

Edgar Filing: COMMODORE APPLIED TECHNOLOGIES INC - Form 10-Q

COMMODORE APPLIED TECHNOLOGIES INC  
Form 10-Q  
November 14, 2006

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

(Mark One)

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  
OR  
--- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 1-11871

COMMODORE APPLIED TECHNOLOGIES, INC.  
-----

(Exact name of Registrant as specified in its charter)

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

11-3312952  
-----  
(I.R.S. Employer  
Identification No.)

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

10155  
-----  
(Zip Code)

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes [ ] No [ X ]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

Yes [ ] No [ X ]

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [ X ] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [ X ]

Indicate by check mark whether the registrant is a shell company (as



## PART I - FINANCIAL INFORMATION

ITEM 1: Condensed Consolidated Financial Statements (unaudited)  
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## COMMODORE APPLIED TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

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

ASSETS	September 30, 2006	December 31, 2005
Current Assets:		
Cash and cash equivalents	\$ 126	\$ 65
Accounts receivable, net	2,033	2,065
Prepaid assets and other current assets	140	139
	-----	-----
Total Current Assets	2,299	2,269
Property and equipment, net	128	148
	-----	-----
Total Assets	\$ 2,427 =====	\$ 2,417 =====

See notes to condensed consolidated financial statements.

## COMMODORE APPLIED TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

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

LIABILITIES AND STOCKHOLDERS' DEFICIT	September 30, 2006	December 31, 2005
	-----	-----

Current Liabilities:

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Accounts payable	\$ 1,196	\$ 1,376
Related party payable	252	253
Line of credit	344	141
Notes payable, net	375	635
Other accrued liabilities	5,180	4,450
	-----	-----
Total Current Liabilities	7,347	6,855
Long term debt, net of current portion	6,193	5,426
	-----	-----
Total Liabilities	13,540	12,281
Commitments and contingencies		
Stockholders' Deficit		
Convertible preferred stock, Series H & J Par value \$0.001 per share, liquidation value of \$6,353 as of September 30, 2006 and December 31, 2005, 3% cumulative dividends for Series H, 10% cumulative dividend for Series J, 1,550,000 shares authorized, 1,188,302 shares issued and outstanding.	1	1
Common stock, par value \$0.001 per share, 300,000,000 shares authorized, 8,168,217 And 7,948,217 shares issued and outstanding, respectively.	8	8
Additional paid-in capital	69,399	69,680
Accumulated deficit	(80,258)	(79,290)
	-----	-----
Treasury stock, 171,875 shares	(10,850)	(9,601)
	(263)	(263)
	-----	-----
Total Stockholders' Deficit	(11,113)	(9,864)
	-----	-----
Total Liabilities and Stockholders' Deficit	\$ 2,427	\$ 2,417
	=====	=====

See notes to condensed consolidated financial statements.

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COMMODORE APPLIED TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited - Dollars in Thousands, except per share data)

Three months ended                      Nine months ended  
September 30,    September 30,    September 30,    September 30,

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	2006 -----	2005 ----- (restated)	2006 -----	2005 ----- (restated)
Contract revenues	\$ 2,281	\$ 3,900	\$ 6,343	\$ 8,259
Costs and expenses:				
Cost of sales	2,106	3,034	5,865	7,073
General and administrative	345	694	1,111	1,637
Depreciation and amortization	8	21	16	33
Total costs and expenses	----- 2,459	----- 3,749	----- 6,992	----- 8,743
Income (loss) from operations	----- (178)	----- 151	----- (649)	----- (484)
Other income (expense):				
Gain on settlement of note payable and accrued interest	7	--	158	--
Interest expense	(167)	(432)	(477)	(1,009)
Net gain (loss) on embedded derivative liability	--	44	--	(544)
Net other expense	----- (160)	----- (388)	----- (319)	----- (1,553)
Income (loss) before income taxes	(338)	(237)	(968)	(2,037)
Income taxes	--	--	--	--
Net loss	----- (338)	----- (237)	----- (968)	----- (2,037)
Deemed dividends and dividends accrued to preferred stockholders	(103)	(3,805)	(309)	(3,963)
Net loss applicable to common shareholders	----- \$ (441)	----- \$ (4,042)	----- \$ (1,277)	----- \$ (6,000)
Loss per share - basic and diluted	----- \$ (0.06)	----- \$ (0.53)	----- \$ (0.16)	----- \$ (0.84)
Number of weighted average shares outstanding (000's)	----- 7,836	----- 7,647	----- 7,796	----- 7,118

See notes to condensed consolidated financial statements.

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COMMODORE APPLIED TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited - Dollars in Thousands, except per share data)

Nine months ended  
September 30,      September 30,  
2006                      2005  
-----                      -----

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(restated)

Cash flows from operating activities:		
Net loss	\$ (968)	\$ (2,037)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	16	33
Issuance of common stock for services	28	--
Loss on disposal of equipment	4	--
Amortization of debt discount	-	500
Derivative loss	-	544
Gain on settlement of note payable and accrued interest	(158)	-
Changes in assets and liabilities:		
Accounts receivable, net	32	(3,684)
Prepaid assets and other current assets	(1)	(9)
Accounts payable	(180)	695
Other liabilities	518	2,780
	-----	-----
Net cash used in operating activities	(709)	(1,178)
	-----	-----
Cash flows from investing activities:		
Purchase of equipment	-	(105)
	-----	-----
Cash flows from financing activities:		
Advances from (to) related parties, net	(1)	--
Increase in (repayment of) line of credit	203	317
Payment of notes and loans payable	(199)	--
Proceeds from sale or exchange of common stock	--	100
Increase in notes and loans payable	767	1,024
	-----	-----
Net cash provided by financing activities	770	1,441
Increase in cash	61	158
Cash, beginning of period	65	15
	-----	-----
Cash, end of period	\$ 126	\$ 173
	=====	=====

See notes to condensed consolidated financial statements.

COMMODORE APPLIED TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note A - Basis of Presentation

The accompanying unaudited condensed consolidated financial statements for Commodore Applied Technologies, Inc. and subsidiaries (the "Company" or "Applied") have been prepared in accordance with U.S. generally accepted

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accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. The financial statement information was derived from unaudited financial statements unless indicated otherwise. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements.

In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine month period ended September 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006.

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited financial statements included in the Company's annual report on Form 10-K for the year ended December 31, 2005.

Certain prior-year amounts have been reclassified to conform to the current year presentation.

The accompanying financial statements have been prepared under the assumption that Applied will continue as a going concern. Such assumption contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. For the nine months ended September 30, 2006, and for the years ended December 31, 2005, 2004, and 2003, Applied incurred losses of \$968,000, \$2,714,000, \$2,404,000, and \$2,957,000, respectively. The Company has also experienced net cash outflows from operating activities of (\$1,337,000), (\$1,532,000), and (\$955,000), for the years ended December 31, 2005, 2004 and 2003, respectively. These factors raise substantial doubt about Applied's ability to continue as a going concern. The financial statements do not include any adjustments that might be necessary should Applied be unable to continue as a going concern. Applied's continuation as a going concern is dependent upon its ability to generate sufficient cash flow to meet its obligations on a timely basis, to obtain additional financing as may be required, and ultimately to attain profitability. Potential sources of cash include new contracts, external debt, the sale of new shares of Company stock or alternative methods such as mergers or sale transactions. No assurances can be given, however, that Applied will be able to obtain any of these potential sources of cash.

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### Note B - Restatement of financial statements

The Company's previously issued condensed consolidated financial statements as of and for the three and nine months ended September 30, 2005, have been restated to record the embedded derivatives from the embedded conversion option of the Convertible Secured Note and the Series I Convertible Preferred Stock, entered into on April 11, 2005, as a deemed dividend and as a debt discount, respectively, instead of as an other loss. As a result of this restatement the Company recorded a deemed dividend of \$3,701 and a debt discount of \$4,361, and \$273 and \$500 of the debt discount was amortized into interest expense during the three and nine months ended September 30, 2005, respectively. Net income (loss) was reduced by \$273 and \$7,562 for the three and nine months, respectively, due to these restatements. A change in the valuation of the embedded derivative was recorded in the amount of a gain of \$44 and a loss of

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(\$544) for the three and nine months ended September 30, 2005, respectively.

The following table summarizes the effect of the restatement and reclassification adjustments on the financial statements as of and for the three and nine months ended September 30, 2005.

	Three Months Ended		Nine Months Ended	
	September 30, 2005	September 30, 2005	September 30, 2005	September 2005
	(Restated)	(Previously Reported)	(Restated)	(Previous Reporte
Contract Revenues	\$ 3,900	\$ 3,900	\$ 8,259	\$ 8,2
Total cost and expenses	\$ 3,749	\$ 3,749	\$ 8,743	\$ 8,7
Income (loss) From Operations	\$ 151	\$ 151	\$ (484)	\$ (4
Other expense:				
Interest Expense	\$ (432)	\$ (159)	\$ (1,009)	\$ (5
Net gain (loss) on embedded derivative liability	\$ 44	\$ 44	\$ (544)	\$ (8,6
Net gain (loss)	\$ (237)	\$ 36	\$ (2,037)	\$ (9,5
Deemed dividends and dividends accrued to preferred stockholders	\$ (3,805)	\$ (104)	\$ (3,963)	\$ (2
Net loss applicable to common shareholders	\$ (4,042)	\$ (68)	\$ (6,000)	\$ (9,8

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### Note C - Summary of Significant Accounting Policies

#### Allowance for Anticipated Losses on Contracts

Anticipated losses on contracts are provided for by a charge to income during the period such losses are identified. Changes in job performance, job conditions, estimated profitability (including those arising from contract penalty provisions) and final contract settlements may result in revisions to cost and income and are recognized in the period in which the revisions are determined. Allowances for anticipated losses totaled \$376,000 at September 30, 2006 and December 31, 2005. These allowances are included in other accrued liabilities in the accompanying financial statements.

#### Consolidation

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



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amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### Stock Based Compensation

The Company has established the 1998 Stock Option Plan, as amended (the "1998 Plan"), and performance based stock options to executives outside of the 1998 Plan granted in 2003, for the award of stock options and stock bonuses to employees, executive officers, members of the Board of Directors and outside consultants. The Compensation Committee of the Board of Directors has the ability to determine the terms of the option, the exercise price, the number of shares subject to each option, and the exercisability of the options.

Under the terms of the 1998 Plan, options generally expire 10 years from the date of grant or within 90 days of termination. Options granted under these plans generally vest at 25 percent after the completion of one year of service and then 1/36 per month for the remaining three years and would be fully vested at the end of four years. Pursuant to the terms of their grant agreements, certain of the options granted under these plans may be subject to accelerated vesting upon a change in control of the Company.

Under the terms of the performance based stock options to executives outside of the 1998 Plan granted in 2003, options generally expire 5 years from the date of grant or within 90 days of termination. Options granted under these plans generally vest at grant date.

Prior to December 31, 2005, as permitted under Statement of Financial Accounting Standards ("SFAS") No. 123, the Company accounted for its stock option plans following the recognition and measurement principles of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock issued to Employees," and related interpretations. Accordingly, no stock-based

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compensation expense had been reflected in the Company's statements of operations as all options granted had an exercise price equal to or greater than the market value of the underlying common stock on the date of grant and the related number of shares granted was fixed at that point in time.

In December 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 123(R), "Share Based Payment." This statement revised SFAS No. 123 by eliminating the option to account for employee stock options under APB No. 25 and requires companies to recognize the cost of employee services received in exchange for awards of equity instruments based on the grant date fair value of those awards.

Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123(R) using the modified prospective application method. Under this transition method, the Company would have recorded compensation expense on a straight-line basis for the three and nine month periods ended September 30, 2006, for: (a) the vesting of options granted prior to January 1, 2006 (based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and previously presented in the pro-forma footnote disclosures), and (b) stock-based awards granted subsequent to January 1, 2006 (based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R)). In accordance with the modified prospective application method, results for the three and nine months ended September 30, 2005 have not been restated.

There were no options granted in the three and nine month periods ended

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September 30, 2006, and all options granted prior to January 1, 2006 were fully vested prior to January 1, 2006. As such, there was no compensation expense recorded for options during the three and nine month periods ended September 30, 2006. Also, there were no options granted to employees in the three and nine month periods ended September 30, 2005.

### Note D - Supplemental cash flow information

During the three and nine month periods ended September 30, 2006, no shares of Series J Preferred Stock were converted into shares of the Company's common stock. During the three and nine month periods ended September 30, 2006, the Company paid no dividends on the Series J Preferred Stock. The Company accrued dividends on Preferred Stock Series J for the three and nine-month periods ended September 30, 2006, of \$97,075 and \$291,226 respectively, which are included in Other Accrued Liabilities.

During the three and nine month periods ended September 30, 2006, no shares of Preferred Stock Series H were converted into shares of the Company's common stock. The Company accrued dividends on Preferred Stock Series H for the three and nine-month periods ended September 30, 2006, of \$6,000 and \$18,000, respectively, which are included in Other Accrued Liabilities.

During the three and nine month periods ended September 30, 2006 the Company paid no accrued dividends on the accrued balance on the Series I Preferred Stock. The balance of dividends accrued on the Series I Preferred Stock as of December 31, 2005 and September 30, 2006 is \$183,697, which is included in Other Accrued Liabilities.

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### Note E - Other Accrued Liabilities

Other accrued liabilities consist of the following:

	September 30, 2006	December 31, 2005
	----- (unaudited)	----- (audited)
Compensation and employee benefits	\$ 2,114	\$ 1,987
Accrued Interest	1,075	694
Dividends Payable	670	361
Subcontractors	650	724
Loss Reserve	376	376
Related parties advances	185	185
Other	110	123
	-----	-----
	\$ 5,180	\$ 4,450
	=====	=====

### Note F - Segment Information

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

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Applied evaluates segment performance based on the segment's net income (loss). Applied's foreign and export sales and assets located outside of the United States are not significant. Summarized financial information concerning Applied's reportable segments is shown in the following tables.

Nine Months Ended September 30, 2006  
(Dollars in Thousands)

	Total	ASI	Solution	Corporate Overhead and Other
Contract revenues	\$ 6,343	\$ 6,343	\$ --	\$ --
Costs and expenses				
Cost of sales	5,865	5,865	--	--
General and administrative	1,111	250	4	857
Depreciation and amortization	16	16	--	--
Total costs and expenses	6,992	6,131	4	857
Income (loss) from operations	(649)	212	(4)	(857)
Gain on settlement of note payable and accrued interest	158	54	--	104
Interest expense	(477)	--	--	(477)
Income (Loss) before income taxes	(968)	266	(4)	(1,230)
Income taxes	--	--	--	--
Net Income (Loss)	\$ (968)	\$ 266	\$ (4)	\$ (1,230)
Total assets	\$ 2,427	\$ 2,427	\$ --	\$ --
Expenditures for long-lived assets	\$ --	\$ --	\$ --	\$ --

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Three Months Ended September 30, 2006  
(Dollars in Thousands)

Corporate Overhead

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	Total	ASI	Solution	and Other
Contract revenues	\$ 2,281	\$ 2,281	\$ --	\$ --
Costs and expenses				
Cost of sales	2,106	2,106	--	--
General and administrative	345	45	--	300
Depreciation and amortization	8	8	--	--
	-----	-----	-----	-----
Total costs and expenses	2,459	2,159	--	300
	-----	-----	-----	-----
Income (Loss) from operations	(178)	122	--	(300)
Gain on settlement of payable and accrued interest	7	--	--	7
Interest expense	(167)	--	--	(167)
	-----	-----	-----	-----
Income (Loss) before income taxes	(338)	122	--	(460)
Income taxes	--	--	--	--
	-----	-----	-----	-----
Net Income (Loss)	\$ (338)	\$ 122	\$ --	\$ (460)
	=====	=====	=====	=====
Total assets	\$ 2,427	\$ 2,427	\$ --	\$ --
Expenditures for long-lived assets	\$ --	\$ --	\$ --	\$ --

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Nine Months Ended September 30, 2005  
(Dollars in Thousands)

	Total	ASI	Solution	Corporate Overhead and Other
Contract revenues	\$ 8,259	\$ 8,173	\$ 86	\$ --
Costs and expenses				
Cost of sales	7,073	7,019	54	--
General and administrative	1,637	603	16	1,018
Depreciation and amortization	33	33	--	--
	-----	-----	-----	-----
Total costs and expenses	8,743	7,655	70	1,018
	-----	-----	-----	-----
Income (loss) from operations	(484)	518	16	(1,018)
Interest expense	(1,009)	(5)	--	(1,004)
Net gain (loss) on embedded derivative	(544)	--	--	(544)
	-----	-----	-----	-----
Income (loss) before income taxes	(2,037)	513	16	(2,566)

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Income taxes	--	--	--	--
Net income (loss)	\$ (2,037)	\$ 513	\$ 16	\$ (2,566)
Total assets	\$ 3,525	\$ 3,433	\$ 86	\$ 6
Expenditures for long-lived assets	\$ 105	\$ 101	\$ --	\$ 4

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

	Total	ASI	Solution	Corporate Overhead and Other
Contract revenues	\$ 3,900	\$ 3,900	\$ 3,900	\$ --
Costs and expenses				
Cost of sales	3,034	3,034	--	--
General and administrative	694	373	--	321
Depreciation and amortization	21	21	--	--
Total costs and expenses	3,749	3,428	0	321
Income (loss) from operations	151	472	0	(321)
Interest expense	(432)	(5)	--	(427)
Net gain (loss) on embedded derivative	44	--	--	44
Loss before income taxes	(237)	467	0	(704)
Income taxes	--	--	--	--
Net income (loss)	\$ (237)	\$ 467	\$ 0	\$ (704)
Total assets	\$ 3,525	\$ 3,433	\$ 86	\$ 6
Expenditures for long-lived assets	\$ 33	\$ 31	\$ --	\$ 2

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### Note G - Net loss per common share

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

Options and warrants to purchase 5,967,755 and 6,079,463 shares of common stock and preferred stock convertible into 34,378,313 and 25,641,808 shares of common stock as of September 30, 2006 and 2005, respectively, were not included in the computation of Diluted EPS. The inclusion of the options, warrants and convertible preferred stock would have been anti-dilutive, thereby decreasing net loss per common share.

### Note H - Contingencies

Applied has matters of litigation arising in the ordinary course of business which, in the opinion of management, will not have a material adverse effect on its financial condition or results of operations.

### Note I - Subsequent Events

On October 26, 2006, Mr. James M. DeAngelis submitted a letter of resignation as Chief Financial Officer, Chief Administration Officer and Treasurer of the Company effective as of December 31, 2006. Mr. DeAngelis will continue to serve the Company as a Director and as Senior Vice President, Strategic Development for the Company in 2007, primarily focused on the investor relations programs for the Company.

On November 1, 2006, the Company entered into an employment agreement with Ted R. Sharp to serve the Company as Chief Financial Officer, effective January 1, 2007. To provide for a period of transition from the current Chief Financial Officer, James M. DeAngelis, who will resign that position effective January 1, 2007, Mr. Sharp began his employment on November 1 and will assume full responsibility for the position on the effective date.

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

### Overview

The Company is engaged in providing a range of environmental services to the public and private sectors related to (i) remediating contamination in soils, liquids and other materials and disposing of or reusing certain waste by-products by utilizing Solvated Electron Technology ("SET"); and (ii) providing services related to environmental management for on-site and off-site identification, investigation, remediation and management of hazardous, mixed and radioactive waste.

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The Company owns technologies related to the separation and destruction of mixed waste, polychlorinated biphenyls (PCBs) and chlorofluorocarbons (CFCs). The Company is currently working on the commercialization of these technologies through development efforts, licensing arrangements and joint ventures. Through Advanced Sciences, formerly Advanced Sciences, Inc., a subsidiary acquired on October 1, 1996, the Company has contracts with various government agencies and private companies in the U.S. As some government contracts are funded in one-year increments, there is a possibility for cut-backs, and such a reduction would materially affect the operations. However, management believes Advanced Sciences' existing client relationships will allow the Company to obtain new contracts in the future.

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

The Company currently requires additional cash to sustain existing operations and to meet current obligations and ongoing capital requirements. The Company's current monthly operating expenses exceed cash revenues by approximately \$80,000 at September 30, 2006. Currently, the Company is addressing this cash shortfall through loans from The Shaar Fund, Ltd., but The Shaar Fund, Ltd. is under no obligation to continue to make such advances to the Company. If this lender decided to discontinue advances, the Company would not be able to meet its current obligations. In addition, the Company owes \$564,429 in loans that are currently due or are payable on demand as of August 21, 2006. Although the lenders on these loans have not yet called the loans, the Company does not currently have the ability to pay these loans absent additional financing.

The Company's report of independent registered public accounting firm on its fiscal 2003, 2004 and 2005 financial statements contains a "going concern" qualification in which they express substantial doubt about the Company's ability to continue in business.

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### CRITICAL ACCOUNTING POLICIES

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

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

Reserves for Doubtful Accounts

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

### Valuation of stock and options

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

### Revenue Recognition

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

Most of the Company's historical contracts provided for reimbursement of costs plus fixed fees. Direct and indirect contract costs incurred in reimbursement plus cost contracts are subject to audit by the Defense Contract Audit Agency ("DCAA"). Management does not expect these audits to materially affect the financial statements and has established appropriate allowances to cover potential audit disallowances. Contract revenues have been recorded in amounts which are expected to be realized upon final settlement. The DCAA has audited the Company's contracts through 1999. An allowance for doubtful accounts and potential disallowances has been established based upon the portion of billed and unbilled receivables that management believes may be uncollectible.

## RESULTS OF OPERATIONS

Three and Nine Months Ended September 30, 2006 Compared to Three and Nine Months Ended September 30, 2005

Revenues were \$2,281,000 and \$6,343,000 for the three and nine months ended September 30, 2006 compared to \$3,900,000 and \$8,259,000 for the three and nine months ended September 30, 2005. Such revenues were primarily from the Company's subsidiary ASI.

In the case of Advanced Sciences, revenues were \$2,281,000 and \$6,343,000, respectively, for the three and nine months ended September 30, 2006 as compared with \$3,900,000 and \$8,173,000, respectively, for the three and nine months ended September 30, 2005. The decrease in revenues can be attributed to a reduction in the overall value of the open environmental sampling and data integration contract ("EDAM") work orders and overall, less work being performed by Advanced Sciences during this period. The revenues from Advanced Sciences



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consisted of engineering and scientific services performed for the United States government under a variety of contracts, most of which provide for reimbursement on a fixed rate and a lump sum basis. Revenue under these contracts is recorded as tasks under various work orders are completed and the client approved invoice is submitted for payment. Advanced Sciences has three major customers, each of which represents more than 10% of total revenue. The combined revenue for these three customers was \$2,281,000 and \$6,343,000 respectively, (100% of total revenues) for the three and nine months ended September 30, 2006. Cost of sales was \$2,106,000 and \$5,865,000, respectively, for the three and nine months ended September 30, 2006 compared to \$3,034,000 and \$7,019,000, respectively, for the three and nine months ended September 30, 2005. The decrease in cost of sales can be attributed to a decrease in variable costs caused by the reduction in the overall value of open EDAM contract work orders and overall, less work being performed by Advanced Sciences during this period.

The Company has experienced a decrease in revenues of \$1,619,000 and \$1,916,000 for the three and nine month periods ended September 30, 2006, respectively, compared to the three and nine month periods ended September 30, 2005, respectively. The decrease in revenues can be attributed to a reduction in the overall value of the open EDAM contract work orders and overall, less work being performed by Advanced Sciences during this period. The Company was recently awarded a two-year extension to the EDAM contract. The EDAM extension will run from October 1, 2006 through September 30, 2008. There will be no laboratory management or data management services as in first two years of the EDAM contract, which had a small contribution margin to the Company, because the Company's client, Bechtel Jacobs, LLC has decided to self perform this work scope during the two-year extension of the EDAM contract.

In the case of Solutions, revenues were \$0 and \$0, respectively, for the three and nine months ended September 30, 2006 as compared with \$0 and \$86,000, respectively, for three and nine months ended September 30, 2005. Solution had no customers during the three and nine-month periods ended September 30, 2006. Revenues, when recognized, are primarily from remediation services performed for engineering and waste treatment companies in the U.S. under a variety of contracts. Cost of sales was \$0 and \$0, respectively, for the

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three and nine months ended September 30, 2006 as compared to \$0 and \$54,000, respectively, for the three and nine months ended September 30, 2005. The cost of sales, when incurred, is attributable to sales and marketing expenses for the SET technology. Anticipated losses on engagements, if any, will be provided for by a charge to income during the period such losses are first identified.

General and administrative expenses for continuing operations for the three and nine months ended September 30, 2006 were \$345,000 and \$1,111,000 respectively, as compared to \$694,000 and \$1,637,000, respectively, for the three and nine months ended September 30, 2005. The decrease in general and administrative expense of \$349,000 and \$526,000, respectively, for the three and nine month periods ended September 30, 2006 as compared to the same periods in the prior year is primarily related to less travel and expense account related items at the corporate level in addition to less use of consultants and professional services at the corporate level.

In the case of Advanced Sciences, general and administrative costs for the three and nine-month periods ended September 30, 2006 were \$45,000 and \$250,000, respectively, compared to \$373,000 and \$603,000, respectively, for the three and nine months ended September 30, 2005. This decrease is primarily due to less administrative costs associated with the EDAM contract in Oak Ridge, TN. Solution incurred general and administrative costs of \$0 and \$4, respectively, for the three and nine-month periods ended September 30, 2006 as compared to \$0

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and \$16,000, respectively, for the three and nine-month periods ended September 30, 2005. This decrease was primarily due to the reassignment of a Solution's employee to CASI field work on the EDAM contract in Oak Ridge, TN.

Interest expense for the three and nine months ended September 30, 2006 was \$167,000 and \$477,000, respectively, as compared to \$432,000 and \$1,009,000, respectively, for the three and nine month periods ended September 30, 2005. The decrease in interest expense of \$265,000 and \$532,000, respectively, for the three and nine month periods ended September 30, 2006 as compared to the same periods in the prior year is primarily related to the interest expense related to amortizing the debt discount related to the embedded derivative recognized in 2005.

### OFF-BALANCE SHEET ARRANGEMENTS

There are no off-balance sheet arrangements, such as financing or variable interest entities, that either have, or are reasonably likely to have, a current or future material effect on financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

### LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2006 and December 31, 2005 Advanced Sciences had a \$344,000 and \$141,000 outstanding balance, respectively, on its revolving line of credit.

The Company currently requires additional cash to sustain existing operations and to meet current obligations and ongoing capital requirements. The Company's current monthly operating expenses exceed cash revenues by approximately \$80,000 at September 30, 2006. Currently, the Company is addressing this cash shortfall through loans from The Shaar Fund, Ltd., but The Shaar Fund, Ltd. is under no obligation to continue to make such advances to the Company. If this lender decided to discontinue advances, the Company would not be able to meet its current obligations. In addition, the Company owes \$564,429

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in loans that are currently due or are payable on demand as of August 21, 2006. Although the lenders on these loans have not yet called the loans, the Company does not currently have the ability to pay these loans absent additional financing.

The report of our independent registered public accounting firm on our fiscal 2003, 2004 and 2005 consolidated financial statements contains a "going concern" qualification in which they express substantial doubt about our ability to continue in business. The Company currently requires additional cash to sustain existing operations and to meet current obligations and ongoing capital requirements.

For the three and nine month periods ended September 30, 2006, the Company incurred a net loss of \$338,000 and \$968,000, respectively, as compared to a net loss of \$237,000 and \$2,037,000, respectively, for the three and nine month periods ended September 30, 2005. For the nine months ended September 30, 2006, and for the years ended December 31, 2005, 2004, and 2003, Applied incurred losses of \$968,000; \$2,714,000, \$2,404,000; and \$2,957,000, respectively. The Company has also experienced net cash outflows from operating activities of (\$1,337,000), (\$1,532,000), and (\$955,000), for the years ended December 31, 2005, 2004 and 2003, respectively.

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For the three and nine month periods ended September 30, 2006, the Company issued no stock with respect to accrued dividends pertaining to the Series I Preferred. For the three and nine month periods ended September 30, 2006, the Company converted no shares of Series J Preferred into shares of the Company's common stock and issued no stock with respect to accrued dividends pertaining to the Series J Preferred. For the three and nine month periods ended September 30, 2006, the Company converted no shares of Series H Preferred and issued no stock with respect to accrued dividends pertaining to the Series H Preferred.

The Company recently settled a note payable that was due and payable in the principal amount of \$254,000 to a vendor for services provided from an earlier period in the three month period ended March 31, 2006. The settlement resulted in the recording of a short term note payable, 0% interest, in the principal amount of \$200,000 to the vendor. The Company has made three of four payments of \$50,000 each on this short term Note payable at September 30, 2006. The settlement of this note payable to the vendor had the effect of recognizing the reduction of a historical recorded note payable by \$54,000 (other income to Advanced Sciences) and the reduction of historical accrued interest payable by \$97,000 (other income to Applied) which was recognized in the nine month period ended September 30, 2006. These income amounts are included in Other Income and have not arisen from the Company's normal base of operations.

Certain prior-year amounts have been reclassified to conform to the current year presentation.

For the three and nine month period ended September 30, 2006, no shares of the Company's Series J Preferred were converted into shares of the Company's common stock. For the three and nine month period ended September 30, 2006, the Company accrued all dividends payable on the Series J Preferred Stock.

For the Year ended December 31, 2005, the Company issued 439,206 shares of the Company's common stock upon conversion of 7,000 shares of Series I Preferred by the holders thereof. For the three and nine month periods ended

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September 30, 2006, the Company issued no stock with respect to accrued dividends pertaining to the Series I Preferred. The Company accrued dividends on the Series I Preferred for the three and nine month periods ended September 30, 2006, of \$183,696, which is included in Other Accrued Liabilities.

For the three and nine month periods ended September 30, 2006, the Company converted no shares of Series H Preferred and issued no stock with respect to accrued dividends pertaining to the Series H Preferred. For the three and nine month periods ended September 30, 2006, the Company paid no dividends on the Series H Preferred Stock. The Company accrued dividends on Series H Preferred for the three and nine month period ended September 30, 2006 of \$6,000 and \$18,000, which is included in Other Accrued Liabilities.

For the three and nine month periods ended September 30, 2006, the Company converted no shares of Series J Preferred and issued no stock with respect to accrued dividends pertaining to the Series J Preferred. For the three and nine month periods ended September 30, 2006, the Company paid no dividends on the Series J Preferred. The Company accrued dividends on Series J Preferred for the three and nine month period ended September 30, 2006 of \$97,076 and \$291,226, which is included in Other Accrued Liabilities.

In November 2000, the Company completed \$500,000 in financing in the form of a loan (the "Weiss Group Note") from a group of four investors. The Weiss Group Note bears interest at 12% per annum and was due and payable on

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February 12, 2001. The current principal balance of the Weiss Group Note is \$252,397 and is due and payable as of September 30, 2006 and remains unpaid as of November 14, 2006.

Mr. Blum, a director of the Company, provided cash installments in the form of a loan to the Company through February 2004 (the "Blum Demand Note"). The Blum Demand Note bears interest at 9% per annum and is payable on demand. The current principal balance of the Blum Demand Note is \$312,032 as of September 30, 2006 and remains unpaid as of November 14, 2006.

On September 5, 2006, The Aurelius Consulting Group ("Aurelius"), received 220,000 shares of the Company's unregistered common stock in connection with the execution of a one year consulting agreement between Aurelius and the Company (the "IR Agreement") to provide investment relations services to the Company. The 220,000 shares of restricted common stock were accepted by Aurelius as partial payment for the first six months of the IR Agreement. An additional 120,000 shares of the Company's unregistered common stock will be due and payable to Aurelius on or about March 5, 2007 as partial payment for the remaining six months of the IR Agreement. The Company pays Aurelius \$4,000 per month in cash for the balance of the investment relations services to the Company as per terms and conditions of the IR Agreement. The Company believes that this transaction is exempt from the registration requirements of the Securities Act under Section 4(2) thereof as a transaction not involving any public offering of securities.

The current principal balance of the New Shaar Note is \$6,193,233 as of September 30, 2006 and remains unpaid as of November 14, 2006.

The recipient of securities in this transaction represented its intention to acquire the securities for investment only and not with a view to, or for sale in connection with, any distribution thereof, and appropriate restrictive legends were affixed to the warrants and the certificates representing the shares issued in this transaction. The Company made available to The Shaar Fund Ltd., written information about the Company in accordance with

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Rule 502 of the Securities Act and advised such recipient of the limitations on resale of such securities. In addition, The Shaar Fund Ltd. was offered the opportunity, prior to exchanging and/or purchasing any securities, to ask questions of, and receive answers from, the Company concerning the terms and conditions of the transaction and to obtain additional relevant information about the Company. Based upon the facts above, the Company believed this transaction to be exempt from the registration requirements of the Securities Act in reliance on Section 4 (2) thereof as a transaction not involving any public offering of securities.

The Company hopes to meet its short-term capital requirements (including its \$80,000 monthly cash shortfall) through continued loans from The Shaar Fund, Ltd., although this lender is under no obligation to continue to make advances to the Company. The Company intends to negotiate a forbearance arrangement with other lenders on loans that are currently due. Ultimately, the Company intends to reduce its cash shortfall and intends to meet its long term capital needs through obtaining additional contracts that will generate funds from operations and obtaining additional debt or equity financing as necessary or engaging in merger or sale transactions. There can be no assurance that such sources of funds will be available to the Company or that it will be able to meet its short or long term capital requirements.

NET OPERATING LOSS CARRYFORWARDS

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The Company has net operating loss carryforwards (the "NOLs") of approximately \$39,000,000 as of December 31, 2005, which expire in the years 2010 through 2025. The amount of NOLs that can be used in any one year will be limited by the applicable tax laws that are in effect at the time such NOLs can be utilized. The unused NOLs balances may be accumulated and used in subsequent years. A full valuation allowance has been established to offset any benefit from the net operating loss carryforwards. It cannot be determined when or if the Company will be able to utilize the NOLs.

### FORWARD-LOOKING STATEMENTS

Certain matters discussed in this Annual Report are "forward-looking statements" intended to qualify for the safe harbors from liability established by Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These forward-looking statements can generally be identified as such because the context of the statement will include words such as the Company "believes," "anticipates," "expects" or words of similar import. Similarly, statements that describe the Company's future plans, objectives or goals are also forward-looking statements.

Such statements may address future events and conditions concerning, among other things, the Company's results of operations and financial condition; the consummation of acquisition and financing transactions and the effect thereof on the Company's business; capital expenditures; litigation; regulatory matters; and the Company's plans and objectives for future operations and expansion. Any such forward-looking statements would be subject to the risks and uncertainties that could cause actual results of operations, financial condition, acquisitions, financing transactions, operations, expenditures,

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expansion and other events to differ materially from those expressed or implied in such forward-looking statements. Any such forward-looking statements would be subject to a number of assumptions regarding, among other things, future economic, competitive and market conditions generally. Such assumptions would be based on facts and conditions as they exist at the time such statements are made as well as predictions as to future facts and conditions, the accurate prediction of which may be difficult and involve the assessment of events beyond the Company's control.

Further, the Company's business is subject to a number of risks and uncertainties that would affect any such forward-looking statements. These risks and uncertainties include, but are not limited to:

- o the Company's critical need for additional cash to sustain existing operations and meet existing obligations and capital requirements (the Company's auditor's opinion on our fiscal 2003, 2004 and 2005 financial statements contains a "going concern" qualification in which they express doubt about the Company's ability to continue in business, absent additional financing);
- o the ability to generate profitable operations from a large scale remediation project;
- o the ability of the Company to renew its nationwide permit to treat PCBs;
- o the ability of the Company to implement its waste processing operations, including obtaining commercial waste processing contracts and processing waste under such contracts in a timely and cost effective manner; the timing and award of contracts by the U.S. Department of Energy for the cleanup of waste sites administered by it;
- o the timing and award of contracts by the U.S. Department of Energy

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- o for the cleanup of waste sites administered by it;
- o the acceptance and implementation of the Company's waste treatment technologies in the government and commercial sectors;
- o the Company's ability to obtain and perform under other large technical support services projects; developments in environmental legislation and regulation;
- o the ability of the Company to obtain future financing on favorable terms; and
- o other circumstances affecting anticipated revenues and costs.

These risks and uncertainties could cause actual results of the Company to differ materially from those projected or implied by such forward-looking statements.

### ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

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Not applicable.

### ITEM 4. Controls and Procedures

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- (a) Evaluation of disclosure controls and procedures

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

As required by Rule 13a-15(b) under the Exchange Act, we conducted an evaluation, under the supervision of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of September 30, 2006. Based on their evaluations as of September 30, 2006, the chief executive officer and chief financial officer of the Company have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act) are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC.

Management has taken steps to correct any material weaknesses that were identified in Company's fiscal 2005 10K report filed April 18, 2006 ("2005 Annual Report") on form 10K for the period ended December 31, 2005 with respect to analyzing debt and equity instruments to identify potential embedded derivatives and any required accounting entries and disclosures pertaining to embedded derivatives.

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## PART II - OTHER INFORMATION

### ITEM 1. Legal Proceedings

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There have been no material legal proceedings to which the Company is a party which have not been disclosed in previous filings with the Securities and Exchange Commission. There are no material developments to be reported in any previously reported legal proceedings.

### ITEM 1A. Risk Factors

Investing in our securities involves a material degree of risk. In addition to the other information set forth in this report, you should carefully consider the risk factors discussed in Item 1A, Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2005, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

### ITEM 2. Change in Securities

Not applicable

### ITEM 3. Defaults among Senior Securities

Not applicable.

### ITEM 4. Submission of Matters to a Vote of Security Holders

Not applicable.

### ITEM 5. Other Events

Not applicable.

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

#### (a) Exhibits.

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

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

1. The Company filed a Current Report on Form 8-K, dated

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August 14, 2006, regarding a press release issued by the Company announcing that its wholly owned subsidiary, Commodore Advanced Sciences, Inc., was awarded an Advanced Remediation Demonstration Phase 1 contract by the Department of Energy's Environmental Management Office for the separation of radioactive (surrogate) and RCRA heavy metals from sludges and other waste matrices.

2. The Company filed a Current Report on Form 8-K, dated August 23, 2006, regarding a press release issued by the Company announcing its second quarter 2006 earnings.
3. The Company filed a Current Report on Form 8-K, dated September 21, 2006 regarding a press release issued by the Company announcing that its wholly owned subsidiary, Commodore Advanced Sciences, Inc., has been awarded a two year option extension to the environmental sampling and data integration contract by Bechtel Jacobs Company, LLC (BJC) of Oak Ridge, TN. The contract option extends the contract through September 2008.
4. The Company filed a Current Report on Form 8-K, dated October 31, 2006, announcing that on October 26, 2006, Mr. James M. DeAngelis submitted a letter of resignation as Chief Financial Officer, Chief Administration Officer and Treasurer of the Company effective as of December 31, 2006. Mr. DeAngelis will continue to serve the company as a Director and as Senior Vice President, Strategic Development for the Company in 2007, primarily focused on the investor relations programs for the Company.
5. The Company filed a Current Report on Form 8-K, dated November 02, 2006, announcing that on November 1, 2006, the Company entered into an employment agreement with Ted R. Sharp to serve the Company as Chief Financial Officer, effective January 1, 2007. To provide for a period of transition from the current Chief Financial Officer, James M. DeAngelis, who will resign that position effective January 1, 2007, Mr. Sharp began his employment on November 1 and will assume full responsibility for the position on the effective date.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 14, 2006

COMMODORE APPLIED TECHNOLOGIES, INC.  
(Registrant)

By /s/ James M. DeAngelis



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James M. DeAngelis - Senior Vice President  
and Chief Financial Officer (as both a  
duly authorized officer of the registrant  
and the principal financial officer of the  
registrant)