued to RBC Capital Markets- Custodian of Leonard Samuels IRA (as amended) in the principal amount of $620,000, the Amended and Restated Convertible Promissory Note, dated March 22, 2011, issued to the Investor in the principal amount of $1,000,000 and other unsecured indebtedness for borrowed money in an amount not to exceed $750,000.

Pursuant to the Patent Security Agreement issued in connection with the Note and Warrant Purchase of March 22, 2011, the Company shall not, without the Investor s prior consent, sell, dispose or otherwise transfer all or any portion of the Collateral, except for license grants in the ordinary course of business. In addition, the Company will take all actions reasonably necessary to prosecute to allowance applications for patents and maintain all patents, and to seek to recover damages for infringement, misappropriation or dilution of the Collateral with limited exceptions.

In connection with such qualified offering, and subject to the terms and conditions of the Convertible Note, the Company will use reasonable efforts to include the Investor s securities in such offering. Pursuant to the terms and conditions of the Exchange Agreements, the Investor will not sell, offer to sell or otherwise transfer or dispose of (other than to affiliates) any securities of the Company held by it for a period of 180 days from the date of the final prospectus relating to such qualified offering, except for certain limited sales as more fully described in the Exchange Agreements.

The Company secured loans from two investors in the principal amounts of $250,000 and $620,000. The loan amounts were received by the Company on December 31, 2009 and February 18, 2010, respectively. Pursuant to the terms of the notes, the Company is to pay the holders simple interest at the rate of ten percent per annum commencing on the date of issuance with all interest and principal due and payable in cash on or before June 30, 2010 and August 10, 2010, respectively.

On December 27, 2010, one of the investors elected to apply all of the proceeds due and payable under the $250,000 Note, including all accrued interest, to the purchase of our common stock. Pursuant to this transaction, the investors subscribed for and received 1,052,950 shares of common stock at a purchase price of $0.26 per share resulting in an aggregate purchase price of $273,767 (the principal amount and related accrued interest under the note).

The $620,000 note s maturity date was extended to April 30, 2011.

At maturity, we may not be able to repay all or any of the outstanding notes when due without severely impacting our ability to continue operations and we may not be able to secure additional financing to repay the notes on acceptable terms, if at all. Should we be unable to repay or renegotiate the notes, as an alternative, management

Table of Contents

could attempt to renegotiate the repayment terms of the notes and seek extension of the maturity dates. There is no guarantee that, if we should need to renegotiate these notes, any negotiated terms we may be able to secure would be favorable to the Company. Unfavorable terms, in either a financing transaction or a debt renegotiation, could adversely impact our business, financial condition and/or results of operations. Should we be unable to repay the loan and unsuccessful in securing additional financing or renegotiating the, $1.5 million dollar secured convertible note the holder would have the option to foreclose on all of our patents and patent applications which would likely result in the failure of our business.

Any future financing may result in substantial dilution to existing shareholders, and future debt financing, if available, may include restrictive covenants or may require us to grant a lender a security interest in any of our assets not already subject to an existing security interest. To the extent that we attempt to raise additional funds through third party collaborations and/or licensing arrangements, we may be required to relinquish some rights to our technologies or products currently in various stages of development, or grant licenses or other rights on terms that are not favorable to us. Any failure by us to timely procure additional financing or investment adequate to fund our ongoing operations, including planned product development initiatives and commercialization efforts, will have material adverse consequences on our financial condition, results of operations and cash flows.

We will be dependent upon our existing cash of $304,656 at December 31, 2010, the proceeds of our March 22, 2011 $1.5 million dollar secured convertible note issuance, product sales and additional debt and equity issuances to finance our operations through the next 12 months. We need to raise additional capital of approximately $13 million to $18 million, net of costs, during the next eighteen months, the proceeds of which will be used to pay down existing debt, secure new patents for innovative applications of our core technology, purchase equipment, and fund our working capital requirements through September 2012. We currently have no commitments for any such funds. If we are unable to raise the funds we may delay development plans and reduce expenditures wherever possible.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. For the year ended December 31, 2010, the Company incurred a net loss of $1,433,593 and has incurred significant losses since inception. As of December 31, 2010, the Company has an accumulated deficit of $35,637,962, negative working capital of $2,861,488 and a stockholders deficit of $6,722,092. The Company used $1,180,848 and $818,378 of cash from operations during 2010 and 2009, respectively, which was funded by proceeds from debt and equity financings. There is no assurance that such financing will be available in the future. In view of these matters, there is substantial doubt that the Company will continue as a going concern. The Company is currently pursuing the following sources of short and long-term working capital:

1. We are currently holding preliminary discussions with parties who are interested in licensing, purchasing the rights to, or establishing a joint venture to commercialize, certain applications of our technology.

2. We are seeking growth capital from certain strategic and/or government (grant) related sources. In addition to said capital, these sources may, pursuant to any agreements that may be developed in conjunction with such funding, assist in the product definition and design, roll-out, and channel penetration of our products. As part of this step we will attempt to take advantage of key programs associated with the recently enacted American Recovery and Reinvestment Act of 2009.

The Company s ability to continue as a going concern is highly dependent on our ability to obtain additional sources of cash flow sufficient to fund our working capital requirements. However, there can be no assurance that the Company will be successful in its efforts to secure such cash flow. Any failure by us to timely procure additional financing or investment adequate to fund our ongoing operations, including planned product development initiatives and commercialization efforts, will have material adverse consequences on our financial condition, results of operations and cash flows.

The financial statements of the Company do not include any adjustments relating to the recoverability and classification of recorded assets, or the amounts and classifications of liabilities that might be necessary should the Company be unable to continue as a going concern.

Statements of Cash Flows

Cash and cash equivalents as of December 31, 2010 was $304,656 compared to $1,085,628 as of December 31, 2009. Cash is primarily used to fund our working capital requirements.

Table of Contents

As of December 31, 2010, the Company had an increase in working capital of $596,118, resulting in a working capital deficit of $2,861,488 compared to $2,265,370 of working capital deficit as of December 31, 2009. During the year ended 2010, we used approximately $1,180,800 of cash to fund our operations, approximately $100,000 to repay debt, and approximately $113,300 to purchase property and equipment. These uses of cash are partially offset by approximately $620,000 of proceeds received during 2010 in connection with the issuance of debt.

Net cash used in operating activities was approximately $1,180,800 for the year ended December 31, 2010 compared to approximately $818,000 for the same period in 2009. During the year ended December 31, 2010, we used additional cash to fund operating losses of approximately $1,879,000 and working capital requirements of approximately $2,861,500 compared to the same period in 2009.

Net cash used in investing activities was approximately $120,000 for the year ended December 31, 2010 compared to approximately $41,000 for the same period in 2009. During the year ended December 31, 2010, we used additional cash to purchase equipment.

Net cash provided by financing activities was approximately $520,000 for the year ended December 31, 2010 compared to approximately $1,918,000 for the same period in 2009. During the year ended December 31, 2010, we received net proceeds of $620,000 from the issuance of debt net of $100,000 of payments on notes payable.

ECONOMY AND INFLATION

We have not experienced any significant cancellation of orders due to the downturn in the economy and only a small number of customer requested delays in delivery or production of orders in process.

Our management believes that inflation has not had a material effect on our results of operations

CONTRACTUAL OBLIGATIONS

As of December 31, 2010, we have contractual obligations of $1,828,255 as indicated below:

Contractual Obligations	Total	Less than 1 Year	1-3 Years	3-5 Years
Long-term debt	$ 1,670,674	$ 1,670,674	$	$
Purchase obligations	158,255	158,255		
Total	$ 1,828,929	$ 1,828,929	$	$

OFF-BALANCE SHEET ARRANGEMENTS

We do not have any off balance sheet arrangements that are reasonably likely to have a current or future effect on our financial condition, revenues, results of operations, liquidity or capital expenditures.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of the accompanying financial statements and related disclosures in conformity with U.S. GAAP requires us to make judgments, assumptions and estimates that affect the amounts reported in the accompanying financial statements and the accompanying notes. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. When making these estimates and assumptions, we consider our historical experience, our knowledge of economic and market factors and various other factors that we believe to be reasonable under the circumstances. Actual results could differ from these estimates. The following critical accounting policies are significantly affected by judgments, assumptions and estimates used in the preparation of the financial statements:

The significant accounting policies followed are:

Revenue Recognition

Generally, the Company recognizes revenue for its products upon shipment to customers, provided no significant obligations remain and collection is probable. This policy applies to all of our customers, including Genertec America (a distribution agreement) and CAST Systems Control Technology Co. (an agreement for the purchase of specific goods).

Table of Contents

Our ConsERV product typically carries a warranty of two years for all parts contained therein with the exception of the energy recovery ventilator core which typically carries a 10 year warranty. The warranty includes replacement of defective parts. Warranty costs have been immaterial; however, the Company has recorded an accrual of approximately $11,500 for future warranty expenses at December 31, 2010.

Revenue derived from the sale of licenses is deferred and recognized as revenue on a straight-line basis over the life of the license, or until the license arrangement is terminated. The Company recognized revenue of approximately $82,000 and $84,000 from license agreements for the years ended December 31, 2010 and 2009, respectively.

Impairment of Long-Lived and Intangible Assets

Long-lived and intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the book value of the asset may not be recoverable. The Company periodically evaluates whether events and circumstances have occurred that indicate possible impairment. When impairment indicators exist, the Company uses market quotes, if available or an estimate of the future undiscounted net cash flows of the related asset or asset group over the remaining life in measuring whether or not the asset values are recoverable. There have been no significant impairments of long-lived and intangible assets during the two-year period ended December 31, 2010.

Stock-Based Compensation

The Company recognizes all share-based payments to employees, including grants of employee stock options, as compensation expense in the financial statements based on their fair values. That expense is recognized over the period during which an employee is required to provide services in exchange for the award, known as the requisite service period (usually the vesting period).

The value of each grant is estimated at the grant date using the Black-Scholes option model with the following assumptions for options granted during the years ended December 31, 2010 and 2009:

	Years Ended December 31, 2010	2009
Dividend rate	0%	0%
Risk free interest rate	1.96% 3.68%	1.65% 3.49%
Expected term	5 6.5 years	5 10 years
Expected volatility	97% 112%	92% 106%

The basis for the above assumptions are as follows: the dividend rate is based upon the Company s history of dividends; the risk-free interest rate for periods within the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant; the expected term was calculated based on the Company s historical pattern of options granted and the period of time they are expected to be outstanding; and expected volatility was calculated by review of a peer company s historical stock prices.

Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Based on historical experience of forfeitures, the Company estimated forfeitures at 0% for the each of the years ended December 31, 2010 and 2009.

Taxes

Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus deferred taxes resulting from temporary differences. Such temporary differences result from differences in the carrying value of assets and liabilities for tax and financial reporting purposes. The deferred tax assets and liabilities represent the future tax consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

Table of Contents

As of December 31, 2010, the Company had no unrecognized tax benefits or related interest and penalties. We will include future interest and penalties associated with any unrecognized benefits within provision for income taxes on the Statements of Operations, if applicable. We do not anticipate any unrecognized benefits in the next 12 months that would result in a material change to our financial position.

RECENT ACCOUNTING PRONOUNCEMENTS

For a description of recent accounting standards, including the expected dates of adoption and estimated effects, if any, on our financial statements, see Note 3: Significant Accounting Policies: Recent Accounting Standards in Part II, Item 8 of this Form 10-K.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

Our financial statements and the related notes begin on Page F-1, which are included in this Annual Report on Form 10-K.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

ITEM 9A(T). CONTROLS AND PROCEDURES.

Disclosure Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act. Management conducted its evaluation based on the framework in *Internal Control Integrated Framework* issued by the Committee on Sponsoring Organizations of the Treadway Commission (COSO). Based on that evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that, at December 31, 2010, such disclosure controls and procedures were not effective due to the material weakness identified by the Company s CEO and CFO discussed below.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure.

Management s Annual Report on Internal Control over Financial Reporting

The Company s management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rue 13a-15(f) under the Exchange Act). Internal control over financial reporting is a process, including policies and procedures, designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles. Our management assessed our internal control over financial reporting based on the *Internal Control Integrated Framework* issued by the COSO. Based on the results of this assessment, our management concluded that our internal control over financial reporting were not effective as of December 31, 2010 based on such criteria for the reasons discussed below.

In the course of management s evaluation, each of our Company's CEO and CFO considered the restatement of the financial statements presented in Part II, Items 6, 7 and 8, respectively, included in this Form 10-K and concluded that such restatements were the result of a material weakness relating to the accounting and disclosure for complex

Table of Contents

and non-standard common stock warrant transactions. To address our Company's material weakness related to the accounting and disclosure for complex and non-standard stockholders' equity transactions, we are in the process of enhancing our internal control processes in order to be able to comprehensively review the accounting and disclosure implications of such transactions on a timely basis.

Limitations on the Effectiveness of Controls

Our disclosure controls and procedures are designed to provide reasonable, not absolute, assurance that the objectives of our disclosure control system are met. Because of inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues, if any, within a company have been detected. Based on their evaluation as of the end of the period covered by this report, management concluded that our disclosure controls and procedures were sufficiently effective to provide reasonable assurance that the objectives of our disclosure control system were met.

Auditor s Report on Internal Control over Financial Reporting

This Annual Report does not include an attestation report of the Company s independent registered public accounting firm regarding internal control over financial reporting. Management s report was not subject to attestation by the Company s registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit the Company to provide only management s report in this Annual Report.

ITEM 9B. OTHER INFORMATION

On March 29, 2011, the Company concluded that the audited financial statements included in the Company s Form 10K as filed with the Securities and Exchange Commission on March 30, 2010 for the year ended December 31, 2009 should no longer be relied upon.

The Company's CEO and CFO identified a material weakness in our internal controls over financial reporting relating to the accounting and disclosure for complex and non-standard common stock warrant transactions. The Company applied the guidance of Accounting Standards Codification 815-40 (ASC 815-40) and recorded a $618,801 gain on the fair value of the warrant liability for the year ended December 31, 2010. The warrants had been issued in December 2007, January 2008 and August 2008, in connection with convertible promissory notes and were originally accounted for as an equity instrument. Upon further review of the warrants, it was determined that these warrants were not indexed to the Company s stock and therefore required derivative accounting treatment.

The Chief Executive Officer and the Financial Officer of the Company discussed with the registrant s independent auditor, Cross, Fernandez & Riley, LLP. and determined that due to the materiality of the transaction, the Company should restate its financial statements included in Form 10K as filed on March 30, 2010, for the year ended December 31, 2009 to reflect the proper accounting treatment. The Company has included the restated financial statements for the year ended December 31, 2009 herein.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The following table sets forth the names and ages of all of our directors and executive officers as of the date of this Annual Report. Also provided herein is a brief description of the business experience of each director and executive officer during the past five years and an indication of directorships held by each director in other companies subject to the reporting requirements under the Federal securities laws. All of the directors will serve until the next annual meeting of shareholders and until their successors are elected and qualified, or until their earlier death, retirement, resignation or removal. There are no arrangements or understandings between any director or executive officer and any other person pursuant to which the director or executive officer was selected.

Name	Age	Position
Timothy N. Tangredi	55	President, Chief Executive Officer and Chairman of the Board of Directors
Scott G. Ehrenberg	57	Chief Technology Officer and Secretary
Judith C. Norstrud	42	Chief Financial Officer and Treasurer
David Longacre	52	Vice President Sales and Marketing

Robert W. Schwartz	66	Director
Raymond Kazyaka Sr.	75	Director

Table of Contents

Directors and Executive Officers

The following are the Company s directors and executive officers:

Timothy N. Tangredi has been our Chief Executive Officer since 1996. Mr. Tangredi joined the Company in 1996, and was appointed a member of our board of directors in 1997. In 1999 and 2000, respectively, Mr. Tangredi initiated and executed the strategic purchases of Analytic Power and American Fuel Cell Corporation. From 1979 to 1990, Mr. Tangredi worked for AT&T, as a member of the Leadership Continuity Program working in technical marketing, network operations, and project management. Mr. Tangredi earned his BS from Siena College and MBA from Rensselaer Polytechnic Institute. He is a founder and member of the board of directors of Aegis BioSciences, LLC (Aegis). Aegis, created in 1995, is a licensee of the Company s nano-structured intellectual property and materials in the biomedical and healthcare fields. Mr. Tangredi spends approximately one to two days per month on Aegis business and is compensated by Aegis for his time and contribution(s).

Scott G. Ehrenberg, is a founder of the Company and has been our Chief Technology Officer since 1993 and Secretary since November 7, 2008. He has thirty years of experience developing along with others new materials and applications. These applications range from laser cutting systems, optical inspection technology, and new organic electronic packages for IBM to new polymer electrolytes for electrochemical and mass transport devices for the Company. His background includes 12 years at IBM plus two previous startups in the fields of electronic packaging and ultrasonic devices: a firm which became Tessera of San Jose, CA and Sono-Tek of Milton, NY. He has 14 issued patents with 6 more pending along with numerous technical papers and presentations. Mr. Ehrenberg received his bachelor of science from Pennsylvania State University in 1976.

Judith C. Norstrud, CPA was appointed Chief Financial Officer and Treasurer on October 14, 2009. In March 2002, Judith founded Norco Accounting & Consulting, Inc., a firm that provides various accounting and consulting services to small companies on an as needed basis. From July 1999 to June 2002, Judith served as a manager with Pender, Newkirk and Company, CPAs. While at Pender, Judith served a variety of companies from start up enterprises to mid-sized publicly traded companies. Previously, from August 1996 to July 1999, Judith was an Audit Senior with PricewaterhouseCoopers, LLP. Judith graduated from the University of South Florida s College of Business Administration with a Master of Accountancy degree in 2002.

David E. Longacre has been Vice President of Sales and Marketing since January 2010. His background includes over 25 years of experience in the Heating, Ventilation and Air Conditioning (HVAC) industry. His career started with York International as a Sales Engineer, progressing to a Zone Manager over 17 years. He worked as an independent manufactures representative for two years before joining Trane, where he was a Strategic Account Manager and Team Leader for five years. He then worked with Siemens Building Technologies as their Service Sales Manager for a district from 2005 through 2007, then became Branch Manager for Johnson Controls handling the profit and loss for both sales and operations during 2007 through 2009. Mr. Longacre received his BS in Commerce and Engineering from Drexel University in 1980. He is also a LEED AP.

Non-Employee Directors

Raymond Kazyaka Sr. was appointed to our board of directors in 1995. He is the President of RJK Tech Ltd. Since 2005. Mr. Kazyaka is the former President (1976-2004) and a co-founder of Wright Malta Corporation, which was founded in 1972. Wright Malta, liquidated in 2005, owned and operated the Malta Test Station, which had performed military product development for various governmental and commercial organizations. Mr. Kazyaka has also served as a consultant to the Canadian National Defense on facility noise abatement. Prior to founding Wright Malta, Mr. Kazyaka worked for General Electric as a rocket engine design engineer and a manager. Mr. Kazyaka holds several patents on rocket engine components and noise abatement systems, and is a senior member of the American Institute of Aeronautics and Astronautics. Mr. Kazyaka graduated from Union College with a degree in Mechanical Engineering in 1953.

Robert W. Schwartz was appointed to our board of directors in 2001. Mr. Schwartz founded the Schwartz-Heslin Group (SHG) in 1985 and serves as one of its Managing Directors. Mr. Schwartz specializes in corporate planning, finance and development. Prior to starting SHG, he was a founder, President and Chief Executive Officer of a venture-funded high tech telecommunications company (Windsource, Inc.). In addition, he was the President and Chief Operating Officer of an American Stock Exchange listed company (Coradian Corporation). He was also the Chief Financial Officer of a major manufacturer of outdoor power equipment (Troy Built Products, Troy, NY). His earlier experience was with KPMG as a management consultant and with IBM. Mr. Schwartz received a Bachelor of Science from Cornell University in 1967 and attended graduate courses at the University of New York Albany. He currently serves on the boards of five corporations, including ours.

The Board members serve for the latter of a period of one year or until the next annual meeting of Company s shareholders.

Involvement in Certain Legal Proceedings

None of our directors or executive officers has been, during the past ten years:

(i) involved in any bankruptcy petition filed by or against such person or any business of which such person was a general partner or executive officer, either at the time of the bankruptcy or within two years prior to that time;

(ii) convicted of any criminal proceeding or subject to a pending criminal proceeding (excluding traffic violations and other minor offences);

(iii) subject to any order, judgment, or decree, not subsequently reversed, suspended or vacated, of any court of competent jurisdiction, permanently or temporarily enjoined, barred, suspended or otherwise limited from involvement in any type of business, securities, futures, commodities or banking activities;

(iv) found by a court of competent jurisdiction (in a civil action), the Securities and Exchange Commission or the Commodity Futures Trading Commission to have violated a federal or state securities or commodities law, and the judgment has not been reversed, suspended, or vacated

(v) found by a court of competent jurisdiction in a civil action or by the Commission to have violated any Federal or State securities law, and the judgment in such civil action or finding by the Commission has not been subsequently reverse, suspended, or vacated;

(vii) subject of, or a party to, any Federal or State judicial or administrative order, judgment, decree, or finding, not subsequently reversed, suspended or vacated, related to an alleged violation of securities or commodities law or regulation; any law or regulation respecting financial institutions or insurance companies; or any law or regulation prohibiting mail or wire fraud or fraud in connection with any business entity; or

(viii) the subject of, or a party to, any sanction or order, not subsequently reversed, suspending or vacated, of any self-regulatory any registered entity of the Commodity Exchange Act or any equivalent exchange, association, entity or organization that has disciplinary authority over its members or persons associated with a member.

Director Independence

The OTC Bulletin Board does not have rules regarding director independence. We expect to apply for listing of our common stock on American Stock Exchange on or soon after the date of the final prospectus in connection with the offering described in our S-1 filing of February 14, 2011. Therefore, our determination of the independence of directors is made using the definition of independent contained in the listing standards of the American Stock Exchange. On the basis of information solicited from each director, the board has determined that Raymond Kazyaka Sr. and Robert W. Schwartz have no material relationship with the Company and is independent within the meaning of such rules. In making this determination, the board evaluated responses to a questionnaire completed by each director regarding relationships and possible conflicts of interest between each director, the company and management. In its review of director independence, the board considered all commercial, industrial, banking, consulting, legal, accounting, charitable, and familial relationships any director may have with the company or management At present, we do not have audit or compensation committees established. It is our intention on the closing of the above described offering to add new outside Board members, and establish at a minimum an audit and compensation committee.

Board Meetings and Committees; Annual Meeting Attendance

Our board of directors has not adopted any committees to the board of directors. Our board of directors held ten formal meeting during the most recently completed fiscal year. Other proceedings of the board of directors were conducted by resolutions consented to in writing by all the directors and filed with the minutes of the proceedings of the directors. Such resolutions consented to in writing by the directors entitled to vote on that resolution at a meeting of the directors are, according to the corporate laws of the State of New York and our bylaws, as valid and effective as if they had been passed at a meeting of the directors duly called and held.

At each annual meeting of shareholders, directors will be elected by the holders of common stock to succeed those directors whose terms are expiring. Directors will be elected annually and will serve until successors are duly elected and qualified or until a director s earlier death, resignation or removal. Our bylaws provide that the authorized number of directors may be changed by action of the majority of the board of directors or by a vote of the shareholders of our Company. Vacancies in our board of directors may be filled by a majority vote of the board of directors with such newly appointed director to serve until the next annual meeting of shareholders, unless sooner removed or replaced. We currently do not have a policy regarding the attendance of board members at the annual meeting of shareholders.

Code of Ethics

We have adopted a code of ethics that applies to our officers, directors and employees in accordance with applicable federal securities laws. We have filed a copy of our code of ethics as an exhibit to our Annual Report on Form 10-K as filed on March 31, 2009. This document may be reviewed by accessing our public filings at the SEC s web site at www.sec.gov. In addition, a copy of the code of ethics will be provided without charge upon request to us. We intend to disclose any amendments to or waivers of certain provisions of our code of ethics in a Current Report on Form 8-K

Compliance with Section 16(a) of the Exchange Act

Section 16(a) of the Exchange Act requires our executive officers and directors, and persons who own more than 10% of any publicly traded class of our equity securities, to file reports of ownership and changes in ownership of our equity securities with the SEC. Officers, directors, and greater than ten percent stockholders are required by SEC regulation to furnish the Company with copies of all Section 16(a) forms that they file.

Based solely on the reports received and on the representations of the reporting persons, we believe that these persons have complied with all applicable filing requirements of Section 16(a) of the Exchange Act during fiscal 2010.

ITEM 11. EXECUTIVE COMPENSATION

The table below summarizes the total compensation earned by or paid to our principal executive officer, our principal financial officer and each of our two other executive officers other than our principal executive officer and principal financial officer for the fiscal years ended December 31, 2010 and 2009. The amounts represented in the Options Award column reflect the stock compensation expense recorded pursuant to the ASC Topic 718 and does not necessarily equate to the income that will ultimately be realized by the named executive for such awards.

Table of Contents

SUMMARY COMPENSATION TABLE

Summary Compensation Table

Name and principal position (a)	Year (b)	Salary ($) (c)	Bonus ($) (d)	Stock Awards ($)(2) (e)	Option Awards ($)(2) (f)	Non-Equity Incentive Plan (g)	Non-qualified Deferred Compensation Earnings ($) (h)	All other compensation ($) (i)	Total ($) (j)
Timothy N. Tangredi Chief Executive Officer, President, and Chairman of the Board of Directors(1)	2010	$ 170,000			$ 95,869				$ 265,869
	2009	$ 170,000			$ 1,134,425				$ 1,304,425
Robert W. Brown Vice President of Marketing (3)	2009	$ 57,187							$ 57,187
David E. Longacre Vice President of Sales and Marketing	2010	$ 125,000	$ 10,000		$ 73,386				$ 208,386
Scott G. Ehrenberg, Chief Technology Officer and Secretary	2010	$ 74,808			$ 89,877				$ 164,685
	2009	$ 67,100							$ 67,100
Judith C. Norstrud, Chief Financial Officer and Treasurer	2010	$ 50,000			$ 35,951				$ 85,951
	2009	$ 13,447			$ 82,930				$ 96,377

(1) Mr. Tangredi receives a salary of $170,000 per year, and a bonus in an amount not to exceed 100% of his salary, which bonus shall be measured by meeting certain performance goals as determined in the sole discretion of our board of directors. In 2010 and 2009, Mr. Tangredi was paid $110,833 and $55,350, respectively and has accrued unpaid salary of $59,167 for 2010 and $114,650 for 2009. Additional accruals have been made for the years prior to 2009.

(2) The amounts included in these columns are the aggregate dollar amounts of compensation expense recognized by us for financial statement reporting purposes in accordance with Accounting Standards Codification 718, *Compensation-Stock Compensation,* for the fiscal years ended December 31, 2010 and December 31, 2009, and thus include amounts from option awards granted in and prior to the indicated year. For information on the valuation assumptions used in calculating these dollar amounts, see Note 1 to our audited financial statements included in this Report for the fiscal years ended December 31, 2010 and December 31, 2009, each as filed with the SEC. These amounts reflect our accounting expense for these awards and do not correspond to the actual value that may be recognized by the individuals upon option exercise. During the fiscal year ended December 31, 2010, there were 361,125 option award forfeitures related to service-based vesting conditions.

(3) Mr. Brown s employment with us terminated on July 6, 2010.

Narrative Disclosure to Summary Compensation Table

Employment Agreements

Officer Employment Agreement

Timothy N. Tangredi. We are party to an employment agreement with Mr. Tangredi, our President, Chief Executive Officer, and director. The employment agreement, as amended and restated on July 29, 2008, sets forth Mr. Tangredi s compensation level and eligibility for salary increases, bonuses, benefits, royalty sharing for newer applications, and option grants. Mr. Tangredi s employment agreement provided for an initial term of three years with the term extending on the second anniversary thereof for an additional one year period and on each subsequent anniversary of the agreement for an additional year period. The agreement sets forth Mr. Tangredi s compensation level, conditions for certain option grants, benefits and the obligations of the Company in the event of termination. Mr. Tangredi s base salary is $170,000, plus certain allowances as well as performance related payments and option issuances.

For each product for which the Company commences commercial sale or licensing during the term and receives more than $1 million of revenue during any 12 month period, Mr. Tangredi, in addition to any other compensation which he may receive under the agreement, shall be granted options to purchase a minimum of 10,000 shares of the Company s common stock at an exercise price equal to either (i) the lower of: (a) $2.50 per share or (b) the fair market value per share of the stock on the date of grant as determined in good faith by the Compensation Committee of the Board of Directors, if the Company has not conducted an initial public offering prior to the date of grant (as hereinafter defined), or (ii) at an exercise price equal to 75% of the market price of the common stock, if the Company has completed an initial public offering of its common stock prior to the date of grant (with the market price to be the average of the closing sale prices during the five trading days immediately preceding the date of grant of the option). Such options, as well as any other options granted to Mr. Tangredi during the term of his employment, shall be granted under the Company s then existing stock option plan, shall be immediately exercisable, have a term of ten years, shall be exercisable for up to three years after termination of employment (unless termination is for cause, in which event they shall expire on the date of termination), shall have a cashless exercise feature, and shall be subject to such additional terms and conditions as are then applicable to options granted under such plan provided they do not conflict with the terms set forth in the agreement.

In the event that the fair market value of the Company s common stock (the average of the closing prices of the common stock for any five consecutive trading days, as reported by the principal exchange or other stock market on which the commons stock is then traded) equals or exceeds 200% of the price at which the Company sells common stock in a public offering (the Target Value) at any time during the term of the agreement, Mr. Tangredi shall be granted options to purchase 50,000 shares of common stock at an exercise price equal to 75% of the Target Value, on terms identical to the options provided for above.

In the event Mr. Tangredi s employment is terminated by the Company without cause or by Mr. Tangredi for good reason, death or disability, Mr. Tangredi shall be entitled to the following:

(i) An amount equal to the sum of (A) the greater of 200% of the base salary then in effect for Mr. Tangredi or $270,000 plus (B) the cash bonus, if any, awarded to Mr. Tangredi for the most recent year shall be payable by the Company in full within 10 days following termination;

(ii) The Company shall continue to provide Mr. Tangredi the health and life insurance, car allowance and other benefits set forth in the agreement until two years following termination of employment, and shall continue to offer any of such benefits to Mr. Tangredi beyond such two year period to the extent required by COBRA or similar statute which may then be in effect;

(iii) All stock options, to the extent they were not exercisable at the time of termination of employment, shall become exercisable in full; and

(iv) Any indebtedness of Mr. Tangredi to the Company shall thereupon be cancelled and of no further force and effect, and the Company shall pay to Mr. Tangredi, within ten days following receipt of a written demand therefore, any income or other taxes resulting from such cancellation.

In the event that Mr. Tangredi elects to terminate employment within one year following a change in control of the Company, he shall receive, within the later of ten days following the date on which the change in control occurs or the date on which he gives notice of his election to terminate employment, a lump sum payment equal to three times the greater of (i) his then current base salary plus the cash bonus, if any, awarded to him for the most recent year or (ii) $350,000 plus said cash bonus. In addition, he will be entitled to accelerated vesting of outstanding options and continuing benefits as described above.

Significant Employee

Patricia K. Tangredi. We are a party to an employment agreement with Ms. Tangredi. The agreement, provided for an initial term of 3 years beginning on January 1, 2001, with automatic extensions for subsequent one year terms, unless the Company or Ms. Tangredi provides the other party with written notice of intent not to renew. The

Table of Contents

agreement was subsequently amended and restated on July 29, 2008. The employment agreement set forth Ms. Tangredi s compensation level and eligibility for salary increases, options, royalty sharing for newer applications, benefits and the obligations of the Company in the event of termination. A portion of Ms. Tangredi s salary has been accrued and carried on the Company s books since 2002.

In the event Ms. Tangredi s employment is terminated by the Company without cause or by the Ms. Tangredi for good reason or by reason of death or disability, Ms. Tangredi shall be entitled to the following:

(i) the greater of 100% of the base salary then in effect for Employee or $115,000, which amount shall be payable by the Company in full within 10 days following termination;

(ii) the Company shall provide, at its sole cost, Ms. Tangredi with the medical benefits for one year following the date of termination. The Company shall continue to offer such benefits to Ms. Tangredi beyond such one year period to the extent required by COBRA or any similar statute which may then be in effect; and

(iii) all stock options granted to Ms. Tangredi at any time during the course of the term shall be exercisable in full.

In the event that Ms. Tangredi elects to terminate her employment within six months following a change in control of the Company, she shall receive, within the later of 10 days following the date on which the change in control occurs or the date on which she give notice of her election to terminate employment, a lump sum payment equal to the greater of three times her then current base salary or $235,000. In addition, she will be entitled to accelerated vesting of outstanding options and continuing medical benefits as described above.

Table of Contents

Outstanding Equity Awards

The following table summarizes outstanding unexercised options, unvested stocks and equity incentive plan awards held by each of our name executive officers and significant employees, as of December 31, 2010.

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END

OPTION AWARDS						**STOCK AWARDS**			
Name (a)	**Number of securities underlying unexercised options (#) Exercisable (b)**	**Number of securities underlying unexercised options (#) Unexercisable (c)**	**Equity Incentive Plan Awards: Number of Securities underlying unexercised unearned options (#) (d)**	**Option exercise price ($) (e)**	**Option expiration date (f)**	**Number of shares or units of stock that have not vested (#) (g)**	**Market value of shares or units of stock that have not vested ($) (h)**	**Equity incentive plan awards: number of unearned shares, units or other rights that have not vested (#) (i)**	**Equity incentive plan awards: Market or payout value of unearned shares, units or other rights that have not vested ($) (j)**
Timothy N. Tangredi (1)	825,000	0	0	$ 0.26	9/23/2014				
	150,000	0	0	$ 0.10	5/10/2015				
	120,000	0	0	$ 0.10	10/1/2015				
	40,000	0	0	$ 0.30	5/2/2016				
	110,000	0	0	$ 0.55	11/1/2016				
	140,000	0	0	$ 0.55	2/20/2017				
	300,000	0	0	$ 0.21	8/18/2017				
	350,000	0	0	$ 0.21	1/30/2018				
	3,000,000*	0	0	$ 0.36	4/18/2013				
	75,000	0	0	$ 0.30	8/4/2018				
	100,000	0	0	$ 0.42	11/12/2019				
	3,540,058	0	0	$ 0.42	11/12/2019				
	400,000	0	0	$ 0.30	6/25/2020				
* Warrant									
Scott G. Ehrenberg (2)	140,000	0	0	$ 0.26	9/23/2014				
	110,000	0	0	$ 0.10	5/10/2015				
	80,000	0	0	$ 0.10	10/1/2015				
	40,000	0	0	$ 0.55	11/1/2016				
	120,000	0	0	$ 0.55	2/20/2017				
	50,000	0	0	$ 0.21	8/18/2017				
	250,000	0	0	$ 0.30	8/4/2018				
	*250,000	0	0	$ 0.30	8/4/2013				
	125,000	250,000	250,000	$ 0.30	6/25/2020				

* Warrant

Judith C. Norstrud (3)	200,000	0	0	$ 0.45	10/15/2019
	50,000	100,000	100,000	$ 0.30	6/25/2020
David E. Longacre (4)	0	200,000	0	$ 0.28	1/20/2020
	0	100,000	0	$ 0.30	7/6/2020

(1) The April 2008 warrant grant to Mr. Tangredi for 3,000,000 shares was made by the Board of Directors in recognition for Mr. Tangredi s achievement of the following goals: negotiating conversion of the convertible notes issued in the Additional Financing, securing a release with respect to the consulting agreement with Gray Capital Partners, Inc., securing and closing upon the Financing. All stock options issued to Mr. Tangredi prior to December 31, 2009 were issued under the 2000 Plan. The remaining options were issued under the 2009 Plan.

(2) All stock options issued to Mr. Ehrenberg prior to December 31, 2009 were issued under the 2000 Plan. The remaining options issued under the 2009 Plan.

(3) All stock options issued to Ms. Norstrud prior to December 31, 2009 were issued under the 2000 Plan .The remaining options were issued under the 2009 Plan.

(4) All stock options issued to Ms. Longacre were issued under the 2009 Plan.

Director Compensation

The following table sets forth the compensation awarded to, earned by or paid to the directors during the fiscal year ended December 31, 2010.

DIRECTOR COMPENSATION

Name (a)	Fees Earned or Paid in Cash ($) (b)	Stock Awards ($) (c)	Option Awards ($) (d)	Non-Equity Incentive Plan Compensation ($) (e)	Change in Pension Value and Non-qualified Deferred Compensation Earnings ($) (f)	All Other Compensation ($) (g)	Total ($) (h)
Raymond Kazyaka Sr., Director(1)			$ 127,034				$ 127,034
Robert W. Schwartz, Director(2)			$ 127,034				$ 127,034

(1) At fiscal year end December 31, 2010, Mr. Kazyaka had 904,600 option awards outstanding and no stock awards outstanding.

(2) At fiscal year end December 31, 2010, Mr. Schwartz had 874,600 option awards outstanding and no stock awards outstanding.

Table of Contents

We do not have a plan pursuant to which our directors are compensated and directors do not receive cash compensation for their services on the Board of Directors although they do receive stock options as determined by the full board of directors. Timothy N. Tangredi, Raymond Kazyaka Sr. and Robert W. Schwartz were each granted an option on June 25, 2010 to purchase 400,000 shares of common stock at an exercise price of $0.30 per share, vesting immediately upon issuance and exercisable for a period of ten years. This option grant to Mr. Tangredi as a director is contained in the table summarizing grants made to our officers.

Our non-employee directors are currently compensated with the issuance of stock options, which generally become exercisable upon the date of grant, and which generally expire on the earlier of ten years from the date of grant or up to three years after the date that the optionee ceases to serve as a director. Non-employee directors are also reimbursed for out-of-pocket expenses associated with attending to the Company s business.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

Securities Authorized for Issuance under Equity Compensation Plans

The following table sets forth information regarding our 2000 Incentive Compensation Plan (the 2000 Plan) and our Long-Term Incentive Plan of 2009 (the 2009 Plan) under which our securities are authorized for issuance as of December 31, 2010.

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans
Equity compensation plans approved by security holders	14,947,757	$ .25	12,040,000
Equity compensation plans not approved by security holders	0	0	0

Security Ownership of Certain Beneficial Owners

The following table sets forth information as of the date of this prospectus as to each person or group who is known to us to be the beneficial owner of more than 5% of our outstanding voting securities and as to the security and percentage ownership of each of our executive officers and directors and of all of our officers and directors as a group.

Beneficial ownership is determined under the rules of the SEC and generally includes voting or investment power over securities. The number of shares shown as beneficially owned in the tables below are calculated pursuant to Rule 13d-3(d)(1) of the Exchange Act. Under Rule 13d-3(d)(1), shares not outstanding that are subject to options, warrants, rights or conversion privileges exercisable within 60 days are deemed outstanding for the purpose of calculating the number and percentage owned by such person, but not deemed outstanding for the purpose of calculating the percentage owned by each other person listed. Except in cases where community property laws apply or as indicated in the footnotes to this table, we believe that each shareholder identified in the table possesses sole voting and investment power over all of the shares of common stock shown as beneficially owned by the shareholder.

The address for each of the persons named below is 11552 Prosperous Drive, Odessa, FL 33556, unless otherwise indicated.

Table of Contents

Applicable percentage ownership in the following table is based on approximately 33,306,215 shares of common stock outstanding as of January 31, 2011 plus, for each individual, any securities that individual has the right to acquire within 60 days of January 31, 2011.

Name of Beneficial Owner	Common Stock Beneficially Owned Number of Shares of Common Stock	Percentage of Class
Timothy N. Tangredi (Officer and Chairman) (1)	11,985,916	26.6%
David Longacre (Officer) (2)	66,667	.2
Scott G. Ehrenberg (3) (Officer)	1,789,467	5.1%
Judith Norstrud (Officer) (4)	350,000	.5%
Raymond Kazyaka Sr. (Director) (5)	1,029,600	3.0%
Robert W. Schwartz (Director) (6)	999,600	2.9%
Executive officers and directors as a group (7 persons)	16,221,250	32.9%
Brian A. Kelly 181C Hague Blvd. Glenmont, N.Y. 12077	2,254,085	6.8%
Michael Gostomski (7) 1666 Valley View Dr. Winnona, MN 55987	3,355,314	9.8%
Louis M. Jaffe (8) 1500 S. Ocean Blvd #5201 Boca Raton, FL 33432	3,631,646	10.5%
Marisa Stadmauer (9) 26 Columbia Turnpike Florham Park, NJ 07932	1,835,373	5.4%
Mark Nordlich (10) 152 West 575th St. 4th Floor New York, NY 10019	3,303,883	9.9%
Erick Richardson (11) 10900 Wilshire Blvd. Suite 500 Los Angeles, CA 90024	1,955,230	5.7
Leonard Samuels (12) 1011 Centennial Road Penn Valley, PA 19072	9,848,162	26.4%
Leah Kaplan Samuels (13) 1011 Centennial Road Penn Valley, PA 19072	3,629,696	10.6%

(1) Includes 9,275,058 shares of common issuable upon exercise of stock options and warrants and 2,690,858 shares beneficially owned by Mr. Tangredi s wife, Patricia Tangredi. 2,563,058 of Ms. Tangredi s shares are issuable upon the exercise of stock options.

(2) Includes 66,667 shares of common stock issuable upon exercise of stock options

(3) Includes 1,706,667 shares of common stock issuable upon the exercise of stock options and warrants and 41,400 shares beneficially owned by Mr. Ehrenberg s wife, Linda Ehrenberg.

(4) Includes 350,000 shares of common stock issuable upon exercise of stock options.

(5) Includes 1,029,600 shares of common stock issuable upon exercise of stock options.

(6) Includes 999,600 shares of common stock issuable upon exercise of stock options.

(7) Includes 807,087 common shares issuable upon exercise of certain warrants.

(8) Includes 666,500 shares of common stock issuable upon exercise of certain outstanding warrants issued in connection with the Financing to Louis M. Jaffe 2004 Intangible Asset Mgmt. TR U/A DTD 5/24/04 and 298,077 shares of common stock issuable upon exercise of certain outstanding warrants issued in connection with a purchase of Company s common stock in 2009. Also includes 1,817,061 shares held by the aforementioned trust, 250,004 shares held by the Louis Jaffe TTEE Irrevocable Trust Jennifer Jaffe and 250,004 shares held by the Louis Jaffe TTEE Irrevocable Trust Lara Jaffe Taylor. The natural person with voting power and investment power on behalf each of the aforementioned trusts is Louis M. Jaffe. Also includes 100,000 shares held by the Diana G. Jaffe Revocable Trust Dated 8/4/99 of which Diana G. Jaffe, Louis M. Jaffe s wife, is the natural person with voting power and investment power on behalf of the trust and 250,000 shares of common stock issuable on exercise of a certain outstanding warrant issued to Louis M. Jaffe pursuant to a consulting agreement.

(9) Includes 999,750 shares of common stock issuable upon exercise of warrants issued in connection with the Financing in the name of MSSRPS, LLC. The natural person with voting power and investment power on behalf of MSSRPS, LLC is Marisa Stadmauer.

(10) Includes 3,238,204 shares of common stock and 65,679 shares issuable upon exercise of certain outstanding warrants. The natural person with voting power and investment power on behalf of Platinum Montaur Life Sciences, LLC is Mark Nordlich. Not included above are 7,933,321 shares of common stock issuable upon exercise of certain warrants and those shares underlying two certain convertible promissory notes. The warrants, as amended, may not be exercised and the notes may not be converted to the extent the shares resulting from such exercise, when aggregated with its other holdings, would result in Platinum Montaur Life Sciences, LLC holding in excess of 9.9% of all our common stock on a beneficially converted basis.

(11) Includes 562,538 shares of common stock issuable upon exercise of certain outstanding warrants issued in connection with the Financing in the name of RP Capital LLC. Erick Richardson and Nimish Patel of Richardson & Patel LLP own RP Capital LLC. Also includes 375,000 shares of common stock and 392,308 shares of common stock issuable upon exercise of certain outstanding warrants held in the name of Richardson & Patel LLP. Erick Richardson is a partner at Richardson & Patel LLP. The natural person with voting and investment control over the shares held by these entities is Erick Richardson.

(12) Includes 905,000 shares of common stock issuable upon exercise of certain outstanding warrants. All of the foregoing warrants are held in the name of Leah Kaplan-Samuels and Leonard Samuels JTWROS. The natural persons with voting power and investment power on behalf of Leah Kaplan-Samuels and Leonard Samuels JTWROS are Leah Kaplan-Samuels and Leonard Samuels. Also includes 3,193,466 shares of common stock and 3,025,000 shares of common stock issuable upon exercise of certain outstanding warrants issued to shareholder RBC Dain Custodian for Leonard Samuels IRA.

(13) Includes 905,000 shares of common stock issuable upon exercise of warrants. All of the foregoing warrants are held in the name of Leah Kaplan-Samuels and Leonard Samuels JTWROS. The natural persons with voting power and investment power on behalf of Leah Kaplan-Samuels and Leonard Samuels JTWROS are Leah Kaplan-Samuels and Leonard Samuels.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.

Timothy N. Tangredi, the Company s Chief Executive Officer and Chairman, is a founder and a member of the board of directors of Aegis BioSciences, LLC (Aegis). Aegis, created in 1995, is a licensee of the Company s nano-structured intellectual property and materials in the biomedical and healthcare fields. Mr. Tangredi spends approximately one to two days per month on Aegis business and is compensated by Aegis for his time and contribution(s). We granted Aegis two exclusive, world-wide licenses, the first in 1995 and the second in 2005. Pursuant to these licenses, Aegis has the right to use and sell products containing our polymer technologies in biomedical and health care applications. The first license was entered into in 1995 and has been amended twice. In 2005, we agreed to accept $150,000 as payment in full of all royalties and no further license revenue will be forthcoming. The second license allows Aegis the use of our intellectual property in the field of health care. A one-time payment of $50,000 was made under this license in 2005. In addition, under the second license Aegis is to make royalty payments of 1.5% of the net sales price it receives with respect to any personal hygiene product, surgical drape or clothing products (the latter when employed in medical and animal related fields) and license revenue it receives should Aegis grant a sublicense to a third party. To date Aegis has sold no such products nor has it received any licensing fees requiring a royalty payment be made to us. All obligations for such payments will end on the earlier of June 2, 2015 or upon the aggregate of all sums paid to us by Aegis under the agreement reaching $1 million. The term of each respective license runs for the duration of the patented technology.

The Company rents a building on a month to month basis from a related party which is wholly owned by two shareholders of the Company, one of which is Timothy N. Tangredi, our Chief Executive Officer. The base monthly rent expense is $3,800 per month. The Company also pays the taxes, insurance and some repairs on the building. For the year ending December 31, 2010 and 2009, the Company recorded $48,792 and $49,604, in rent expense to this related party, respectively.

On November 4, 2010, RP Capital elected to convert the balance of its 9% secured convertible note in the amount of $100,000 into 625,384 shares of our common stock. RP Capital also received an additional five-year warrant to purchase up to 62,538 shares of common stock, at an exercise price of $0.75 per share in consideration for converting its 9% secured convertible note. The warrant is immediately exercisable and subject to adjustment for standard anti-dilution events.

On February 19, 2010, we obtained $620,000 of financing from RBC Capital Markets Corporation Custodian for Leonard Samuels IRA (RBC) in the form of an unsecured, interest-bearing note, due April 30, 2011 (the Note). The Note bears interest at 10% per annum. In connection with the loan, we granted RBC the right to participate in our subsequent financings until the maturity date (the Right of Participation). The Right of Participation entitles RBC the right to participate in subsequent financings up to the unpaid amount of the Note in such applicable subsequent financing. We agreed not to incur additional debt exceeding $500,000 during the Term of the Note without the note holder s consent.

On February 19, 2010, we obtained $250,000 of financing from Leah-Kaplan and Leonard Samuels (Samuels) in the form of an unsecured, interest bearing note, payable in full one June 30, 2010 (the Note). The Note bears interest at 10% per annum. In connection with the loan, we granted Samuels the right to participate in our subsequent financings until the maturity date. On December 27, 2010, the holders elected to apply all of the proceeds due and payable under the Note, including all accrued interest, to purchase our common stock. Pursuant to this transaction, the Samuels subscribed for and purchased 1,052,950 shares of common stock at a purchase price of $0.26 per share resulting in an aggregate purchase price of $273,767 (the principal amount and related accrued interest under the note).

In December 2009, we secured a loan in the principal amount of $1,000,000 Platinum Montaur Life Sciences, L.L.C. (Investor). Pursuant to the terms of the note, we are to pay the holder simple interest at the rate of ten percent per annum commencing on the date of issuance with all interest and principal due and payable in cash on or before June 17, 2010 the note s maturity date was extended to April 30, 2011. On March 22, 2011, the Company entered into a Securities Amendment and Exchange Agreement and an Amended and Restated Convertible Promissory Note (2011 Convertible Note , collectively Exchange Agreements) with this investor. Pursuant to the terms and subject to the conditions set forth in the Exchange Agreements, the Company and the Investor amended and restated the $1,000,000 unsecured promissory note issued by the Company to Investor on or about December 17, 2009 (Original Note) to, among other things, extend the term to March 22, 2012. Interest in the amount of 10% per annum, commencing on December 17, 2009 and calculated on a 365 day year, and the principal amount of $1,000,000 will be paid on March 22, 2012. Subject to the terms and conditions of the 2011 Convertible Note, including limitations on conversion, the outstanding principal and interest under the 2011 Convertible Note will automatically convert into shares of the Company s common stock at the then-effective conversion price upon the closing of a qualified firm commitment underwritten public offering or may be voluntarily converted by the investor at anytime during the term. The initial conversion price is $0.26 per share. Any principal or interest which is not converted will be repaid by the Company at the earlier of a qualified offering, (as defined in the 2011 Convertible Note which is filed as an exhibit to the Form 8K filed with the Securities and Exchange Commission on March 28, 2011), or March 22, 2012. Pursuant to and during the term of the 2011 Convertible Note, the Company will not issue or allow to exist any obligation for borrowed money, except for subordinate indebtedness in payment and priority, trade payables incurred in the ordinary course of business, purchase money secured indebtedness for equipment or inventory, unsecured and subordinate, or unsecured and subordinate working capital guarantees provided by, the Export Import Bank of the United States (the EXIM Bank), and indebtedness evidenced by the promissory note dated February 19, 2010 issued to RBC Capital Markets-Custodian of Leonard Samuels IRA (as amended) in the principal amount of $620,000. In addition, on March 22, 2011, in connection with the above Exchange Agreements, the Company entered into an Amendment to 2007 Warrant and an Amendment to 2009 Warrant to extend the terms of the Stock Purchase Warrant, dated on or about December 31, 2007, and Stock Purchase Warrant, dated on or about March 12, 2009, respectively, to March 22, 2016 and to provide for cashless exercise unless such warrant shares are registered for resale under a registration statement. In addition, on March 22, 2011, the Company issued a Stock Purchase Warrant to the Investor to purchase 1,000,000 shares of the Company s common stock at $0.45 per share, exercisable commencing on the earliest of the consummation of the qualified offering (as defined in the Exchange Agreements), the date of conversion of the 2011 Convertible Note in full, or the date of conversion of the Convertible Note by the Investor in the greatest number of shares of the Company s common stock not to exceed 9.99% beneficial ownership of Company outstanding common stock and terminating on March 22, 2016.

Also, on March 22, 2011, the Company entered into a Note and Warrant Purchase Agreement, Secured Convertible Promissory Note and Patent Security Agreement (Financing Agreements) with the above Investor. Pursuant to the terms and subject to the conditions set forth in the Financing Agreements, the Investor has provided a bridge loan in the amount of $1,500,000 (Loan) to the Company, which will be secured in all patents, patent applications and similar protections of the Company and all rents, royalties, license fees and accounts with respect to such intellectual property assets. Pursuant to the Secured Convertible Promissory Note (Secured Note), interest in the amount of 10% per annum, calculated on a 365 day year, and the principal amount of $1,500,000 will be paid on March 22, 2012, but repayment is accelerated upon a qualified offering (as defined in the note). In the event of such qualified offering, and subject to the terms and conditions of the Secured Note, the outstanding principal and interest under the Secured Note will automatically convert, subject to the limitations on conversion described in the note, into shares of the Company s common stock at the then-effective conversion price upon the closing of such qualified offering. The initial conversion price is $0.26 per share. Any principal or interest which is not converted will be repaid by the Company at the earlier of a qualified offering or March 22, 2012. No cash fees were paid to any party to the transaction in exchange for lending the money. On March 22, 2011, in connection with the Financing

Agreements, the Company issued a Stock Purchase Warrant to the Investor to purchase 3,000,000 shares of the Company s common stock at $0.45 per share, exercisable until March 22, 2012. Pursuant to and during the term of the Secured Note, the Company will not issue or permit to exist any obligation for borrowed money, except for trade payables incurred in the ordinary course of business, purchase money secured indebtedness for equipment or inventory, unsecured and subordinate indebtedness to, or unsecured and subordinate working capital guarantees provided by, the EXIM Bank, the promissory note dated February 19, 2010 issued to RBC Capital Markets- Custodian of Leonard Samuels IRA (as amended) in the principal amount of $620,000, the Amended and Restated Convertible Promissory Note, dated March 22, 2011, issued to the Investor in the principal amount of $1,000,000 and other unsecured indebtedness for borrowed money in an amount not to exceed $750,000. Pursuant to the Patent Security Agreement issued in connection with the Note and Warrant Purchase of March 22, 2011, the Company shall not, without the Investor s prior consent, sell, dispose or otherwise transfer all or any portion of the Collateral, except for license grants in the ordinary course of business. In addition, the Company will take all actions reasonably necessary to prosecute to allowance applications for patents and maintain all patents, and to seek to recover damages for infringement, misappropriation or dilution of the Collateral with limited exceptions.

On November 23, 2009, Michael Stone elected to convert the interest accrued on his 9% secured convertible note in the amount of $34,027 into 170,137 shares of our common stock. The note was modified so as to end accrual of interest on November 20, 2009.

On October 9, 2009, Leonard and Leah Kaplan Samuels JTWROS and RBC Capital- Custodian for Leonard Samuels IRA elected to convert their 9% secured convertible notes and the related accrued interest in the amounts of $174,349 and $638,693 into 871,746 and 3,193,466 shares of our common stock, respectively. Said investors also received an additional five-year warrant to purchase up to 75,000 and 275,000 shares, respectively, of common stock, at an exercise price of $0.75 per share in consideration for converting their 9% secured convertible note. The warrant is immediately exercisable and subject to adjustment for standard anti-dilution events.

On September 17, 2009, we entered into subscription agreements with Leonard and Leah Kaplan Samuels pursuant to which the investors purchased 800,000 shares of our common stock. As part of the purchase, the Samuels received a five year warrant to purchase 80,000 shares of Common Stock, at an exercise price of $0.75 per share. The aggregate gross proceeds received by us for the sale was $200,000. The warrants are immediately exercisable and subject to adjustment for standard anti-dilutions events.

On September 11, 2009, to evidence a loan, we issued Timothy N. Tangredi a promissory note in the principal amount of $124,000. The note is unsecured and bears a simple interest rate of 9% per annum. This note was paid in full prior to October 15, 2009.

On September 11, 2009, to evidence a loan, we issued a promissory note in the principal amount of $37,000 to Ethos Business Ventures, an entity in which our Chief Executive Officer holds a position. The note is unsecured and bears a simple interest rate of 9% per annum. This note was paid in full prior to October 15, 2009.

In July 2009, we secured a loan of $300,000 from Michael Gostomski. Pursuant to the terms of the note, we are to pay the note holder simple interest at the rate of seven percent per annum commencing on July 17, 2009 with all interest and principal due there under payable in cash on or before January 16, 2011. On December 30, 2010, the investor elected to apply all of the proceeds due and payable under the Note, including all accrued interest, to purchase the Company s Common Stock. Pursuant to this transaction, the investor subscribed for and purchased 1,268,472 shares of Common Stock at a purchase price of $0.26 per share resulting in an aggregate purchase price of $329,803.

On June 30, 2009, we entered into a subscription agreement with the Louis M. Jaffe 2004 Intangible Asset Trust U/A DTD 5/24/04 pursuant to which the trust purchased 596,154 shares of Company s Common Stock and a five year warrant to purchase an additional 298,078 shares of Common Stock at an exercise price of $0.26 per share. The aggregate gross proceeds received by Company for this sale was $155,000. The warrants are immediately exercisable and subject to adjustment for standard anti-dilution events.

On June 10, 2009, to evidence a loan, we issued a promissory note in the principal amount of $10,000 to Ethos Business Ventures, an entity in which our Chief Executive Officer holds a position. The note is unsecured and bears a simple interest rate of 9% per annum. The note was paid in full July of 2009.

Table of Contents

On May 21, 2009, to evidence a loan, the Company issued its Chief Executive Officer a promissory note in the principal amount of $51,900. The note is unsecured and bears a simple interest rate of 9% per annum. The note was paid in full prior to July 31, 2009.

On April 30, 2009, the Company issued a five year warrant to purchase 250,000 shares of Common Stock at an exercise price of $0.26 per share pursuant to Louis Jaffe pursuant to a consulting agreement. The warrants are immediately exercisable and subject to adjustment for standard anti-dilution events.

On April 30, 2009, MSSRPS, Inc. elected to convert its 9% secured convertible note and the related accrued interest in the amounts of $167,125 into 835,623 shares of common stock. This investor also received an additional warrant to purchase up to 249,750 shares of common stock at an exercise price of $0.25 per share in consideration for converting its 9% secured convertible note. The warrant is immediately exercisable and subject to adjustment for standard anti-dilution events.

On April 6, 2009 the Louis M. Jaffe 2004 Intangible Asset Trust U/A DTD 5/24/04 elected to convert its 9% secured convertible notes and the related accrued interest in the amounts of $110,849 into 554,247 shares of common stock. This investor also received an additional warrant to purchase up to 166,500 shares of common stock at an exercise price of $0.25 per share in consideration for converting its 9% secured convertible note. The warrant is immediately exercisable and subject to adjustment for standard anti-dilution events.

On March 9, 2009, we entered into a subscription agreement Michael Gostomski pursuant to which Mr. Gostomski purchased 576,923 shares of common stock and a five year warrant to purchase an additional 288,462 shares of common stock at an exercise price of $0.26 per share. The aggregate gross proceeds received by us for this sale was $150,000. The warrant is immediately exercisable and subject to adjustment for standard anti-dilutions events.

On February 16, 2009, and March 12, 2009, Michael Gostomski and Platinum Montaur Life Sciences, L.L.C.; respectively, elected to convert their 9% secured convertible notes and the related accrued interest in the amounts of $83,007 and $664,948 into 415,038 and 3,324,740 shares of common stock, respectively. Such investors also received an additional warrant to purchase up to 124,875 and 999,000 shares of common stock, respectively, at an exercise price of $0.25 per share in consideration for converting their 9% secured convertible note. The warrants are immediately exercisable and subject to adjustment for standard anti-dilution events.

There are no material relationships between us and our directors or executive officers except as previously discussed herein.

Since the beginning of our last fiscal year, we have not been a participant in any transaction, or proposed transaction, not disclosed herein in which any related person had or will have a direct or indirect material interest and in which the amount involved exceeds the lesser of $120,000 or one percent of our total assets at year end for the last two completed fiscal years.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.

Audit Fees

The aggregate audit fees billed for the years ended December 31, 2010 and 2009 was $43,000 and $40,000, respectively. Audit services include the audits of the financial statements included in the Company s annual reports on Form 10-K and reviews of interim financial statements included in the Company s quarterly reports on Form 10-Q.

Audit-Related Fees

None.

Tax Fees

None

Table of Contents

All Other Fees

Aggregate other fees billed for the year ended December 31, 2010 and 2009 was $8,047 and $4,000, respectively for general consulting services related to the filing of our registration statements and other general questions.

Audit Committee Policies and Procedures

As of the date of this Annual Report, the Company does not have an established audit committee. The appointment of Cross, Fernandez & Riley LLP was approved by the Board of Directors as the principal auditors for the Company. There are no board members that are considered to have significant financial experience. When independent directors with the appropriate financial background join the board, the board plans to establish an audit committee, which will then adopt an appropriate charter and pre-approval policies and procedures in connection with services to be rendered by the independent auditors.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES.

No.	Exhibit
3.1	Certificate of Incorporation of The Dais Corporation filed April 8, 1993 (Incorporated by reference to Exhibit 3.1 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
3.2	Certificate of Amendment of the Certificate of Incorporation of The Dais Corporation filed February 21, 1997 (Incorporated by reference to Exhibit 3.2 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
3.3	Certificate of Amendment of the Certificate of Incorporation of The Dais Corporation filed June 25, 1998 (Incorporated by reference to Exhibit 3.3 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
3.4	Certificate of Amendment of the Certificate of Incorporation of Dais Analytic Corporation filed December 13, 1999 (Incorporated by reference to Exhibit 3.4 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
3.5	Certificate of Amendment of the Certificate of Incorporation of Dais Analytic Corporation filed September 26, 2000 (Incorporated by reference to Exhibit 3.5 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
3.6	Certificate of Amendment of the Certificate of Incorporation of Dais Analytic Corporation filed September 28, 2000 (Incorporated by reference to Exhibit 3.6 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
3.7	Certificate of Amendment of the Certificate of Incorporation of Dais Analytic Corporation filed August 28, 2007 (Incorporated by reference to Exhibit 3.7 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
3.8	Certificate of Amendment of the Certificate of Incorporation of Dais Analytic Corporation filed March 20, 2008 (Incorporated by reference to Exhibit 3.8 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
3.9	Bylaws of The Dais Corporation (Incorporated by reference to Exhibit 3.9 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
3.10	Certificate of Amendment of the Certificate of Incorporation of Dais Analytic Corporation filed December 17,2009 (Incorporated by reference to the exhibits included with the Definitive Proxy Statement Form DEF 14A as filed on October 9, 2009)
3.11	Form of Certificate of Amendment of the Certificate of Incorporation of Dais Analytic Corporation (Incorporated by reference to the exhibits included with the Definitive Proxy Statement Form DEF 14A as filed on October 27, 2010)

4.1	Form of Non-Qualified Stock Option Agreement (Incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
4.2	Form of Non-Qualified Option Agreement (Incorporated by reference to Exhibit 4.2 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
4.3	Form of Warrant (Daily Financing) (Incorporated by reference to Exhibit 4.3 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
4.4	Form of Warrant (Financing) (Incorporated by reference to Exhibit 4.4 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
4.5	Form of Warrant (Robb Trust Note and Additional Financing) (Incorporated by reference to Exhibit 4.5 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
4.6	Form of Placement Agent Warrant (Financing) (Incorporated by reference to Exhibit 4.6 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
4.7	Form of 9% Secured Convertible Note (Financing) (Incorporated by reference to Exhibit 4.7 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
4.8	Form of Note (Robb Trust Note) (Incorporated by reference to Exhibit 4.8 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
4.9	Form of Amendment to Note (Robb Trust Note) (Incorporated by reference to Exhibit 4.9 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
4.10	Form of Warrant (Note Conversion) (Incorporated by reference to the Exhibits 4.1 included with the Current Report on Form 8-K, as filed March 13, 2009)
4.11	Form of Warrant (2009 Purchases) (Incorporated by reference to the Exhibits 4.2 included with the Current Report on Form 8-K, as filed March 13, 2009)
4.12	Unsecured Promissory Note from Gostomski, dated December 8, 2009 (Incorporated by reference to the exhibits included with the Annual Report on Form 10K as filed on March 30, 2010)
4.13	Unsecured Promissory Note from Platinum-Montaur, dated December 17, 2009 (Incorporated by reference to the exhibits included with the Current Report on Form 8-K/A as filed on December 22, 2009)
4.14	Unsecured Promissory Note from Samuels, dated February 19, 2010 (Incorporated by reference to the exhibits included with the Current Report on Form 8-K as filed on February 23, 2010)
4.15	Unsecured Promissory Note from RBC Capital Markets - Custodian for Leonard Samuels IRA, dated February 19, 2010. (Incorporated by reference to the exhibits included with the Current Report on Form 8-K as filed on February 23, 2010)
4.16	First Amendment to Unsecured Promissory Note from Platinum-Montaur, dated June 28, 2010 (Incorporated by reference to exhibits included in Quarterly Report on Form 10Q as filed August 16, 2010)
4.17	First Amendment to Unsecured Promissory Note from Samuels, dated June 28, 2010 (Incorporated by reference to exhibits included in Quarterly Report on Form 10Q as filed August 16, 2010)
4.18	First Amendment to Unsecured Promissory Note from RBC Capital Markets- Custodian for Leonard Samuels IRA, dated June 28, 2010 (Incorporated by reference to exhibits included in Quarterly Report on Form 10Q as filed August 16, 2010)
4.19	Second Amendment to Unsecured Promissory Note from Platinum-Montaur, dated September 30, 2010 (Incorporated by reference to exhibits included in Quarterly Report on Form 10Q as filed November 15, 2010)
4.20	Second Amendment to Unsecured Promissory Note from Samuels, dated September 30, 2010 (Incorporated by reference to exhibits included in Quarterly Report on Form 10Q as filed November 15, 2010)

4.21	Second Amendment to Unsecured Promissory Note from RBC Capital Markets- Custodian for Leonard Samuels IRA, dated September 30, 2010 (Incorporated by reference to exhibits included in Quarterly Report on Form 10Q as filed November 15,2010)
4.22	Third Amendment to Unsecured Promissory Note from Platinum-Montaur, dated December 29, 2010 (Incorporated by reference to Exhibit 4.22 to Registration Statement on Form S-1 (File No. 333-172259), as filed February 14, 2011)
4.23	Third Amendment to Unsecured Promissory Note from RBC Capital Markets- Custodian for Leonard Samuels IRA, dated December 31, 2010 (Incorporated by reference to Exhibit 4.23 to Registration Statement on Form S-1 (File No. 333-172259), as filed February 14, 2011)
4.24	Form of Non-Qualified Stock Option Agreement 2009 Long-Term Incentive 2009 Plan Directors and certain designated employees (Incorporated by reference to Exhibit 4.24 to Registration Statement on Form S-1 (File No. 333-172259), as filed February 14, 2011)
4.25	Form of Non-Qualified Option Agreement -2009 Long-Term Incentive 2009 Plan employees (Incorporated by reference to Exhibit 4.25 to Registration Statement on Form S-1 (File No. 333-172259), as filed February 14, 2011)
4.26	Fourth Amendment to Unsecured Promissory Note from Platinum-Montaur, dated February 28, 2011
4.27	Fourth Amendment to Unsecured Promissory Note from RBC Capital Markets Custodian for Leonard Samuels IRA, dated February 28, 2011
4.28	Securities Amendment and Exchange Agreement by and between the Company and Platinum-Montaur Life Sciences, LLC dated March 23, 2011 (Incorporated by reference to Exhibit 10.1 to Form 8K as filed on March 28, 2011)
4.29	Amended and Restated Convertible Promissory Note by and between the Company and Platinum-Montaur Life Sciences, LLC dated March 23, 2011 (Incorporated by reference to Exhibit 10.2 to Form 8K as filed on March 28, 2011)
4.30	Form of Warrant by and between the Company and Investors dated 2007 and 2008 (Incorporated by reference to Exhibit 10.3 to Form 8K as filed on March 28, 2011)
4.31	Amendment to 2007 Warrant by and between the Company and Platinum-Montaur Life Sciences, LLC dated March 23, 2011 (Incorporated by reference to Exhibit 10.4 to Form 8K as filed on March 28, 2011)
4.32	Amendment to 2009 Warrant by and between the Company and Platinum-Montaur Life Sciences, LLC dated March 23, 2011 (Incorporated by reference to Exhibit 10.5 to Form 8K as filed on March 28, 2011)
4.33	Stock Purchase Warrant by and between the Company and Platinum-Montaur Life Sciences, LLC dated March 23, 2011 (Incorporated by reference to Exhibit 10.6 to Form 8K as filed on March 28, 2011)
4.34	Note and Warrant Purchase Agreement by and between the Company and Platinum-Montaur Life Sciences, LLC dated March 23, 2011 (Incorporated by reference to Exhibit 10.7 to Form 8K as filed on March 28, 2011)
4.35	Secured Convertible Promissory Note by and between the Company and Platinum-Montaur Life Sciences, LLC dated March 23, 2011 (Incorporated by reference to Exhibit 10.8 to Form 8K as filed on March 28, 2011)
4.36	Stock Purchase Warrant by and between the Company and Platinum-Montaur Life Sciences, LLC dated March 23, 2011 (Incorporated by reference to Exhibit 10.9 to Form 8K as filed on March 28, 2011)
4.37	Patent Security Agreement by and between the Company and Platinum-Montaur Life Sciences, LLC dated March 23, 2011 (Incorporated by reference to Exhibit 10.10 to Form 8K as filed on March 28, 2011)
10.1	2000 Equity Compensation Plan (Incorporated by reference to Exhibit 10.1 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)

Table of Contents

10.2	Form of Employee Non-Disclosure and Non-Compete Agreement (Incorporated by reference to Exhibit 10.2 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
10.3	Amended and Restated Employment Agreement between Dais Analytic Corporation and Timothy N. Tangredi dated July 29, 2008 (Incorporated by reference to Exhibit 10.3 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
10.4	Amended and Restated Employment Agreement between Dais Analytic Corporation and Patricia K. Tangredi dated July 29, 2008 (Incorporated by reference to Exhibit 10.4 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
10.5	Commercial Lease Agreement between Ethos Business Venture LLC and Dais Analytic Corporation dated March 18, 2005 (Incorporated by reference to Exhibit 10.6 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
10.6	First Amendment of Lease Agreement between Ethos Business Venture LLC and Dais Analytic Corporation dated November 15, 2005 (Incorporated by reference to Exhibit 10.7 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
10.7	Form of Subscription Agreement (Daily Financing) (Incorporated by reference to Exhibit 10.8 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
10.8	Form of Subscription Agreement (Financing) (Incorporated by reference to Exhibit 10.9 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
10.9	Form of Registration Rights Agreement (Financing) (Incorporated by reference to Exhibit 10.10 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
10.10	Form of Secured Patent Agreement (Financing) (Incorporated by reference to Exhibit 10.11 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
10.11	Placement Agent Agreement between Dais Analytic Corporation and Legend Merchant Group, Inc., dated October 5, 2007 (Incorporated by reference to Exhibit 10.12 to Registration Statement on Form S-1 (File No. 333-152940), as filed August 11, 2008)
10.12	Consulting Agreement between Dais Analytic Corporation and Harold Mandelbaum dated August 12, 2009 (Incorporated by reference to Exhibit 10.12 to Quarterly Report on Form 10-Q, as filed August 14, 2009)
10.13	Exclusive Distribution Agreement, dated August 21, 2009 between the Company and Genertec America, Inc. (Incorporated by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K filed on August 27, 2009)
10.14	Employee Non-Disclosure and Non-Compete Agreement entered into between Judith Norstrud and Dais Analytic Corporation on October 15, 2009 (Incorporated by reference to the exhibits included with the Current Report on Form 8-K, as filed October 16, 2009).
10.15	2009 Long Term Incentive Plan (Incorporated by reference to the exhibits included with the Definitive Proxy Statement Form DEF14A as filed on October 9, 2009).
10.16	Technical and Sales Agreement between Dais Analytic Corporation, Beijing Jiexun-CAST Systems Control Technology Co., Ltd. and Genertec America, Inc. dated April 8, 2010, incorporated by reference to the exhibits included with the Current Report on Form 8-K, as filed on April 9, 2010.
14.1	Code of Ethics (Incorporated by reference to Exhibit 14.1 to Annual Report on Form 10-K, as filed March 31, 2009)
31.1	Certification of Chief Executive Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of 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 Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Table of Contents

SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DAIS ANALYTIC CORPORATION

Dated: March 31, 2011	By:	/s/ TIMOTHY N. TANGREDI **Timothy N. Tangredi** **Chairman of the Board** **Chief Executive Officer and Director** **(Principal Executive Officer)**
Dated: March 31, 2011	By:	/s/ JUDITH C. NORSTRUD **Judith C. Norstrud** **Chief Financial Officer and Treasurer** **(Principal Financial and Accounting Officer)**

Signatures	Title	Date
/s/ TIMOTHY N. TANGREDI **Timothy N. Tangredi**	Chairman of the Board, Chief Executive Officer and Director	March 31, 2011
/s/ ROBERT W. SCHWARTZ **Robert W. Schwartz**	Director	March 31, 2011
/s/ RAYMOND KAZYAKA SR. **Raymond Kazyaka Sr.**	Director	March 31, 2011

58

Table of Contents

Financial Statements

Dais Analytic Corporation

Years Ended December 31, 2010 and 2009

Report of Independent Registered Public Accounting Firm

Dais Analytic Corporation

Financial Statements

Years Ended December 31, 2010 and 2009

Contents

Table of Contents

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders

Dais Analytic Corporation

Odessa, Florida

We have audited the accompanying balance sheets of Dais Analytic Corporation (the Company) as of December 31, 2010 and 2009, and the related statements of operations, stockholders deficit, and cash flows for the years 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 the standards of the Public Company Accounting Oversight Board (United States). 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 controls over financial reporting. Our audits 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 also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 financial position of Dais Analytic Corporation as of December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2, the Company has incurred significant losses since inception and has a working capital deficit and stockholders deficit of $2,861,448 and $6,722,092 at December 31, 2010. These factors, raise substantial doubt about the Company s ability to continue as a going concern. Management s plans in regard to these matters are also discussed in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Cross, Fernandez & Riley LLP

Orlando, Florida

March 31, 2011

61

Table of Contents

Dais Analytic Corporation

Balance Sheets

	December 31, 2010	December 31, 2009 Restated
Assets		
Current assets:		
Cash and cash equivalents	$ 304,656	$ 1,085,628
Accounts receivable	828,632	187,434
Other receivables	59,526	
Inventory	294,069	149,986
Prepaid expenses and other current assets	258,136	103,571
Total current assets	1,745,019	1,526,619
Property and equipment, net	147,911	19,383
Other assets:		
Deposits	3,280	2,280
Patents, net of accumulated amortization of $112,240 and $107,319 at December 31, 2010 and 2009, respectively	74,363	72,464
Total other assets	77,643	74,744
	$ 1,970,573	$ 1,620,746
Liabilities and Stockholders Deficit		
Current liabilities:		
Accounts payable, including related party payables of $151,440 and $150,740 at December 31, 2010 and 2009, respectively	$ 620,196	$ 385,955
Accrued compensation and related benefits	1,426,022	1,314,356
Accrued expenses, other	241,861	223,597
Current portion of deferred revenue	647,804	292,457
Current portion of notes payable	50,000	150,000
Current portion of notes payable, related party	1,620,624	1,425,624
Total current liabilities	4,606,507	3,791,989
Long-term liabilities:		
Long-term portion of notes payable, related party		300,000
Warrant liability	3,958,318	4,577,119
Deferred revenue, net of current portion	127,840	207,696
Total long-term liabilities	4,086,158	5,084,815
Stockholders deficit:		
Preferred stock; $0.01 par value; 10,000,000 shares authorized; 0 shares issued and outstanding		
	335,635	293,530

Common stock; $0.01 par value; 200,000,000 shares authorized; 33,563,428 and 29,352,930 shares issued and 33,306,215 and 29,095,717 shares outstanding at December 31, 2010 and 2009, respectively		
Capital in excess of par value	29,852,347	27,926,893
Accumulated deficit	(35,637,962)	(34,204,369)
	(5,449,980)	(5,983,946)
Treasury stock at cost, 257,213 shares	(1,272,112)	(1,272,112)
Total stockholders deficit	(6,722,092)	(7,256,058)
	$ 1,970,573	$ 1,620,746

The accompanying notes are an integral part of the financial statements

Table of Contents

Dais Analytic Corporation

Statements of Operations

	Year Ended December 31, 2010	2009 Restated
Revenue:		
Sales	$ 3,260,468	$ 1,447,071
License fees	82,000	84,144
	3,342,468	1,531,215
Cost of goods sold	2,290,041	1,071,098
Gross profit	1,052,427	460,117
Expenses:		
Research and development expenses, net of government grant proceeds of $99,732 and $0	238,182	6,600
Selling, general and administrative	2,693,092	3,217,992
	5,221,315	4,295,690
Loss from operations	(1,878,847)	(2,764,475)
Other expense (income):		
Other (income)	(36,003)	
Change in fair value of warrant liability	(618,801)	3,731,694
Interest expense	209,550	621,574
Interest income		(667)
	(445,254)	4,352,601
Net loss	$ (1,433,593)	$ (7,117,076)
Net loss per common share, basic and diluted	$ (0.05)	$ (0.36)
Weighted average number of common shares, basic and diluted	29,985,632	19,960,150

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

63

Table of Contents

Dais Analytic Corporation

Statements of Stockholders Deficit

Years Ended December 31, 2010 and 2009

	Common Stock		Capital in Excess of	Accumulated	Prepaid Services Paid for with Common	Treasury	Total Stockholders
	Shares	Amount	Par Value	Deficit	Stock	Stock	Deficit
Balance, December 31, 2008	**12,162,398**	**121,624**	**25,253,196**	**(28,776,769)**	**(23,375)**	**(1,272,112)**	**(4,697,436)**
Issuance of common stock for conversion of notes payable and related accrued interest	13,553,822	135,538	2,576,062				2,711,600
Issuance of common stock and warrant for services	344,692	3,448	105,029		23,375		131,852
Stock-based compensation expense			1,504,669				1,504,669
Issuance of warrants for debt conversion			413,008				413,008
Issuance of common stock and warrants for cash	2,490,385	24,904	613,596				638,500
Cumulative effect of change in accounting principle for warrant classification			(3,623,448)	1,689,476			(1,933,972)
Exercise of warrants and options	801,633	8,016	1,084,781				1,092,797
Net loss, restated				(7,117,076)			(7,117,076)
Balance, December 31, 2009, restated	**29,352,930**	**$ 293,530**	**$ 27,926,893**	**$ (34,204,369)**	**$**	**$ (1,272,112)**	**$ (7,256,058)**
Issuance of common stock and warrants for services	888,692	8,887	503,993				512,880
Issuance of common stock for conversion of notes payable	1,000,384	10,004	190,073				200,077
Stock based compensation			651,032				651,032
Issuance of common stock in exchange for debt settlement	2,321,422	23,214	580,356				603,570
Net loss				(1,433,593)			(1,433,593)
Balance, December 31, 2010	**33,563,428**	**$ 335,635**	**$ 29,852,347**	**$ (35,637,962)**	**$**	**$ (1,272,112)**	**$ (6,722,092)**

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

64

Dais Analytic Corporation

Statements of Cash Flows

	Years Ended December 31, 2010	2009 (restated)
Operating activities		
Net loss	$ (1,433,593)	$ (7,117,076)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation and amortization	15,276	19,826
Amortization of deferred loan costs		1,004
Amortization of discount on convertible notes		144
Amortization of the beneficial conversion feature on convertible notes		29,992
Issuance of common stock, stock options and stock warrants for services and amortization of common stock issued for services	287,035	110,316
Stock based compensation expense	651,034	1,504,669
Issuance of common stock warrants to induce conversion of notes payable		413,008
Change in fair value of warrant liability	(618,801)	3,731,694
(Increase) decrease in:		
Accounts receivable	(641,198)	1,536
Other receivables	(59,526)	
Inventory	(144,083)	(2,858)
Prepaid expenses and other current assets	(4,984)	(50,853)
Increase (decrease) in:		
Accounts payable and accrued expenses	380,835	251,014
Accrued compensation and related benefits	111,666	166,967
Deferred revenue	275,491	122,239
Net cash used by operating activities	(1,180,848)	(818,378)
Investing activities		
Increase in patent costs	(6,819)	(39,265)
Purchase of property and equipment	(113,305)	(1,346)
Net cash used by investing activities	(120,124)	(40,611)
Financing activities		
Proceeds from issuance of notes payable, related party	620,000	1,565,000
Payments on notes payable, related party	(100,000)	(290,000)
Proceeds from advance from related party		222,900
Repayments of advance from related party		(222,900)
Issuance of common stock and exercise of warrants for cash		642,750
Net cash provided by financing activities	520,000	1,917,750
Net (decrease) increase in cash and cash equivalents	(780,972)	1,058,761
Cash and cash equivalents, beginning of period	1,085,628	26,867
Cash and cash equivalents, end of period	$ 304,656	$ 1,085,628

Cash paid during the year for interest	$	$ 42,651

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

Table of Contents

Dais Analytic Corporation

Statements of Cash Flows

Supplemental disclosures of cash flow information

and noncash investing and financing activities:

During the years ended December 31, 2010 and 2009, the Company issued 1,000,384 and 13,553,822 shares of common stock in conversion of $175,000 and $2,350,000 of notes payable and $25,077 and $361,600 of accrued interest, respectively.

During the year ended December 31, 2010, two note holders elected to apply all of the proceeds due and payable under their notes, including all accrued interest, to purchase 2,321,422 shares of the Company s Common Stock at a purchase price of $0.26 per share resulting in an aggregate purchase price of $603,570.

During the years ended December 31, 2010 and 2009, the Company issued 888,692 and 344,692 shares of common stock and warrants for services valued at $512,880 and $110,316, respectively.

The cumulative effect for the change in accounting principle related to warrant classification resulted in an increase of $1,689,476 to retained earnings and a $3,623,448 decrease to capital in excess of par value at January 1, 2009. Additionally, the exercise of certain warrants during the year ended December 31, 2009 resulted in the reclassification of $1,088,547 from warranty liability to capital in excess of par value.

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

Table of Contents

Dais Analytic Corporation

Notes to Financial Statements

Years Ended December 31, 2010 and 2009

1. Background Information

Dais Analytic Corporation (the Company), a New York corporation, has developed and is commercializing applications using its nano-structure polymer technology. The first commercial product is an energy recovery ventilator (ERV) (cores and systems) for use in commercial Heating, Ventilating, and Air Conditioning (HVAC) applications. In addition to direct sales, the Company licenses its nano-structured polymer technology to strategic partners in the aforementioned application and is in various stages of development with regard to other applications employing its base technologies. The Company was incorporated in April of 1993 with its corporate headquarters located in Odessa, Florida.

The Company is dependent on third parties to manufacture the key components needed for our nano-structured based materials and value added products made with these materials. Accordingly, a supplier s failure to supply components in a timely manner, or to supply components that meet our quality, quantity and cost requirements or our technical specifications, or the inability to obtain alternative sources of these components on a timely basis or on terms acceptable to us, would create delays in production of our products or increase our unit costs of production. Certain of the components contain proprietary products of our suppliers, or the processes used by our suppliers to manufacture these components are proprietary. If we are required to replace any of our suppliers, while we should be able to obtain comparable components from alternative suppliers at comparable costs, this would create a delay in production.

For the years ended December 31, 2010 and 2009, seven five customers accounted for approximately 61% (seven customers represented the following percentages of sales 13%, 13%, 9%, 7%, 7%, 6% and 6%) and 66% (five customers represented the following percentages of sales 27%, 16%, 12%, 7% and 4%) of the Company s total revenue, respectively. At December 31, 2010 and 2009 amounts due from these customers was approximately 61% and 25% of total accounts receivable, respectively.

2. Going Concern

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. For the year ended December 31, 2010, the Company incurred a net loss of $1,433,593 and has incurred significant losses since inception. As of December 31, 2010, the Company has an accumulated deficit of $35,673,962, negative working capital of $2,861,488 and a stockholders deficit of $6,722,092. The Company used $1,180,848 and $818,378 of cash from operations during 2010 and 2009, respectively, which was funded by proceeds from debt and equity financings. There is no assurance that such financing will be available in the future. In view of these matters, there is substantial doubt that the Company will continue as a going concern. The Company is currently pursuing the following sources of short and long-term working capital:

1. We are currently holding preliminary discussions with parties who are interested in licensing, purchasing the rights to, or establishing a joint venture to commercialize certain applications of our technology.

2. We are seeking growth capital from certain strategic and/or government (grant) related sources. In addition to said capital, these sources may, pursuant to any agreements that may be developed in conjunction with such funding, assist in the product definition and design, roll-out, and channel penetration of our products. As part of this step we will attempt to take advantage of key programs associated with the recently enacted American Recovery and Reinvestment Act of 2009.

The Company s ability to continue as a going concern is highly dependent on our ability to obtain additional sources of cash flow sufficient to fund our working capital requirements. However, there can be no assurance that the Company will be successful in its efforts to secure such cash flow. Any failure by us to timely procure additional

Table of Contents

financing or investment adequate to fund our ongoing operations, including planned product development initiatives and commercialization efforts, will have material adverse consequences on our financial condition, results of operations and cash flows.

The financial statements of the Company do not include any adjustments relating to the recoverability and classification of recorded assets, or the amounts and classifications of liabilities that might be necessary should the Company be unable to continue as a going concern.

3. Significant Accounting Policies

The significant accounting policies followed are:

Use of estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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 and cash equivalents - All cash, other than held in escrow, is maintained with a major financial institution in the United States. Deposits with this bank may exceed the amount of insurance provided on such deposits. Temporary cash investments with an original maturity of three months or less are considered to be cash equivalents.

Accounts receivable - Accounts receivable consist primarily of receivables from the sale of our ERV products. The Company regularly reviews accounts receivable for any bad debts based on an analysis of the Company s collection experience, customer credit worthiness, and current economic trends. At December 31, 2010, the days sales outstanding was 93, as compared to 47 at December 31, 2009. The increase in the number of days to collect our receivables is primarily a result of the downturn in the economy and additional approval and certifications that our products had to pass (for a small number of customers) prior to payment being made. Based on management s review of accounts receivable, no allowance for doubtful accounts is considered necessary at December 31, 2010 and 2009.

Inventory - Inventory consists of raw materials and work-in-process and is stated at the lower of cost, determined by first-in, first-out method, or market. Market is determined based on the net realizable value, with appropriate consideration given to obsolescence, excessive levels, deterioration and other factors. At December 31, 2010 and 2009, the Company had $11,869 and $2,160 of in-process inventory, respectively. A reserve is recorded for any inventory deemed excessive or obsolete. No reserve is considered necessary at December 31, 2010 and 2009.

Property and equipment - Property and equipment are recorded at cost. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets ranging from 5 to 7 years. Depreciation expense was approximately $10,400 and $8,900 for the years ended December 31, 2010 and 2009, respectively. Gains and losses upon disposition are reflected in the statement of operations in the period of disposition. Maintenance and repair expenditures are charged to expense as incurred.

Intangible assets - Identified intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The Company s existing intangible assets consist solely of patents. Patents are amortized over their estimated useful or economic lives of 15 years. Patent amortization expense was approximately $4,900 and $10,100 for the years ended December 31, 2010 and 2009, respectively. Total patent amortization expense for the next five years is estimated to be approximately $15,000 per year.

Long-lived assets - Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the book value of the asset may not be recoverable. The Company periodically evaluates whether events and circumstances have occurred that indicate possible impairment. When impairment indicators exist, the Company uses market quotes, if available or an estimate of the future undiscounted net cash flows of the related asset or asset group over the remaining life in measuring whether or not the asset values are recoverable. There have been no significant impairments of long-lived assets during the two-year period ended December 31, 2010.

Table of Contents

Research and development expenses, and grant proceeds - Expenditures for research, development, and engineering of products are expensed as incurred. For the years ended December 31, 2010 and 2009, the Company incurred research and development costs of approximately $337,900 and $6,600, respectively. The Company accounts for proceeds received from government grants for research as a reduction in research and development costs. For the year ended December 31, 2010, the Company recorded approximately $99,000 in grant proceeds against research and development expenses on the statement of operations. No such grant proceeds were recognized for the year ended December 31, 2009.

Stock issuance costs - Stock issuance costs are recorded as a reduction of the related proceeds through a charge to stockholders equity.

Common stock - The Company records common stock issuances when all of the legal requirements for the issuance of such common stock have been satisfied.

Revenue recognition - Generally, the Company recognizes revenue for its products upon shipment to customers, provided no significant obligations remain and collection is probable. This policy applies to all of our customers, including Genertec America (a distribution agreement) and CAST Systems Control Technology Co. (an agreement for the purchase of specific goods).

Our ConsERV product typically carries a warranty of two years for all parts contained therein with the exception of the energy recovery ventilator core which typically carries a 10 year warranty. The warranty includes replacement of defective parts. The Company has recorded an accrual of approximately $11,500 for future warranty expenses at December 31, 2010.

Revenue derived from the sale of licenses is deferred and recognized as revenue on a straight-line basis over the life of the license, or until the license arrangement is terminated. The Company recognized revenue of approximately $82,000 and $84,000 from license agreements for the years ended December 31, 2010 and 2009, respectively.

Government Grants - Grants are recognized when there is reasonable assurance that the grant will be received and that any conditions associated with the grant will be met. When grants are received related to Property and Equipment, the Company reduces the basis of the assets on the Statement of Financial Position, resulting in lower depreciation expense over the life of the associated asset. Grants received related to expenses are reflected as a reduction of the associated expense in the period in which the expense is incurred.

Stock based compensation - The Company recognizes all share-based payments to employees, including grants of employee stock options, as compensation expense in the financial statements based on their fair values. That expense will be recognized over the period during which an employee is required to provide services in exchange for the award, known as the requisite service period (usually the vesting period).

The value of each grant is estimated at the grant date using the Black-Scholes option model with the following assumptions for options granted during the years ended December 31, 2010 and 2009:

	Years Ended December 31, 2010	2009
Dividend rate	0%	0%
Risk free interest rate	1.96% 3.68%	1.65% 3.49%
Expected term	5 6.5 years	5 10 years
Expected volatility	97% 112%	92% 106%

69

Table of Contents

The basis for the above assumptions are as follows: the dividend rate is based upon the Company s history of dividends; the risk-free interest rate for periods within the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant; the expected term was calculated based on the Company s historical pattern of options granted and the period of time they are expected to be outstanding; and expected volatility was calculated by review of a peer company s historical activity.

Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Based on historical experience of forfeitures, the Company estimated forfeitures at 0% for each of the years ended December 31, 2010 and 2009.

Non-employee stock-based compensation - The Company s accounting policy for equity instruments issued to consultants and vendors in exchange for goods and services follows the provisions of EITF 96-18, *Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring , or in Conjunction with Selling Goods or Services,* now ASC 505 and EITF 00-18 *Accounting Recognition for Certain Transactions Involving Equity Instruments Granted to Other Than Employees,* now ASC 505. The measurement date for the fair value of the equity instruments issued is determined at the earlier of (i) the date at which a commitment for performance by the consultant or vendor is reached or (ii) the date at which the consultant or vendor s performance is complete. In the case of equity instruments issued to consultants, the fair value of the equity instrument is recognized over the term of the consulting agreement. Stock-based compensation related to non-employees is accounted for based on the fair value of the related stock or options or the fair value of the services, whichever is more readily determinable in accordance with ASC 718.

The fair value of warrants issued in 2010 and 2009 was calculated using the Black-Scholes model with the following assumptions: Expected life in years: 5-10 years and 5-10 years, respectively; Estimated volatility 96% - 100% and 80% - 114%, respectively; Risk-free interest rate: 2.38% - 2.57% and 2.64% - 3.98%, respectively; Dividend yield: 0%.

Financial instruments - In September 2006, the Financial Accounting Standards Board (FASB) introduced a framework for measuring fair value and expanded required disclosure about fair value measurements of assets and liabilities. The Company adopted the standard for those financial assets and liabilities as of the beginning of the 2008 fiscal year and the impact of adoption was not significant. FASB Accounting Standards Codification (ASC) 820 *Fair Value Measurements and Disclosures* (ASC 820) which defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy that distinguishes between (1) market participant assumptions developed based on market data obtained from independent sources (observable inputs) and (2) an entity s own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The fair value hierarchy consists of three broad levels, which gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy are described below:

Level 1 - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, including quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability (e.g., interest rates); and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 - Inputs that are both significant to the fair value measurement and unobservable.

Fair value estimates discussed herein are based upon certain market assumptions and pertinent information available to management as of December 31, 2010. The Company uses the market approach to measure fair value for its Level 1 financial assets and liabilities, which include cash equivalents of $10,150 at December 31, 2010. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities.

Table of Contents

The respective carrying value of certain on-balance sheet financial instruments approximated their fair values due to the short-term nature of these instruments. These financial instruments include cash, accounts receivable, other receivables, accounts payable, accrued compensation and accrued expenses. The fair value of the Company s notes payable is estimated based on current rates that would be available for debt of similar terms which is not significantly different from its stated value.

The Company s financial liabilities measured at fair value consisted of the following as of December 31, 2010 and were valued as discussed in Note 12:

		Fair Value Measurements at December 31, 2010		
	Total carrying value	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Warrant liability	3,958,318			3,958,318

A reconciliation of the beginning and ending fair values of financial instruments valued using significant unobservable inputs (Level 3) is presented as follows:

	Warrant Liability
Balance at December 31, 2009	$ 4,577,119
Changes in fair value	(618,801)
Balance at December 31, 2010	$ 3,958,318

Income taxes - Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus deferred taxes resulting from temporary differences. Such temporary differences result from differences in the carrying value of assets and liabilities for tax and financial reporting purposes. The deferred tax assets and liabilities represent the future tax consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

The Company identifies and evaluates uncertain tax positions, if any, and recognizes the impact of uncertain tax positions for which there is a less than more-likely-than-not probability of the position being upheld when reviewed by the relevant taxing authority. Such positions are deemed to be unrecognized tax benefits and a corresponding liability is established on the balance sheet. The Company has not recognized a liability for uncertain tax positions. If there were an unrecognized tax benefit, the Company would recognize interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. The Company s remaining open tax years subject to examination by the Internal Revenue Service include the years ended December 31, 2007 through 2009.

Loss per share - Basic and diluted earnings per share are computed based on the weighted-average common shares and common share equivalents outstanding during the period. Common share equivalents consist of stock options, warrants and convertible notes payable. Common share equivalents of 39,026,278 and 30,003,977 were excluded from the computation of diluted earnings per share for the years ended December 31, 2010 and 2009, respectively, because their effect is anti-dilutive.

Table of Contents

Derivative Financial Instruments - The Company does not use derivative instruments to hedge exposure to cash flow, market or foreign currency risk. Terms of convertible promissory note instruments are reviewed to determine whether or not they contain embedded derivative instruments that are required under ASC 815 *Derivative and Hedging* (ASC 815) to be accounted for separately from the host contract, and recorded on the balance sheet at fair value. The fair value of derivative liabilities, if any, is required to be revalued at each reporting date, with corresponding changes in fair value recorded in current period operating results.

Freestanding warrants issued by the Company in connection with the issuance or sale of debt and equity instruments are considered to be derivative instruments and are evaluated and accounted for in accordance with the provisions of ASC 815. Pursuant to ASC 815, an evaluation of specifically identified conditions is made to determine whether fair value of warrants issued is required to be classified as equity or as a derivative liability.

Recent accounting pronouncements

Recent accounting pronouncements issued by FASB (including EITF), the AICPA and the SEC did not or are not believed by management to have a material impact on the Company s present or future financial statements.

4. Property and Equipment

Property and equipment consist of the following:

	December 31,	
	2010	**2009**
Furniture and fixtures	$ 38,764	$ 33,530
Computer equipment	64,305	57,344
Demonstration equipment	104,871	
Office and lab equipment	216,248	194,429
	424,188	285,303
Less accumulated depreciation	276,277	265,920
	$ 147,911	$ 19,383

5. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist of the following:

	December 31,	
	2010	**2009**
Prepaid expenses	$ 31,070	$ 50,335
Prepaid insurance	29,948	31,699
Prepaid services paid for with common stock	172,118	21,537
Prepaid loan costs	25,000	
	$ 258,136	$ 103,571

6. Accrued Expenses, Other

Accrued expenses, other consist of the following:

	December 31, 2010	2009
Accrued expenses, other	$ 39,850	$ 127,768
Accrued registration rights penalty	5,000	41,000
Accrued interest	14,676	28,127
Accrued interest, related party	157,683	13,502
Accrued warranty costs	11,452	
Contractual obligation	13,200	13,200
	$ 241,861	$ 223,597

72

Table of Contents

7. Notes Payable

Notes payable consist of the following:

	December 31, 2010	December 31, 2009
Convertible notes payable; interest at 9%; $50,000 currently in default; collateralized by the Company s patents and patent applications	$ 50,000	$ 150,000
Convertible notes payable, related party; interest at 9%; collateralized by the Company s patents and patent applications		175,000
Note payable, related party; 7% interest; unsecured; settled during 2010		300,000
Note payable, related party; interest at 10% per annum; due April 30, 2011	1,000,000	1,000,000
Note payable, related party; 10% interest; unsecured; due April 30, 2011	620,000	250,000
Note payable; related party	624	624
	1,670,624	1,875,624
Less amounts currently due	1,670,624	1,575,624
Long-term portion	$	$ 300,000

Convertible Notes

During December 2007 and January 2008, the Company issued convertible promissory notes (the Convertible Notes) and warrants to purchase common stock in exchange for proceeds totaling $2,950,000. The Convertible Notes bear interest at nine percent per annum and have stated maturity dates from December 2008 to January 2009. The Convertible Notes are repayable in cash or convertible into shares of the Company s stock at a rate of one share per $0.20 of outstanding principal and interest. Warrants to purchase 14,750,000 shares of the Company s common stock accompanying the Convertible Notes are, subject to certain limitations, exercisable at $0.25 per share, vest immediately, and expire between December 2012 and January 2013. Due to certain adjustments that may be made to the terms of the warrants issued in December 2007, January 2008 and August 2008, if the Company issues or sell shares below the exercise price, the warrants have been classified as a liability as opposed to equity in accordance with the Derivatives and Hedging Topic of the FASB ASC 815-10-15 as it was determined that these warrants were not indexed to the Company s stock. As a result, the fair market value of these warrants was remeasured on January 1, 2009 and marked to market at each subsequent financial reporting period. The Company has restated their 2009 Financial Statements to reflect this adjustment, see Note 12.

The Convertible Notes contain an embedded conversion feature. The Company accounted for this conversion feature and the detachable warrants by allocating the proceeds from issuance of the convertible notes to the beneficial conversion feature and the warrants based on their relative fair values.

To recognize the fair value of the warrants, the Company discounted the notes and increased additional paid in capital. The fair value of the beneficial conversion feature of $1,383,437 and discount of $1,566,563 related to the warrants were amortized over the term of the Convertible Notes. For the years ended December 31, 2010 and 2009, the Company recognized interest expense from the amortization of the beneficial conversion feature and discount of $0 and $30,136, respectively.

During the year ended December 31, 2009 eighteen holders converted their Convertible Notes, having an aggregate principal balance of $2,350,000 plus accrued interest of $361,600, into 13,553,822 shares of common stock. Some of the holders converted during periods in which we were offering an additional warrant as an inducement to convert. In accordance with said offers we issued additional warrants to purchase 1,665,000 shares of common

Table of Contents

stock, exercisable immediately at $0.25 per share and valued at $126,367, and 575,000 warrants, exercisable immediately at $0.75 per share valued at $286,641 which was recorded as interest expense during the twelve months ended December 31, 2009.

The value of each of the above groups of warrants was estimated using the Black-Scholes option model with the following assumptions for each of the exercise prices:

	Exercise Prices			
	$0.25 per share		$0.75 per share	
Fair value of underlying stock on date of award	$ 0.09	$0.19	$ 0.51	$1.49
Dividend rate	0%		0%	
Risk free interest rate	1.65%	2.58%	2.20%	2.49%
Expected term	5 years		5 years	
Expected volatility	92%	94%	95%	96%

The warrants to purchase 1,665,000 shares of common stock as compared to the warrants to purchase 575,000 shares of common stock resulted in a lower fair value due to the lower fair value of the underlying common stock on the date of the award.

The warrants were issued as follows:

February 2009	124,875
March 2009	999,000
April 2009	416,250
August 2009	124,875
	1,665,000
September 2009	162,500
October 2009	412,500
	575,000

During 2009, four investors holding Convertible Notes with an aggregate outstanding principal balance of approximately $450,000 at December 31, 2008 notified the Company that they were asserting their rights to receive payment of the principal and interest pursuant to the terms of the Convertible Notes. In June of 2009, three of these investors, holding an aggregate principal note balance of $250,000, entered into a confession of judgment with the Company. Under that agreement, the three investors had the right, should the Company fail to pay all principal and interest due pursuant to their Convertible Notes on or before September 11, 2009, to file the confession of judgment with the court and seek to secure a judgment against the Company in the amount of all principal and interest due under their Convertible Notes together with the reasonable cost and expense of collection. All interest and principal related to the three Convertible Notes, $289,803 in the aggregate, was paid in full by the Company on or before September 11, 2009. In July 2009, the fourth investor, holding a Convertible Note in the principal amount of $200,000, agreed to extend said note to September 2009. In November 2009, this investor and the Company modified the Convertible note to extend the maturity date of said note to July 2010, pay the principal amount due in eight monthly installments commencing December of 2009, end the accrual of interest as of November 20, 2009 and convert the $34,861 in interest due under the Convertible Note as of November 20, 2009 into 170,137 shares of Company s common stock. During the year ended December 31, 2010 the remaining principal balance of said loan of $175,000 was extinguished in full by the Company through cash payments of $100,000 and the conversion of $75,000 into 375,000 shares of common stock based on a per share conversion rate of $0.20. As of December 31, 2010 the outstanding principal balance of said loan was $0.

On November 4, 2010, an investor elected to convert his 9% secured convertible note of $100,000 principal and the related accrued interest $25,077 into 625,384 shares of Company s Common Stock. Said investor also received an additional five-year warrant to purchase up to 62,538 shares of Common Stock, at an exercise price of $0.75 per share in consideration for converting his 9% secured convertible note.

Table of Contents

As of December 31, 2010, $50,000 of principal on the Convertible Notes was outstanding, in default and due and payable in full. On March 23, 2011 this note was paid in full by Company.

Other Notes

In July 2009 we secured a loan of $300,000 from an investor and issued the lender an unsecured promissory note for the principal amount on December 8, 2009. Pursuant to the terms of the note, we are to pay the note holder simple interest at the rate seven percent per annum commencing on July 17, 2009 with all interest and principal due there under payable in cash on or before January 16, 2011. If an event of default were to occur the interest rate would increase to ten percent for the duration of the event. Should we not cure the default within 60 days of receiving notice the note holder may, at his option, declare all interest accrued and unpaid and principal outstanding immediately due and payable. On December 30, 2010, the investor elected to apply all of the proceeds due and payable under the Note, including all accrued interest, to the purchase of the Company s Common Stock. Pursuant to this transaction, the investor subscribed for and received 1,268,472 shares of Common Stock at a purchase price of $0.26 per share resulting in an aggregate purchase price of $329,803. The number of shares issued was based upon the $0.26 fair value of the Company s common stock on the settlement date.

In December 2009, we secured a loan in the principal amount of $1,000,000 from an investor. Pursuant to the terms of the note, we are to pay the holder simple interest at the rate of ten percent per annum commencing on the date of issuance with all interest and principal due and payable in cash on or before June 17, 2010 the note s maturity date was extended to April 30, 2011. On March 22, 2011, the Company entered into a Securities Amendment and Exchange Agreement and an Amended and Restated Convertible Promissory Note (2011 Convertible Note , collectively Exchange Agreements) with the this investor. Pursuant to the terms and subject to the conditions set forth in the Exchange Agreements, the Company and the Investor amended and restated the $1,000,000 unsecured promissory note issued by the Company to Investor on or about December 17, 2009 (Original Note) to, among other things, extend the term to March 22, 2012. Interest in the amount of 10% per annum, commencing on December 17, 2009 and calculated on a 365 day year, and the principal amount of $1,000,000 will be paid on March 22, 2012. Subject to the terms and conditions of the 2011 Convertible Note, including limitations on conversion, the outstanding principal and interest under the 2011 Convertible Note will automatically convert into shares of the Company s common stock at the then-effective conversion price upon the closing of a qualified firm commitment underwritten public offering or may be voluntarily converted by the investor at anytime during the term. The initial conversion price is $0.26 per share. Any principal or interest which is not converted will be repaid by the Company at the earlier of a qualified offering, (as defined in the 2011 Convertible Note which is filed as an exhibit to the Form 8K filed with the Securities and Exchange Commission on March 28, 2011), or March 22, 2012. Pursuant to and during the term of the 2011 Convertible Note, the Company will not issue or allow to exist any obligation for borrowed money, except for subordinate indebtedness in payment and priority, trade payables incurred in the ordinary course of business, purchase money secured indebtedness for equipment or inventory, unsecured and subordinate, or unsecured and subordinate working capital guarantees provided by, the Export Import Bank of the United States (the EXIM Bank), and indebtedness evidenced by the promissory note dated February 19, 2010 issued to RBC Capital Markets- Custodian of Leonard Samuels IRA (as amended) in the principal amount of $620,000.

The Company secured loans from two investors in the principal amounts of $250,000 and $620,000. The loan amounts were received by the Company on December 31, 2009 and February 18, 2010, respectively, and the Company issued the lenders unsecured promissory notes with respect to said loans on February 19, 2010. Pursuant to the terms of the notes, the Company is to pay the holders simple interest at the rate ten percent per annum commencing on the date of issuance with all interest and principal due and payable in cash on or before June 30, 2010 and August 10, 2010. After receipt of proceeds on the foregoing loans, we may not incur more than $500,000 in debt without the holders prior approval and said additional debt may not be senior to these promissory notes without holder s permission. During the term of the notes, each note holder has the right to participate, by investing additional funds the total amount of which may not exceed the outstanding balance of the holder s note, in any subsequent financings undertaken by Company. Any such participation shall be upon the same terms as provided for in the subsequent financing. If an event of default were to occur and said default is not cured within the allotted period, the holders may declare all principal and accrued and unpaid interest due and payable without presentment, demand, protest or notice. Further, in addition to all remedies available under law, each holder may in the event of a default opt to convert the principal and interest outstanding under its note into any debt or equity security which Company issued after the date of its note and prior to the date of full payment of its note in accordance with the same terms as the subsequent financing.

Table of Contents

On December 27, 2010, one of the investors elected to apply all of the proceeds due and payable under the $250,000 Note, including all accrued interest, to the purchase of our common stock. Pursuant to this transaction, the investors subscribed for and received 1,052,950 shares of common stock at a purchase price of $0.26 per share resulting in an aggregate purchase price of $273,767 (the principal amount and related accrued interest under the note). The number of shares issued was based upon the $0.26 fair value of the Company s common stock on the settlement date.

The $620,000 note s maturity date was extended to April 30, 2011.

Accrued interest on the notes was $157,683 and $13,502 at December 31, 2010 and 2009, respectively.

8. Related Party Transactions

Timothy Tangredi, the Company s Chief Executive Officer and Chairman, is a founder and a member of the Board of Directors of Aegis Biosciences, LLS (Aegis). Aegis, created in 1995, is a licensee of the Company s nano-structured intellectual property and materials in the biomedical and healthcare fields. Mr. Tangredi spends approximately one to two days per month on Aegis business and is compensated by Aegis for his time and contribution(s). We granted Aegis two exclusive, world-wide licenses, the first in 1995 and the second in 2005. Pursuant to these licenses, Aegis has the right to use and sell products containing our polymer technologies in biomedical and healthcare applications. The first license was entered into in 1995 has been amended twice. In 2005, we agreed to accept $150,000 as payment in full of all royalties and no further license revenue will be forthcoming. The second license allows Aegis the use of our intellectual property in the field of healthcare. A one-time payment of $50,000 was made under this license in 2005. In addition, under the second license Aegis is to make royalty payments of 1.5% of the net sales price it receives with respect to any personal hygiene product, surgical drape or clothing products (the latter when employed in medical and animal related fields) and license revenue it receives should Aegis grant a sublicense to a third party. To date Aegis has sold no such products nor has it received any licensing fees requiring a royalty payment be made to us. All obligations for such payments will end on the earlier of June 2, 2015 or upon the aggregate of all sums paid to us by Aegis under the agreement reaching $1 million. The term of each respective license runs for the duration of the patented technology.

The Company rents a building that is owned by two stockholders of the Company, one of which is the Chief Executive Officer. Rent expense for this building is $3,800 per month. The Company recognized rent expense of approximately $49,000 in each of years ended December 31, 2010 and 2009. At December 31, 2010 and 2009, $151,440 and $150,740, respectively, were included in accounts payable for amounts owed to these stockholders for rent.

The Company also has accrued compensation due to the Chief Executive Officer and one other employee for deferred salaries earned and unpaid as of December 31, 2010 and 2009 of $1,415,606 and $1,314,356, respectively.

On May 21, 2009, to evidence a loan, the Company issued its Chief Executive Officer a promissory note in the principal amount of $51,900. The note is unsecured and bears a simple interest rate of 9% per annum. The principal amount plus all accrued interest is to be paid in full to the holder no later than July 31, 2009. This note was paid in full prior to maturity.

On June 10, 2009, to evidence a loan, the Company issued a promissory note in the principal amount of $10,000 to Ethos Business Ventures, an entity in which the Company s Chief Executive Officer holds a controlling financial position. The note is unsecured and bears a simple interest rate of 9% per annum. The principal amount plus all interest accrued is to be paid in full to the holder no later than July 31, 2009. This note was paid in full prior to July 31, 2009.

On September 11, 2009, to evidence a loan, Company issued its Chief Executive Officer a promissory note in the principal amount of $124,000. The note is unsecured and bears a simple interest rate of 9% per annum. The principal amount plus all accrued interest is to be paid in full to the holder no later than October 15, 2009. This note was paid in full prior to October 15, 2009.

On September 11, 2009, to evidence a loan, the Company issued a promissory note in the principal amount of $37,000 to Ethos Business Ventures, an entity in which its Chief Executive Officer holds a position. The note is unsecured and bears a simple interest rate of 9% per annum. The principal amount plus all interest accrued is to be paid in full to the holder no later than October 15, 2009. This note was paid in full prior to October 15, 2009.

Table of Contents

9. Authorized Shares

During the year ended December 31, 2009, the Company s board of directors approved proposals to amend the Articles of Incorporation to increase the number of authorized shares of common stock from 100,000,000 to 200,000,000, respectively.

10. Preferred Stock

The Company s Board of Directors has authorized 10,000,000 million shares of preferred stock with a par value of $0.01 to be issued in series with terms and conditions to be determined by the Board of Directors. The Company has designated 400,000 shares of Series A convertible preferred stock; 1,000,000 shares of Series B convertible preferred stock; 500,000 shares of Series C convertible preferred stock; and 1,100,000 shares of Series D convertible preferred stock. The Series A through D convertible preferred stock rank senior to the common stock as to dividends and liquidation. Each share of Series A through D convertible preferred stock is convertible into one share of common stock, except in specified circumstances as defined by the Company s Certificate of Incorporation, and is automatically converted into common stock upon the occurrence of an initial public offering that meets certain criteria. No dividend or distribution may be paid on any shares of the Company s common stock unless an equivalent dividend or distribution is paid on the Series A through D convertible preferred stock.

11. Stock Options and Warrants

In June 2000 and November 2009, our Board of Directors adopted, and our shareholders approved, the 2000 Plan and 2009 Plan, respectively (together the Plans). The Plans provide for the granting of options to qualified employees of the Company, independent contractors, consultants, directors and other individuals. As of December 31, 2009, the Company s Board of Directors approved and made available 15,000,000 shares of common stock to be issued pursuant to the 2009 Plan. The Plans permit grants of options to purchase common shares authorized and approved by the Company s Board of Directors.

The average fair value of options granted at market during 2010 and 2009 was $0.25 and $0.31 per option, respectively. The total intrinsic value of options exercised during the years ended December 31, 2010 and 2009 was $0 and $3,250, respectively.

The following summarizes the information relating to outstanding stock options activity with employees during 2010 and 2009:

	Common Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at December 31, 2008	8,606,556	$ 0.26	7.58	$ 38,294
Granted	4,190,058	$ 0.21		
Exercised	(25,000)	$ 0.17		$ 3,250
Forfeited or expired	(472,732)	$ 0.58		
Outstanding at December 31, 2009	12,298,882	$ 0.26	7.64	$ 1,052,839
Granted	2,970,000	$ 0.30		
Forfeited or expired	(371,125)	$ 0.32		
Outstanding at December 31, 2010	14,897,757	$ 0.25	7.19	$ 946,754
Exercisable at December 31, 2010	13,834,563	$ 0.25	7.02	$ 940,594
Exercisable at December 31, 2009	11,951,021	$ 0.24	7.61	$ 1,034,594

Stock compensation expense was approximately $651,000 for the year ended December 31, 2010 and $1,580,000 for the year ended December 31, 2009, including approximately $75,000 that was accrued for warrants issued subsequent to year end. The total fair value of shares vested during the years ended December 31, 2010 and 2009 was approximately $556,000 and $1,549,000, respectively.

Table of Contents

As of December 31, 2010, there was approximately $222,000 of unrecognized employee stock-based compensation expense related to non vested stock options, of which $129,000, $81,000 and $12,000 is expected to be recognized for the years ended December 31, 2011, 2012 and 2013, respectively.

The following table represents our non vested share-based payment activity with employees for the year ended December 31, 2010 and 2009:

	Number of Options	Weighted Average Grant Date Fair Value
Nonvested options - December 31, 2008	1,276,563	$ 0.37
Granted	4,190,058	$ 0.31
Forfeited	(30,334)	$ 0.17
Vested	(5,088,426)	$ 0.30
Nonvested options - December 31, 2009	347,861	$ 0.27
Granted	2,970,000	$ 0.25
Vested	(2,244,663)	$ 0.25
Forfeited	(10,004)	$ 0.28
Nonvested options - December 31, 2010	1,063,194	$ 0.25

Warrants

At December 31, 2010, the Company had outstanding warrants to purchase the Company s common stock which were issued in connection with multiple financing arrangements and consulting agreements. Information relating to these warrants is summarized as follows:

Warrants	Remaining Number Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price
Warrants-Daily Financing	197,055	.98	$ 0.55
Warrants-Additional Financing	428,637	1.70	$ 0.40
Warrants-Robb Trust Note	50,000	1.42	$ 0.55
Warrants-Financing	14,750,000	1.99	$ 0.25
Warrants-Placement Agent Warrants	793,641	2.26	$ 0.25
Warrants-Tangredi	3,000,000	2.25	$ 0.36
Warrants-Ehrenberg	250,000	2.59	$ 0.30
Warrants-Consulting Agreement	825,000	3.77	$ 0.31
Warrants-Note Conversions	2,302,538	3.42	$ 0.39
Warrants-Stock Purchases 2009	758,270	3.40	$ 0.34
Warrants-Mandelbaum	50,000	3.33	$ 0.19
Warrants-Services	400,000	4.06	$ 0.50
Total	23,805,141		

Common Stock Issued For Services

The Company entered into a consulting agreement in September of 2008. In October of 2009, the agreement was amended to extend the term for nine months. Company is to issue the consultant 10,000 shares of common stock in

each of said nine months for total shares of 90,000, with no award of stock for January and February 2010. For the year ended December 31, 2010, the Company has issued 106,000 shares of common stock and recorded $44,050 as consulting expense on its statement of operations.

The Company entered into an agreement for consulting services in April 2010. The term of the agreement is for twelve months and calls for the Company to issue the consultant 100,000 shares of common stock upon execution of the agreement and an additional 100,000 shares of common stock after six months of service. The agreement also calls for a monthly cash payment of $6,000 for the first six months and $7,500 per month for the remainder of the agreement. The Company has fair valued the initial 100,000 shares of common stock at $53,000 and the additional 100,000 shares of common stock at $36,000 and is expensing the fair value of those shares over life of the agreement. For the year ended December 31, 2010, the Company has recorded $68,000 as consulting expense on its statement of operations and included $21,000 as prepaid expenses in the balance sheet.

The Company issued 207,692 shares of common stock during the year ended December 31, 2010 valued at $64,384 for legal services to be provided from January 1, 2010 through December 31, 2010. For the year ended December 31, 2010, the Company has recorded $64,384 as legal expense in its statement of operations.

On November 4, 2010, the Company entered into an agreement for legal services in exchange for 375,000 shares of Common Stock valued at $150,000. For the year ended December 31, 2010, the Company has recorded $150,000 as prepaid expenses in the accompanying balance sheet.

12. Derivative Financial Instruments

In September 2008, the FASB ratified the consensus reached on EITF Issue No. 07-5, *Determining Whether an Instrument (or an Embedded Feature) is Indexed to an Entity s Own Stock* (EITF 07-5) (codified as ASC 815-40-15-5). This EITF provides guidance for determining whether an equity-linked financial instrument (or embedded feature) is indexed to an entity s own stock. The EITF applies to any freestanding financial instrument or embedded feature that has all the characteristics of a derivative under ASC 815-10-15-13 through 15-130, *Accounting for Derivative Instruments and Hedging Activities*, for purposes of determining whether that instrument or embedded feature qualifies for the first part of the scope exception. The EITF also applies to any freestanding financial instrument that is potentially settled in an entity s own stock, regardless of whether the instrument has all the characteristics of a derivative under ASC 815-10-13 through 15-130, for purposes of determining whether the instrument is within the scope of EITF No. 00-19 *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock* (EITF 00-19) (codified as ASC subtopic 815-40). EITF No. 07-5 was effective beginning the first quarter of fiscal 2009.

Due to certain adjustments that may be made to the exercise price of the warrants issued in December 2007, January 2008 and August 2008, if the Company issues or sell shares of its common stock at a price which is less than the then current warrant exercise price, these warrants have been classified as a liability as opposed to equity in accordance with the Derivatives and Hedging Topic of the FASB ASC 815-10-15 as it was determined that these warrants were not indexed to the Company s stock. As a result, the fair market value of these warrants was remeasured on January 1, 2009 and marked to market at each subsequent financial reporting period. The change in fair value of the warrants is recorded in the statement of operations and is estimated using the Black-Scholes option-pricing model with the following assumptions:

	For the Years Ended December 31, 2010	2009
Exercise price	$ 0.25	$ 0.25
Market value of stock at end of period	$ 0.29	$ 0.30
Expected dividend rate	N/A	N/A
Expected volatility	158% 165%	112% 117%
Risk-free interest rate	0.61% 0.82%	1.70% 2.20%
Expected life in years	2.00 2.58	3.00 3.58
Shares underlying warrants outstanding classified as liabilities	15,543,641	15,543,641

All warrants issued by the Company other than the above noted warrants are classified as equity.

Table of Contents

During the fourth quarter of the year ended December 31, 2010, the Company applied the guidance of Accounting Standards Codification 815-40 (ASC 815-40) and recorded a $618,801 gain on the fair value of the warrant liability for the year then ended. The warrants had been issued in December 2007, January 2008 and August 2008, in connection with convertible promissory notes as described in Note 7 and were originally accounted for as an equity instrument. Upon further review of the warrants, it was determined that these warrants were not indexed to the Company s stock and therefore required derivative accounting treatment. Accordingly, the Company has restated its financial statements for the year ended December 31, 2009 provided herein to reflect the proper accounting treatment. If the Company would have recorded these warrants as a derivative liability upon initial adoption of ASC 815-40, the Company would have recorded the following amounts in the accompanying balance sheet and income statement:

	Total Liabilities As previously Reported	Change	Total Liabilities As Restated	Stockholders Deficit As previously Reported	Change	Stockholders Deficit As Restated
March 31, 2009	$ 4,599,317	$ 2,080,830	$ 6,680,147	$ (4,246,075)	$ (2,080,830)	$ (6,326,905)
June 30, 2009	$ 4,565,431	$ 2,425,223	$ 6,990,654	$ (3,982,146)	$ (2,425,223)	$ (6,407,369)
September 30, 2009	$ 3,968,231	$ 10,774,888	$ 14,743,119	$ (3,158,106)	$ (10,774,888)	$ (13,932,994)
December 31, 2009	$ 4,299,685	$ 4,577,119	$ 8,876,8045	$ (2,678,939)	$ (4,577,1119)	$ (7,256,058)
March 31, 2010	$ 5,117,253	$ 6,085,147	$ 11,202,400	$ (3,058,161)	$ (6,085,147)	$ (9,143,308)
June 30, 2010	$ 5,165,059	$ 4,250,053	$ 9,415,112	$ (3,094,998)	$ (4,250,053)	$ (7,345,051)
September 30, 2010	$ 5,147,657	$ 4,861,284	$ 10,008,941	$ (3,428,140)	$ (4,861,284)	$ (8,289,424)

	Other Inc (Exp) As previously Reported	Change	Other Inc (Exp) As Restated	Net Loss As previously Reported	Change	Net (Loss) Income As Restated	EPS As previously Reported	EPS As Restated
For the Three Months Ended:								
March 31, 2009	$ (156,161)	$ (146,858)	$ (303,019)	$ (648,786)	$ (146,858)	$ (795,644)	$ (0.05)	$ (0.06)
June 30, 2009	$ (95,353)	$ (344,392)	$ (439,745)	$ (344,000)	$ (344,392)	$ (688,392)	$ (0.04)	$ (0.04)
September 30, 2009	$ (203,771)	$ (9,438,212)	$ (9,641,983)	$ (436,927)	$ (9,438,212)	$ (9,875,139)	$ (0.06)	$ (0.50)
For the Year Ended December 31, 2009	$ (620,907)	$ (3,731,694)	$ (4,352,601)	$ (3,385,382)	$ (3,731,694)	$ (7,117,076)	$ (0.17)	$ (0.36)
For the Three Months Ended:								
March 31, 2010	$ (46,504)	$ (1,508,027)	$ (1,554,531)	$ (520,038)	$ (1,508,027)	$ (2,028,065)	$ (0.02)	$ (0.07)
June 30, 2010	$ (55,233)	$ 1,835,094	$ 1,779,861	$ (624,681)	$ 1,835,094	$ 1,210,413	$ (0.02)	$ 0.04
September 30, 2010	$ (55,933)	$ (611,231)	$ (667,164)	$ (555,692)	$ (611,231)	$ (1,166,923)	$ (0.02)	$ (0.04)

13. Deferred Revenue

The Company entered into a licensing agreement during the year ended December 31, 2003 and received an initial fee of $770,000. This fee is deferred and recognized on a straight-line basis over the life of the license agreement of 10 years. In addition, the Company received royalties of $100,000 in each of the first three years of the agreement. The Company recognized revenue of approximately $77,000 for this agreement during each of the years ended December 31, 2010 and 2009.

Table of Contents

The Company entered into a licensing agreement with a biomedical entity during the year ended December 31, 2005 and received an initial license fee of $50,000. This fee is deferred and recognized on a straight-line basis over the life of the license agreement of 7 years. The Company recognized revenue of approximately $5,000 for this agreement during each of the years ended December 31, 2010 and 2009.

14. Commitments and Contingencies

The Company has employment agreements with some of its key employees and executives. These agreements provide for minimum levels of compensation during current and future years. In addition, these agreements call for grants of stock options and for payments upon termination of the agreements.

The Company entered into an agreement with the holders of the Convertible Notes to file a registration statement within 45 days of the first Note conversion and to have the registration statement declared effective within 150 days. The Company will incur penalties and damages of up to approximately $236,000 if it does not file and keep the registration statement effective pursuant to the terms of this agreement. As of December 31, 2010, the Company has recorded a liability of $5,000 in accrued expenses related to this agreement on its balance sheet.

On September 17, 2010, the U.S. Department of Energy approved a grant of up to $681,322 to the Company for the funding of a project to scale up, in size and field trial, a novel dehumidification system similar to the Company s NanoAir prototype, that is operated by directly manipulating water vapor using a selectively permeable membrane made of a nano-structure solid polymer. The grant is conditioned upon the Company contributing $171,500 of the proposed total project cost of $852,822. The Company will receive the grant amount in phases upon the meeting of certain milestones. As of December 31, 2010, the Company has incurred $79,786 in expenses and recognized the same amount as revenue related to this grant award.

In December 2010, Pasco County Florida approved a grant of $254,500 to the Company for the funding of the NanoAir product into commercialization. The grant from Pasco County requires us to pay the county 2% of the gross sales of products using a certain unique pump assembly for 5 years or for a total of $1,000,000 whichever comes first. As of December 31, 2010, the Company has incurred $19,946 in expenses and recognized the same amount as revenue related to this grant award.

The Company is not currently a party to any pending legal proceedings. In the ordinary course of business the Company may become a party to various legal proceedings generally involving contractual matters, infringement actions, product liability claims and other matters.

15. Income Taxes

There is no current or deferred income tax expense or benefit for the years ended December 31, 2010 and 2009.

The provision for income taxes is different from that which would be obtained by applying the statutory federal income tax rate to income before income taxes. The items causing this difference are as follows:

	Year ended December 31,	
	2010	**2009**
Tax benefit at U.S. statutory rate	$ (487,000)	$ (2,420,000)
State income tax benefit, net of federal benefit	(52,000)	(258,000)
Effect of non-deductible expenses	1,000	1,000
Employee stock-based compensation	221,000	536,000
Change in warrant valuation	(210,000)	1,269,000
Other adjustments	154,000	994,000
Change in valuation allowance	373,000	(132,000)
	$	$

81

Table of Contents

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are as follows:

	December 31, 2010	December 31, 2009
Deferred tax assets (liabilities), current:		
Bonus payable	$ 108,300	$ 108,300
Accrued deferred compensation payable	428,300	386,300
Stock warrant consideration and other	84,000	49,100
Deferred license revenue	30,900	32,400
Valuation allowance	(651,500)	(576,100)
	$	$
Deferred tax assets (liabilities), noncurrent:		
Deferred license revenue	$ 48,100	$ 77,400
Depreciation	3,400	3,400
Net operating loss carryforwards	7,644,600	7,261,000
Valuation allowance	(7,596,100)	(7,341,800)
	$	$

As of December 31, 2010 and 2009, the Company had federal and state net operating loss carry-forwards totaling approximately $20,100,000 and $21,400,000, respectively, which begin expiring in 2012. The Company has established a valuation allowance to fully reserve all deferred tax assets at December 31, 2010 and 2009 because it is more likely than not that the Company will not be able to utilize these assets.

As of December 31, 2010, the Company has not performed an IRC Section 382 study to determine the amount, if any, of its net operating losses that may be limited as a result of the ownership change percentages during 2010. However, the Company will complete the study prior to the utilization of any of its recorded net operating losses.

16. Genertec Agreement

On August 21, 2009, we entered into an Exclusive Distribution Agreement with Genertec, under which we are to supply and Genertec is to distribute, on an exclusive basis, three of our nanotechnology-based membrane products and related products in Great China, including mainland China, Hong Kong, Macau and Taiwan. The agreement provides that during the initial term of the agreement, Genertec will order and purchase these products in the aggregate amount of Two Hundred Million U.S. Dollars. A minimum quantity of said products is to be purchased by Genertec during each contract year of the initial term. In the event Genertec fails to purchase the minimum amount of products in any given year, we may convert the exclusivity provided to Genertec to a non-exclusive or terminate the agreement. Genertec has agreed to engage and appoint authorized person(s) or firm(s), to install, engineer, perform maintenance, sell and use the products within the defined distribution area and neither Genertec nor its designated buyer is permitted to alter, decompile or modify our products in any way. As consideration for entering into this agreement, Genertec agreed to pay us a deposit in monthly installments beginning in September 2009 and continuing through April, 2010. All such payments are to be applied to products purchased by Genertec. During the initial term of the agreement, the parties are to negotiate in good faith a royalty bearing license agreement whereby Genertec may be granted a license to manufacture certain portions of the our products in the designated territory. The initial term of the agreement shall be for a period of five (5) years, commencing on August 21, 2009, unless earlier terminated. Unless notice of termination is delivered to the respective parties 180 days prior to the expiration of the initial term, the Agreement will automatically renew for consecutive one year periods. We may terminate this agreement in the event: (1) Genertec fails to pay the deposit as indicated, (2) Genertec does not purchase the minimum amount of our designated products during any contract year, (3) breach by Genertec of its obligations under the Agreement, or (4) at our discretion immediately upon the transfer of fifty percent (50%) or more of either the assets of the voting stock of Genertec to any third party. Genertec may not assign the Agreement to any party without our prior written consent. As of December 31, 2010, the Company has $406,356 in accounts receivable and $500,000 in deferred revenue to be applied against future orders. Genertec America s partners in China have received the product and are continuing to perform tests; however there have been delays in completing this testing process. As a result, Genertec America has not yet begun to order product from the Company under this agreement. The Company is currently meeting with Genertec to resolve the payment of the receivable and expects that the amounts will be collected.

Table of Contents

17. CAST Systems Control Technology

In April 2010, the Company entered into a technical and sales agreement with CAST Systems Control Technology Co., Ltd. (CAST) and Genertec with a value of up to approximately $48 million U.S. Dollars over a twelve month period. Under the terms of the Agreement, the Company will supply to CAST, through Genertec, key system components of its nanotechnology clean water process. The Agreement is conditioned upon the Company obtaining a letter of credit from Genertec in the amount as agreed to by the parties on or before April 13, 2010. As of the date of this filing, the Company has received the required letter of credit from Genertec. This Agreement, the terms of which are disclosed in the Company s Current Report on Form 8-K, filed on April 9, 2010, is made pursuant to and in support of the $200 million distribution agreement made between the Company and Genertec on August 21, 2009, granting Genertec the exclusive right to obtain, distribute and market the Company s nanotechnology-based membrane and related products in China, including mainland China, Hong Kong, Macau and Taiwan, the terms of which are summarized above and more fully disclosed in the Company s Current Report on Form 8-K, filed August 27, 2009. For the year ended December 31, 2010, the Company has sold one unit under this agreement and recognized $300,000 in revenue which has been billed and $254,000 of which has been collected. The Company expects the remainder of the $300,000 receivable to be collected in 2011.

18. Subsequent Events

Subsequent to December 31, 2010, the Company issued 121,346 shares of common stock for services.

During January 2011, the Company issued 1,810,000 options under the 2009 Option Plan.

In December 2009, we secured a loan in the principal amount of $1,000,000 from an investor. Pursuant to the terms of the note, we are to pay the holder simple interest at the rate of ten percent per annum commencing on the date of issuance with all interest and principal due and payable in cash on or before June 17, 2010 the note s maturity date was extended to April 30, 2011. On March 22, 2011, the Company entered into a Securities Amendment and Exchange Agreement and an Amended and Restated Convertible Promissory Note (Convertible Note , collectively Exchange Agreements) with the this investor. Pursuant to the terms and subject to the conditions set forth in the Exchange Agreements, the Company and the Investor amended and restated the $1,000,000 unsecured promissory note issued by the Company to Investor on or about December 17, 2009 (Original Note) to, among other things, extend the term to March 22, 2012 (2011 Convertible Note). Interest in the amount of 10% per annum, commencing on December 17, 2009 and calculated on a 365 day year, and the principal amount of $1,000,000 will be paid on March 22, 2012. Subject to the terms and conditions of the 2011 Convertible Note, including limitations on conversion, the outstanding principal and interest under the 2011 Convertible Note will automatically convert into shares of the Company s common stock at the then-effective conversion price upon the closing of a qualified firm commitment underwritten public offering or may be voluntarily converted by the investor at anytime during the term. The initial conversion price is $0.26 per share. Any principal or interest which is not converted will be repaid by the Company at the earlier of a qualified offering, (as defined in the 2011 Convertible Note which is filed as an exhibit to the Form 8K filed with the Securities and Exchange Commission on March 28, 2011), or March 22, 2012. Pursuant to and during the term of the 2011 Convertible Note, the Company will not issue or allow to exist any obligation for borrowed money, except for subordinate indebtedness in payment and priority, trade payables incurred in the ordinary course of business, purchase money secured indebtedness for equipment or inventory, unsecured and subordinate, or unsecured and subordinate working capital guarantees provided by, the Export Import Bank of the United States (the EXIM Bank), and indebtedness evidenced by the promissory note dated February 19, 2010 issued to RBC Capital Markets-Custodian of Leonard Samuels IRA (as amended) in the principal amount of $620,000.

On March 22, 2011, in connection with the above Exchange Agreements, the Company entered into Amendment to 2007 Warrant and Amendment to 2009 Warrant to extend the terms of the Stock Purchase Warrant, dated on or about December 31, 2007, and Stock Purchase Warrant, dated on or about March 12, 2009, respectively, to March 22, 2016 and to provide for cashless exercise unless such warrant shares are registered for resale under a registration statement. In addition, on March 22, 2011, the Company issued a Stock Purchase Warrant to the Investor to purchase 1,000,000 shares of the Company s common stock at $0.45 per share, exercisable commencing on the earliest of the consummation of the qualified offering (as defined in the Exchange Agreements), the date of conversion of the Convertible Note in full, or the date of conversion of the Convertible Note by the Investor in the greatest number of shares of the Company s common stock not to exceed 9.99% beneficial ownership of Company outstanding common stock and terminating on March 22, 2016.

Table of Contents

Also, on March 22, 2011, the Company entered into a Note and Warrant Purchase Agreement, Secured Convertible Promissory Note and Patent Security Agreement (Financing Agreements) with the Investor. Pursuant to the terms and subject to the conditions set forth in the Financing Agreements, the Investor has provided a bridge loan in the amount of $1,500,000 (Loan) to the Company, which will be secured in all patents, patent applications and similar protections of the Company and all rents, royalties, license fees and accounts with respect to such intellectual property assets. Pursuant to the Secured Convertible Promissory Note (Secured Note), interest in the amount of 10% per annum, calculated on a 365 day year, and the principal amount of $1,500,000 will be paid on March 22, 2012, but repayment is accelerated upon a qualified offering (as defined in the note). In the event of such qualified offering, and subject to the terms and conditions of the Secured Note, the outstanding principal and interest under the Secured Note will automatically convert, subject to the limitations on conversion described in the note, into shares of the Company s common stock at the then-effective conversion price upon the closing of such qualified offering. The initial conversion price is $0.26 per share. Any principal or interest which is not converted will be repaid by the Company at the earlier of a qualified offering or March 22, 2012. No cash fees were paid to any party to the transaction in exchange for lending the money. On March 22, 2011, in connection with the Financing Agreements, the Company issued a Stock Purchase Warrant to the Investor to purchase 3,000,000 shares of the Company s common stock at $0.45 per share, exercisable until March 22, 2016.

Pursuant to and during the term of the Secured Note, the Company will not issue or permit to exist any obligation for borrowed money, except for trade payables incurred in the ordinary course of business, purchase money secured indebtedness for equipment or inventory, unsecured and subordinate indebtedness to, or unsecured and subordinate working capital guarantees provided by, the EXIM Bank, the promissory note dated February 19, 2010 issued to RBC Capital Markets- Custodian of Leonard Samuels IRA (as amended) in the principal amount of $620,000, the Amended and Restated Convertible Promissory Note, dated March 22, 2011, issued to the Investor in the principal amount of $1,000,000 and other unsecured indebtedness for borrowed money in an amount not to exceed $750,000.

Pursuant to the Patent Security Agreement issued in connection with the Note and Warrant Purchase of March 22, 2011, the Company shall not, without the Investor s prior consent, sell, dispose or otherwise transfer all or any portion of the Collateral, except for license grants in the ordinary course of business. In addition, the Company will take all actions reasonably necessary to prosecute to allowance applications for patents and maintain all patents, and to seek to recover damages for infringement, misappropriation or dilution of the Collateral with limited exceptions.

In connection with such qualified offering, and subject to the terms and conditions of the Convertible Note, the Company will use reasonable efforts to include the Investor s securities in such offering. Pursuant to the terms and conditions of the Exchange Agreements, the Investor will not sell, offer to sell or otherwise transfer or dispose of (other than to affiliates) any securities of the Company held by it for a period of 180 days from the date of the final prospectus relating to such qualified offering, except for certain limited sales as more fully described in the Exchange Agreements.