PROTON LABORATORIES INC
Form 10QSB
November 20, 2006

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

FORM 10-QSB

[X] Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2006

[ ] Transition Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from --- to ---

Commission file number: 000-31883

PROTON LABORATORIES, INC.
(NAME OF SMALL BUSINESS ISSUER IN ITS CHARTER)

Washington	91-2022700
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1135 Atlantic Avenue, Suite 101
Alameda, CA 94501
(Address of principal executive offices)

(510) 865-6412
Issuer's telephone number

Check whether the Issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes [X] [ ] No

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

On November 7, 2006 the registrant had outstanding 21,658,020 shares of Common Stock, $0.0001 par value per share. This includes approximately 182,010 shares that were subscribed for by investors but not paid for yet, which such stock certificates we retain.

Transitional Small Business Disclosure Format: Yes [ ] No [X]

PART I
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

PROTON LABORATORIES, INC.
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PROTON LABORATORIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	SEPTEMBER 30, 2006	DECEMBER 2
ASSETS		
CURRENT ASSETS		
Cash	$ 48,891	$ 1,3
Accounts receivable, less allowance for doubtful accounts of 16,522 and $16,522, respectively	14,756	21,92
Stock subscription receivable	16,533	
Prepaid expenses	389,693	
Inventory	240,935	32,8
Product development	136,335	
TOTAL CURRENT ASSETS	847,143	56,1
PROPERTY AND EQUIPMENT		
Furniture and fixtures	20,461	19,7
Equipment and machinery	161,833	161,8
Leasehold improvements	11,323	11,3
Accumulated depreciation	(69,175)	(45,8
NET PROPERTY AND EQUIPMENT	124,442	147,0
DEPOSITS	6,131	6,1
TOTAL ASSETS	$ 977,716	$ 209,3
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
CURRENT LIABILITIES		
Accounts payable	$ 73,425	$ 168,3
Accrued expenses	306,106	252,7
Deferred revenue	52,506	52,5
Preferred dividends payable	14,400	9,6
Stockholder loans, current portion	290,642	444,6
TOTAL CURRENT LIABILITIES	737,079	927,8
STOCKHOLDER LOANS, NET OF CURRENT PORTION	-	40,0

STOCKHOLDERS' EQUITY DEFICIT		
Series A convertible preferred stock, 400,000 shares authorized with a par value of $0.0001; 8,000 shares issued and outstanding; liquidation preference of $80,000 and $0, respectively	80,000	80,0
Undesignated preferred stock, 19,600,000 shares authorized with a par value of $0.0001; no shares issued or outstanding	-	
Common stock, 100,000,000 common shares authorized with a par value of $0.0001; 21,308,020 and 14,270,100 shares issued and outstanding, respectively	2,133	1,4
Additional paid in capital	3,887,906	1,856,6
Stock subscription receivable	(20,000)	
Accumulated deficit	(3,709,402)	(2,696,5
TOTAL STOCKHOLDERS' EQUITY (DEFICIT)	240,637	(758,5
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)	$ 977,716	$ 209,3

The accompanying notes are an integral part of these condensed consolidated financial statements.

PROTON LABORATORIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	FOR THE THREE MONTHS ENDED SEPTEMBER30,		FOR THE NINE MONTHS ENDED SEPTEMBER 30,	
	2006	2005	2006	2005
SALES	$ 10,433	$ 116,791	$ 94,994	$ 274,501
COST OF GOODS SOLD	10,900	113,787	81,379	214,649
GROSS PROFIT (LOSS)	(467)	3,004	13,615	59,852
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES (including equity-based expenses of $674,238, $0, $633,712 and $459,040, respectively)	724,615	114,219	976,656	793,599
LOSS FROM OPERATIONS	(725,082)	(111,215)	(963,041)	(733,747)
OTHER INCOME AND (EXPENSE)				
Interest income	963	61	1,163	161
Interest expense	(13,366)	(17,826)	(46,147)	(90,645)
NET OTHER EXPENSE	(12,403)	(17,765)	(44,984)	(90,484)

NET LOSS	(737,485)	(128,980)	(1,008,025)	(824,231)
PREFERRED STOCK DIVIDEND	1,600	1,600	4,800	4,800
LOSS APPLICABLE TO COMMON SHAREHOLDERS	$ (739,085)	$ (130,580)	$(1,012,825)	$ (829,031)
BASIC AND DILUTED LOSS PER COMMON SHARE	$ (0.04)	$ (0.01)	$ (0.06)	$ (0.06)
BASIC AND DILUTED WEIGHTED AVERAGE SHARES OUTSTANDING	19,983,251	14,234,230	16,631,410	13,543,217

The accompanying notes are an integral part of these condensed consolidated financial statements.

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PROTON LABORATORIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

FOR THE NINE MONTHS ENDED SEPTEMBER 30,	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$(1,008,025)	$(824,231)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation	23,355	16,370
Loss on disposal of property and equipment	-	-
Common stock issued for services	674,238	459,040
Amortization of loan costs	-	27,075
Changes in operating assets and liabilities		
Accounts receivable	7,171	(7,153)
Inventory and product development	(344,409)	(29,701)
Deposits	-	(1,131)
Deferred revenue	-	52,506
Accounts payable	(54,427)	(32,579)
Accrued expenses	53,337	108,708
NET CASH FROM OPERATING ACTIVITIES	(648,760)	(231,096)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(752)	(3,562)
NET CASH FROM INVESTING ACTIVITIES	(752)	(3,562)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of common stock, net	891,019	20,000
Proceeds from stockholder loans	73,852	48,642
Proceeds form notes payable	-	164,000
Payment on note payable	(267,852)	-

NET CASH FROM FINANCING ACTIVITIES	697,019	232,642
NET INCREASE IN CASH	47,507	(2,016)
CASH AT BEGINNING OF PERIOD	1,384	14,412
CASH AT END OF PERIOD	$ 48,891	$ 12,396
NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Stock issued for accrued legal services	$ 40,526	$ -
Stock issued for future services	$ 389,693	$ -
Stock issued under subscription agreement	$ 36,533	$ -
Accrual of preferred stock dividends	$ 4,800	$ 4,800
Transfer of inventory to equipment	$ -	$ 64,500
Issuance of common stock for loan costs	$ -	$ 27,075

The accompanying notes are an integral part of these condensed consolidated financial statements.

PROTON LABORATORIES, INC

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1 - BASIS OF PRESENTATION AND NATURE OF OPERATIONS

BASIS OF PRESENTATION - The condensed consolidated financial statements include the accounts of Proton Laboratories, Inc., and its wholly owned subsidiary ("Proton" or the "Company"). All significant intercompany transactions and balances have been eliminated in consolidation.

In April 2004, the Company changed its name from BentleyCapitalCorp.com, Inc. to Proton Laboratories, Inc. The Company's subsidiary also changed its name from Proton Laboratories, Inc. to Water Science, Inc.

CONDENSED FINANCIAL STATEMENTS - The accompanying unaudited condensed consolidated financial statements are condensed and, therefore, do not include all disclosures normally required by accounting principles generally accepted in the United States of America. These statements should be read in conjunction with the Company's annual financial statements included in the Company's December 31, 2005 Annual Report on Form 10-KSB. In particular, the Company's significant accounting principles were presented as Note 1 to the consolidated financial statements in that report. In the opinion of management, all adjustments necessary for a fair presentation have been included in the accompanying condensed consolidated financial statements and consist of only normal recurring adjustments. The results of operations presented in the accompanying condensed consolidated financial statements for the nine months ended September 30, 2006 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2006.

NATURE OF OPERATIONS - The Company's operations are located in Alameda, California. The core business of the Company consists of the sales and marketing of the Company's industrial, environmental and residential systems throughout the United States of America which alter the properties of water to produce functional water. The Company acts as an exclusive importer and master distributor of these products to various companies. Additionally, the Company formulates intellectual properties under licensing agreements, supplies consumer products, consults on projects utilizing functional water, facilitates between manufacturer and industry and acts as educators on the benefits of functional water.

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, disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

INVENTORY - Inventory consists of purchased finished goods and is stated at the lower of cost (using the first-in, first-out method) or market value.

BASIC AND DILUTED LOSS PER COMMON SHARE - Basic loss per common share is calculated by dividing net loss by the weighted-average number of common shares outstanding. Diluted loss per common share is calculated by dividing net loss by the weighted-average number of Series A convertible preferred shares and common shares outstanding to give effect to potentially issuable common shares except during loss periods when those potentially issuable shares are anti-dilutive. Potential common shares from convertible preferred stock have not been included as they are anti-dilutive.

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NOTE 2 - BUSINESS CONDITION

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern. The company has incurred losses applicable to common shareholders of $1,012,825 for the nine months ended September 30, 2006. The Company had working capital of $110,064 at September 30, 2006, and a working capital deficit of $871,723 at December 31, 2005. Loans and equity funding were required to fund operations.

The Company is working towards raising additional public funds to expand its marketing and revenues. The Company has spent considerable time in contracting with several major overseas corporations for the co-development of enhanced antioxidant beverages for distribution into the overseas markets. In addition, the Company is working with its Canadian business associates to identify institutional businesses to market various disinfection applications based upon functional water, pending government approval.

The Company's ability to continue as a going concern is dependent upon its ability to generate sufficient cash flows to meet its obligations on a timely basis, to obtain additional financing as may be required, and ultimately to attain profitable operations. However, there is no assurance that profitable operations or sufficient cash flows will occur in the future.

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NOTE 3 - RELATED PARTY TRANSACTIONS

Stockholder loans as of September 30, 2006 and December 31, 2005 consist of the following:	2006	20

Note payable to President; principal and interest settled at September 30, 2006	$ -	$168
Note payable to President; principal and interest due June 2008; interest is accrued at 7% per annum; unsecured	20,000	
Note payable to CEO and majority shareholder; principal and interest currently due; interest is accrued at 7% per annum; unsecured.	84,000	84
Note payable to CEO and majority shareholder; principal and interest currently due; interest is accrued at 7% per annum; unsecured.	125,000	125
Note payable to CEO and majority shareholder; principal and interest currently due; interest is accrued at 7% per annum; unsecured.	40,000	40
Note payable to CEO and majority shareholder; principal and interest due September 2006; interest is accrued at 7% per annum; unsecured.	13,000	13
Note payable to CEO and majority shareholder; principal and interest due September 2007; interest is accrued at 7% per annum; unsecured.	8,642	14
Note payable to shareholder; principal and interest settled at September 30, 2006	-	40
TOTAL STOCKHOLDER LOANS	290,642	484
Less: Current Portion	290,642	444
TOTAL STOCKHOLDER LOANS - LONG TERM	$ -	$ 40

During the nine months ended September 30, 2006, two shareholders advanced the Company $73,852. The Company made payments on all shareholder notes totaling $267,852 during the nine months ended September 30, 2006.

At September 30, 2006, the Company had accrued interest relating to shareholder loans of $98,018.

During the nine months ended September 30, 2006, the Company accrued $45,000 as salaries payable to the company's CEO, resulting in $202,827 of salaries payable at September 30, 2006.

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NOTE 4 - COMMON STOCK

In March 2006 the Company issued 352,400 shares of common stock for payment of legal fees. The value of the shares issued was $81,052, based on a market price on date of issuance of $0.23. $40,526 of this amount is related to services rendered during the year ended December 31, 2005.

In July and August 2006 the Company issued 1,410,000 shares of common stock for marketing and sales expense through December 2006. The value of the shares was $1,023,405 based on market prices ranging from $0.62 to $0.74 per share which was the market price of the Company's common stock on the date of issuance. Through September 30, 2006, $633,712 of expense related to the shares had been recognized with the remaining $389,693 to be recognized through December 31, 2006.

During May through September the Company issued 5,275,520 shares of common stock for cash proceeds of $891,019 and a stock subscription of $36,533 at prices ranging from $0.11 to $0.34 per share. The proceeds received are net $41,025 of offering costs paid and include 666,250 shares issued to finders as offering costs. Subsequent to September 30, 2006, $16,533 of subscription receivables had been collected and is classified as a current asset in the accompanying financial statements.

NOTE 5 - COMMITMENTS

PRODUCTION AGREEMENT - In June 2005, the Company entered into an agreement with Mitachi, a Japanese electronics component manufacturer, to aid in the production of enhanced drinking water generators. Pursuant to this agreement, Mitachi agreed to pay the Company 25,000,000 Yen for engineering design, molding, tooling and preparation costs, and the exclusive product distribution rights for China, Taiwan, and Japan. As of September 30, 2006, Mitachi had paid 6,000,000 Yen, or $52,506, for the above mentioned distribution rights. Since the project is not yet completed and no units have been sold, this amount is classified as deferred revenue.

EQUITY LINE - In November 2005, the Company entered into an equity line agreement with a private investor (the "Equity Line Investor"). Under the equity line, the Company had the right to draw up to $10,000,000 from the Equity Line Investor. The Company was entitled to draw funds and to "put" to the Equity Line Investor shares of the Company's Class A common stock in lieu of repayment of the draw. As of September 30, 2006, the Company had not drawn funds under the equity line.

NOTE 6 - SUBSEQUENT EVENT

Subsequent to September 30, 2006 the Company issued 350,000 shares of common stock for cash proceeds of $157,500, or $0.45 per share from one investor.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS.

FORWARD-LOOKING STATEMENT

Certain statements contained herein, including, without limitation, statements containing the words, "believes," "anticipates," "expects," and other words of similar meaning, constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements, to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements. Given these uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements. In addition to the forward-looking statements contained herein, the following forward-looking factors could cause our future results to differ materially our forward-looking statements: competition, funding, government compliance and market acceptance of our products.

INTRODUCTION

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our audited financial statements and the accompanying notes thereto for the year ended December 31, 2005 which appear in our Form 10-KSB for the year then ended, and our unaudited financial statements for the quarter ended September 30, 2006 and the accompanying notes thereto and the other financial information appearing elsewhere herein. The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the USA, which contemplate our continuation as a going concern. We have incurred losses applicable to common shareholders of $1,012,825 for the nine months ended September 30, 2006. We had working capital of $110,064 at September 30, 2006, and a working capital deficit of $871,723 at December 31, 2005. Loans and equity funding were required to fund operations.

We had a stockholder equity of $240,637 at September 30, 2006, and a stockholders deficit of $758,547at September 30, 2005.

Stockholder loans as of September 30, 2006 and December 31, 2005 consist of the following:

	2006	20
Note payable to President; principal and interest settled at September 30, 2006	$ -	$168
Note payable to President; principal and interest due June 2008; interest is accrued at 7% per annum; unsecured	20,000	
Note payable to CEO and majority shareholder; principal and interest currently due; interest is accrued at 7% per annum; unsecured.	84,000	84
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TOTAL STOCKHOLDER LOANS	290,642	484
Less: Current Portion	290,642	444
TOTAL STOCKHOLDER LOANS - LONG TERM	$ -	$ 40

During the nine months ended September 30, 2006, two shareholders advanced us $73,852. We made payments on all shareholder notes totaling $267,852 during the nine months ended September 30, 2006.

At September 30, 2006, we had accrued interest relating to shareholder loans of $98,018.

During the nine months ended September 30, 2006, we accrued $45,000 as salaries payable to our CEO, resulting in $202,827 of salaries payable at September 30, 2006.

Our independent auditors made a going concern qualification in their report dated March 29, 2006, which raises substantial doubt about our ability to continue as a going concern. The financial statements herein do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts and classification of liabilities that might be necessary should we be unable to continue in existence.

Our ability to continue as a going concern is dependent upon our ability to generate sufficient cash flows to meet our obligations on a timely basis, to obtain additional financing as may be required, and ultimately to attain profitable operations. However, there is no assurance that profitable operations or sufficient cash flows will occur in the future.

We are located in Alameda, California. We are a biotechnology company that develops new, practical applications for electrolyzed water and the electrolysis process. Our processes and equipment alters the properties of water through electrolysis with electrolytic ion separation and through the conversion of existing properties found in water to achieve functional results. Our business consists of the sales and marketing of the industrial, environmental and residential systems throughout the U.S.A. which alter the properties of water to produce functional water. We act as an exclusive importer and master distributor of these products to various companies in which uses for the product range from food processing to retail water sales. We are working towards raising funds to expand our marketing and revenues. We have spent considerable time negotiating with several overseas corporations for the co-development of enhanced antioxidant beverages for distribution into the overseas markets. In addition, we are working with Canadian businesses to identify markets for various disinfection applications of functional water, pending government approval. We are working on agricultural applications of functional water. We are working on packaging for a spray-on application of function water for pathogen counter-measures.

We formulate intellectual properties under licensing agreements, supply consumer products, consult on projects utilizing functional water, facilitate usage, uses and users of functional water between manufacturer and industry and act as educators on the benefits of functional water. Our business has been focused on marketing functional water equipment and systems. Alkaline-concentrated functional water may have health-beneficial properties and may be used for drinking and cooking purposes. Acidic-concentrated functional water may be used as a topical, astringent medium.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. These estimates and assumptions provide a basis for us to make judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Our actual results may differ from these estimates under different assumptions or conditions, and these differences may be material.

We recognize revenue when all four of the following criteria are met: (i)persuasive evidence that an arrangement exists; (ii) delivery of the product sand/or services has occurred; (iii) the selling price is both fixed and determinable and; (iv) collectibility is reasonably probable. Our revenues are derived from sales of our industrial, environmental and residential systems which alter the properties of water to produce functional water. We believe that this critical accounting policy affects our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Our fiscal year end is December 31.

We have a joint research and development program with Weber Farms locate din Washington State. Weber Farms is family-owned with a long history of raising and marketing quality potatoes, wheat and corn. In 1979, Weber Farms built afresh pack potato warehouse to ensure better quality and more oversight of the marketing of open potatoes both to domestic and foreign markets. In 1997, a state-of- the-art potato storage facility capable of storing 50,000 tons was built. End uses of Weber Farm potatoes are generally in the areas of boxed and bagged potatoes for retail stores, hash browns, French fries and other retail-type products. We will work together in various areas where Proton's electrolyzed water, with its unique efficacies, can be integrated into potato production and post-harvesting processes. Understanding that Proton's water brings about certain potato maintenance efficacies, environmental and worker safety, on-site production abilities and cost efficiencies, both parties are looking forward to a mutually rewarding relationship.

In 2006, we raised funds for the following purposes:

A. Design, assembly and sales of a proprietary residential counter-top unitwhich produces an enhanced drinking water through electrolysis. We will be the exclusive licensee of the patent. This device will have a filtration system coupled to an electrolysis process whicheffectively filters the tap water while restructuring the properties of water to make it: (i) have greater mineral effectiveness; (ii) be tastier than tap water; and, (iii) be more hydrating than tap water. We anticipate that this product line will be ready for marketing in 2007.

We are preparing to file an application for a U.S.A. patent on the design of the proprietary residential water-enhancing device. The patent application has been filed in Japan. and will be filed shortly in the U.S., Canada and China. We are currently evaluating the market positioning of this uniquely advanced product. We will be the exclusive licensee of the patent.

B. Design, assembly, validation and sales of a proprietary anti-microbial spray. We have identified a form of electrolyzed water that may be an effective anti-microbial agent. One of our proprietary aspects of this product may be the stabilization of the electrolyzed water thereby allowing for an extended shelf life compared to other forms of electrolyzed water. This product is being tested by a third party testing lab to establish the efficacies of its anti-microbial effect on MRSA, HBV, HIV and Avian Flu. The objective of our anti-microbial spray is to be able to control and eliminate these four microbial strains on a hard surface or on a topical surface. We anticipate introducing this product to ambulance services as a non-chemical based, user friendly product for which these microbes do not have an immunity. We anticipate that this product line will be ready for marketing in 2007.

Interim laboratory testing results that have been attained from an accredited, 3rd party testing laboratory, show the efficacy of the company's antimicrobial spray to have rapid germicidal activity for an antibacterial and antiviral agent against Staphylococcus aureus (MRSA), ATCC 6538 and Escherichia coli (E. coli), ATCC 11229. The test article was tested in duplicate with three puffs of spray at a distance of 8 inches with exposure periods of 1 minute and 2 minutes. Results showed that a 99.98% (3.71 log10) reduction in numbers of tested

bacteria was shown after 1 minute exposure to the test article and a > 99.999% (> 5.06 log10) reduction in numbers of the test bacteria was shown after 2 minutes exposure to the test article." Currently, we have completed product design of the spray and we await additional testing on the stability of the product.

C. Design and assembly of 3 proprietary commercial-grade electrolysis systems based on a standard platform. There are many industrial uses for water electrolysis systems. Our 3 system designs based on a standard platform which minimizes the need for different components for different applications. The standard platform will provide ease of assembly, ease of use, durability and cost effectiveness. We anticipate that this product line will be ready for marketing in 2007.

D. Testing of wine enhancement and other alcohol-synergistic products. through the use of our equipment being integrated into an existing wine production line to achieve:

1. A jumpstart to the wine aging process.

2. The control of the wine aging process.

3. The termination of the wine aging process.

4. The ability to circumvent the use of a particular wine process ingredient.

5. The ability to bring a specific component of wine to the forefront of taste.

6. The ability to tone down a specific component of wine so as to reduce its taste.

7. The ability to control the classification (rating) of a wine product based on a desired combination of several features of the wine.

Laboratory testing results indicate that the functional water molecules attach to the alcohol resulting in conditions similar to conventional aging methods. During the laboratory testing, a minimum of a 10-year aging characteristic was applied to whiskey enhanced through this process, and similar enhancements to taste, texture and beverage body were observed on other alcohol-synergistic products such as sake and tequila. Further lab testing is being conducted on a 2006 Chardonnay and a 2006 Petite Syrah. One barrel of each wine will be processed through the enhancement process in the near future. These products will be provided as pre-market test products to a focused audience for feedback and recommended product refinements prior to readying a product for market. The first lab test objective is to determine the ability of the wine enhancement process to take a full-bodied Petite Syrah and introduce an aged mellowness to it. Through this objective, and if success is achieved, we will able to introduce this technique to wine makers that are interested in expanding the market presence of an improved Petite Syrah. The second objective is to work through established distribution channels to introduce the electrolysis-enhanced Petite Syrah to an overseas market.

RESULTS OF OPERATIONS-Nine Months ended September 30, 2006 and 2005.

We had revenue of $94,994 for the for the nine months ended September 30, 2006 compared to revenue of $274,501 for the for the nine months ended September 30, 2005. This was a revenue decrease attributable to management efforts being directed at fundraising and product development.

We incurred a net loss of $1,008,025 for the nine months ended September 30, 2006 and a net loss of $824,231 for the nine months ended September 30, 2005. This was an increase in net loss arrtributable to in-kind consultant compensation expenses.

Cash used by operating activities was $648,760 for the for the nine months ended September 30, 2006 compared to cash used by operating activities of $231,096 for the nine months ended September 30, 2005.

We had total assets at September 30, 2006 of $847,143, compared to $56,172 for the quarter ended September 30, 2005. This increase in assets reflects our spending on inventory, product development and prepaid expenses

using funds that we raised in the second and third fiscal quarters of 2006. We anticipate entering the new product sales mode for these new products in late 2006 and early 2007.

LIQUIDITY

At September 30, 2006, we had cash on hand of $48,891. Our growth is dependent on our attaining profit from our operations and our raising of additional capital either through the sale of stock or borrowing funds. There is no assurance that we will be able to raise any equity financing or sell any of our products to generate a profit.

At September 30, 2006, we owed stockholder loans of $290,642.

In 2005, we entered into an agreement with Mitachi, a Japanese electronics component manufacturer, to aid in the production of enhanced drinking water generators. Pursuant to this agreement, Mitachi agreed to pay us 25,000,000 Yen for engineering design, molding, tooling and preparation costs, and the exclusive product distribution rights for China, Taiwan, and Japan. As of September 30, 2006, Mitachi had paid 6,000,000 Yen, or $52,506, for distribution rights. Since the project is not yet completed and no units have been sold, this amount is classified as deferred revenue.

In 2005, we entered into an equity line of credit with a private investor by which we have the right to draw an aggregate of up to $10,000,000 from time to time. As of September 30, 2006, we had not drawn funds under the equity line.

FUTURE CAPITAL REQUIREMENTS

Our growth is dependent on attaining profit from our operations, or our raising additional capital either through the sale of stock or borrowing. There is no assurance that we will be able to raise any equity financing or sell any of our products at a profit.

Our future capital requirements will depend upon many factors, including:

- The cost to acquire equipment that we then would resell.

- The cost of sales and marketing.

- The rate at which we expand our operations.

- The results of our consulting business.

- The response of competitors.

ITEM 3. CONTROLS AND PROCEDURES.

(a) Evaluation of disclosure controls and procedures. Our Principal executive and financial officer evaluated our disclosure controls and procedures(as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this quarterly report. Based on this evaluation, our principal executive officer and principal financial officer concluded that these disclosure controls and procedures are effective and designed to ensure that the information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the requisite time periods.

In connection with its review of the Company's consolidated financial statements for the three and nine months ended September 30, 2006, Hansen, Barnett & Maxwell ("HB&M"), the Company's registered public accounting firm, advised the Audit Committee and management of internal control matters with respect to certain financial reporting controls that they considered to be a material weakness, which is described below. A material weakness is a control deficiency, or a combination of control deficiencies, that results in there being more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The material weakness identified at September 30, 2006 was as follows:

> A material weakness existed in our control environment relating to inadequate staffing of our technical accounting function, including a lack of sufficient personnel with skills, training and familiarity with certain complex technical accounting pronouncements that have or may affect our financial statements and disclosures.

We considered these matters in connection with the quarterly closing process and the preparation of the September 30, 2006 consolidated financial statements included in this Form 10-QSB and determined that no prior period financial statements were materially affected by such matters. In response to the observations made by HB&M, we will implement enhancements to our internal controls, accounting staff and procedures, which we believe address the matters raised by HB&M.

(b) Changes in Internal Control Over Financial Reporting. There was no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended) identified in connection with the evaluation of our internal control performed during the quarter ended September 30, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II

OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

None.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES.

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

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

NONE.

ITEM 5. OTHER INFORMATION.

NONE.

ITEM 6. EXHIBITS.

Exhibit Number	Name
31.1	Certification pursuant to Section 13a-14 of CEO.
31.2	Certification pursuant to Section 13a-14 of CFO.
32.1	Certification pursuant to Section 1350 of CEO.
32.2	Certification pursuant to Section 1350 of CFO.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized in Alameda, California.

PROTON LABORATORIES, INC.

November 20, 2006

By: /s/ Edward Alexander
Edward Alexander
Director, Chief Executive Officer, and
Chief Financial Officer