

SYNERGY TECHNOLOGIES CORP  
Form 10QSB  
August 09, 2002

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

FORM 10-QSB

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended: JUNE 30, 2002

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number 0-26721

SYNERGY TECHNOLOGIES CORPORATION  
(Exact name of small business issuer  
as specified in its charter)

|                                   |                     |
|-----------------------------------|---------------------|
| COLORADO                          | 84-1379164          |
| (State or other jurisdiction      | (IRS Employer       |
| of incorporation or organization) | Identification No.) |

1689 Hawthorne Drive, Conroe, Texas 77301-3284  
(936) 788-8220  
(Issuer's telephone number)

NOT APPLICABLE  
(Former name, former address and former  
fiscal year, if changed since last report)

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

Yes  No

State the number of shares outstanding of each of the issuer's classes of common equity, as of the last practicable date:

45,028,212 shares of Common Stock, \$0.002 par value, as of July 31, 2002.

Transitional Small Business Disclosure Format  
(check one): Yes  No

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PART I -- FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

SYNERGY TECHNOLOGIES CORPORATION  
AND SUBSIDIARIES

FINANCIAL STATEMENTS  
(UNAUDITED)  
PREPARED BY MANAGEMENT

JUNE 30, 2002

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SYNERGY TECHNOLOGIES CORPORATION  
AND SUBSIDIARIES  
(A DEVELOPMENT STAGE COMPANY)  
UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS  
(PREPARED BY MANAGEMENT) FOR THE  
SIX MONTH PERIOD ENDED JUNE 30, 2002

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SYNERGY TECHNOLOGIES CORPORATION  
AND SUBSIDIARIES  
(A DEVELOPMENT STAGE COMPANY)  
CONSOLIDATED BALANCE SHEETS  
ASSETS

|  | AS AT<br>JUNE 30, 2002<br>(UNAUDITED) |
|--|---------------------------------------|
| CURRENT ASSETS   |                                       |
| Cash   | \$ 5,384                              |
| Receivables (Note 5)   | 24,543                                |
| Prepaid expenses   | 78,357                                |
| TOTAL CURRENT ASSETS   | 108,284                               |
| INVESTMENTS (Note 3)   |                                       |
| SynGen Technologies  | 3,500,000                             |
| CPJ Technologies   | 5,064,099                             |
| Investment in Private US corporation   | -                                     |
| Investment in joint venture (Note 3(c))  | 8,564,099                             |
| TOTAL INVESTMENTS  | 59,720                                |
| Office equipment and computers, net of accumulated depreciation of \$64,836                              | 8,623,819                             |
| TOTAL ASSETS   | \$ 8,791,302                          |
| CURRENT LIABILITIES  |                                       |
| Accounts payable   | \$ 791,360                            |
| Accrued expenses (Note 6(a))   | 454,243                               |
| Notes payable (Note 6(b))  | 290,000                               |
| Accrued interest on notes (Note 6(c))  | 250,425                               |
| TOTAL CURRENT LIABILITIES  | 1,786,028                             |
| LONG TERM LIABILITIES  |                                       |
| Notes payable (Note 7)   | 1,005,000                             |
| Investment in joint venture  | -                                     |
| TOTAL LIABILITIES  | 2,791,028                             |
| STOCKHOLDERS' EQUITY   |                                       |
| Common stock, \$0.002 par value, 100,000,000 shares authorized, 43,781,328 shares issued and outstanding | 88,543                                |
| Additional paid in capital   | 56,839,509                            |
| Deferred compensation  | -                                     |
| Deficit accumulated during development stage   | (50,927,778)                          |

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|  |    |           |
|--|----|-----------|
| TOTAL STOCKHOLDERS' EQUITY                 |    | 6,000,274 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ | 8,791,302 |

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

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SYNERGY TECHNOLOGIES CORPORATION  
AND SUBSIDIARIES  
(A DEVELOPMENT STAGE COMPANY)  
CONSOLIDATED STATEMENTS OF OPERATIONS

|  | FOR THE THREE MONTHS<br>ENDED JUNE 30, |                     | FOR THE S<br>ENDED  |
|--|--|---------------------|---------------------|
|  | 2002<br>(UNAUDITED)                    | 2001<br>(UNAUDITED) | 2002<br>(UNAUDITED) |
| REVENUE  |  |                     |                     |
| Interest Income                                  | 7                                      | 491                 | 63                  |
| Consulting Income                                | -                                      | -                   | -                   |
|  | 7                                      | 491                 | 63                  |
| EXPENSES   |  |                     |                     |
| General and administrative                       | 886,216                                | 608,940             | 1,708,410           |
| Stock option compensation                        | -                                      | 21,603              | 13,879              |
| Compensation related to warrants                 | -                                      | -                   | -                   |
| Technology development                           | 209,299                                | 176,579             | 293,189             |
| Other technology costs (Note 6(a))               | 415,200                                | -                   | 415,200             |
| Dry well expenses                                | -                                      | -                   | -                   |
| TOTAL EXPENSES                                   | 1,510,715                              | 807,122             | 2,430,678           |
| LOSS FROM OPERATIONS                             | (1,510,708)                            | (806,631)           | (2,430,615)         |
| OTHER EXPENSES                                   |  |                     |                     |
| Amortization of debt discount and offering costs | -                                      | -                   | -                   |

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|   |                |              |                |
|---|----------------|--------------|----------------|
| Conversion inducement                         | (888,548)      | -            | (888,548)      |
| Interest accrued on notes payable             | (76,209)       | (52,973)     | (131,689)      |
| Share of expenses incurred by joint venture   | (22,016)       | (137,379)    | (33,980)       |
| Write-down of technology                      | -              | -            | -              |
| Gain on disposition                           | -              | 90,263       | -              |
|   | (986,773)      | (100,089)    | (1,054,217)    |
| NET LOSS BEFORE TAXES                         | (2,497,481)    | (906,720)    | (3,484,832)    |
| PROVISION FOR INCOME TAX                      | -              | -            | -              |
| NET LOSS                                      | \$ (2,497,481) | \$ (906,720) | \$ (3,484,832) |
| BASIC AND DILUTED LOSS PER COMMON SHARE       | \$ (0.06)      | \$ (0.03)    | \$ (0.09)      |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES USED | 40,442,432     | 31,194,005   | 38,288,807     |

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

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SYNERGY TECHNOLOGIES CORPORATION AND SUBSIDIARIES  
(A DEVELOPMENT STAGE COMPANY)  
CONSOLIDATED STATEMENTS OF CASH FLOW

|  | FOR THE THREE MONTHS<br>ENDED JUNE 30, |                     | FOR THE<br>ENDE     |
|--|--|---------------------|---------------------|
|  | 2002<br>(UNAUDITED)                    | 2002<br>(UNAUDITED) | 2002<br>(UNAUDITED) |
| CASH FROM OPERATING ACTIVITIES                                   |  |                     |                     |
| Net loss   | (2,497,481)                            | (906,720)           | (3,484,832)         |
| Adjustments to reconcile net loss to net cash<br>from operations |  |                     |                     |
| Dry well expense   | -                                      | -                   | -                   |
| Depreciation, amortization and write-downs                       | 11,344                                 | 30,353              | 35,228              |
| Conversion inducement  | 888,548                                | -                   | 888,548             |
| Accrued interest on notes payable                                | 76,209                                 | 52,973              | 99,593              |
| Issuance of shares for services                                  | 798,648                                | 565,806             | 1,176,725           |
| Issuance of warrants for services                                | -                                      | -                   | -                   |
| Settlement of debt and acquisition of CPJ                        | -                                      | -                   | 357,529             |

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|   |           |            |           |
|---|-----------|------------|-----------|
| Re-issue of founders shares               | -         | -          | 38,500    |
| Investment in joint ventures              | 22,016    | 36,839     | 24,190    |
| Exchange rate loss                        | 12,191    | (11,512)   | 17,672    |
| Loss on disposition of assets             | -         | 904        | -         |
| Changes in assets and liabilities         |           |            |           |
| Accounts receivable                       | 58,207    | 34,162     | 14,017    |
| Prepaid expenses and deposits             | (6,774)   | (14,289)   | (38,629)  |
| Accounts receivable - related parties     | -         | (4,187)    | -         |
| Accounts payable                          | 82,637    | 127,205    | (227,287) |
| Accounts payable - related parties        | -         | 142,943    | -         |
| Accrued expenses                          | 219,614   | (37,325)   | 379,499   |
| -----                                     |           |            |           |
| NET CASH FLOWS FROM OPERATING ACTIVITIES  | (334,841) | 17,152     | (719,247) |
| CASH FROM INVESTING ACTIVITIES            |           |            |           |
| Acquisition of oil and gas properties     | -         | -          | -         |
| Acquisition of property and equipment     | (6,748)   | 152        | (20,770)  |
| Acquisition of equity security            | -         | -          | -         |
| -----                                     |           |            |           |
| NET CASH FLOWS FROM INVESTING ACTIVITIES  | (6,748)   | 152        | (20,770)  |
| CASH FROM FINANCING ACTIVITIES            |           |            |           |
| Proceeds from (payments to) notes payable |           |            |           |
| -related parties                          | -         | (214,139)  | -         |
| Proceeds from (payments to) notes payable | 80,000    | -          | (55,223)  |
| Net proceeds from convertible debt        | -         | -          | -         |
| Sales of common stock                     | 269,650   | 39,000     | 779,550   |
| Other                                     | -         | 266,521    | -         |
| -----                                     |           |            |           |
| NET CASH FLOWS FROM FINANCING ACTIVITIES  | 349,650   | 91,382     | 724,327   |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH   | (12,191)  | 11,512     | (17,672)  |
| NET CHANGE IN CASH                        | (4,130)   | 120,198    | (33,362)  |
| CASH AT BEGINNING OF PERIOD               | 9,514     | 614        | 38,746    |
| -----                                     |           |            |           |
| CASH AT END OF PERIOD                     | \$ 5,384  | \$ 120,812 | \$ 5,384  |
| =====                                     |           |            |           |

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

SYNERGY TECHNOLOGIES CORPORATION  
AND SUBSIDIARIES  
(A DEVELOPMENT STAGE COMPANY)  
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

| SHARES | AMOUNT | ADDITIONAL<br>PAID IN | ACCUMULATED<br>DEFICIT |
|--------|--------|-----------------------|------------------------|
|--------|--------|-----------------------|------------------------|

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|   | CAPITAL    |           |              |                |
|---|------------|-----------|--------------|----------------|
| BALANCE AT DECEMBER 31, 1999  | 11,989,327 | \$23,980  | \$ 1,484,455 | \$(2,958,385)  |
| Cancellation of founders shares   | (496,736)  | -         | -            | -              |
| Issuance of shares for cash   | 710,000    | 1,420     | 353,580      | -              |
| Issuance of shares for royalty  | 500,000    | 1,000     | 1,061,500    | -              |
| Issuance of stock options   | -          | -         | 981,330      | -              |
| Issuance of warrants for services<br>September 29, 2000                   | -          | -         | 343,744      | -              |
| Issuance of convertible debt  | -          | -         | 2,137,500    | -              |
| Issuance of shares from escrow  | 14,943,510 | 29,887    | 37,998,357   | -              |
| Warrants for stock, January through<br>December 2000                      | 431,000    | 862       | 430,138      | -              |
| Issuance of shares for services<br>February 16, 2000 at average<br>prices | 1,359,063  | 2,718     | 890,919      | -              |
| Options exercised   | 105,000    | 210       | 104,790      | -              |
| Unearned compensation   | -          | -         | -            | -              |
| Net loss for the period   | -          | -         | -            | (6,072,071)    |
| BALANCE AT DECEMBER 31, 2000  | 29,541,164 | \$60,077  | \$45,786,313 | \$(9,030,456)  |
| Warrants for stock -- debenture   | 1,000,000  | 2,000     | 998,000      | -              |
| Warrants for stock -- cash  | 264,000    | 528       | 263,472      | -              |
| Options exercised -- cash   | 5,500      | 11        | 5,489        | -              |
| Re-issue of founders shares   | 157,143    | 300       | 106,200      | -              |
| Issuance of stock options   | -          | -         | 120,000      | -              |
| Shares for services   | 893,154    | 1,786     | 858,443      | -              |
| Issuance of shares for cash   | 2,315,382  | 4,631     | 1,495,369    | -              |
| Unearned compensation   | -          | -         | -            | -              |
| Net loss for the period   | -          | -         | -            | (38,412,491)   |
| BALANCE AT DECEMBER 31, 2001  | 34,176,343 | \$ 69,333 | \$49,633,286 | \$(47,442,947) |
| Issuance of shares for cash   | 1,039,400  | 2,078     | 777,472      | -              |
| Shares for services   | 1,295,244  | 2,591     | 692,702      | -              |
| Shares for debt   | 2,504,966  | 5,010     | 1,514,415    | -              |
| Shares for technology acquisition   | 4,291,334  | 8,583     | 3,081,177    | -              |
| Re-issue of founders shares   | 50,000     | 100       | 38,400       | -              |
| Shares for financing services   | 424,041    | 848       | 173,009      | -              |
| Issuance of warrants  | -          | -         | 40,500       | -              |
| Unearned compensation   | -          | -         | -            | -              |
| Conversion inducement   | -          | -         | 888,548      | -              |
| Net loss for the period   | -          | -         | -            | (3,484,831)    |
| BALANCE AT JUNE 30, 2002  | 43,781,328 | \$ 88,543 | \$56,839,509 | \$(50,927,778) |

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

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SYNERGY TECHNOLOGIES CORPORATION AND SUBSIDIARIES  
(A DEVELOPMENT STAGE COMPANY)  
NOTES TO AUDITED CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

All dollar amounts used herein refer to U.S. dollars unless otherwise indicated.

These statements are prepared using Generally Accepted Accounting Principals as well as the terms outlined or explained in the year end 10-KSB filing.

All significant transactions between the parent and consolidated affiliates have been eliminated. The consolidated quarterly financial statements are unaudited. These statements include all adjustments (consisting of normal recurring accruals) considered necessary by management to present a fair statement of the results of operations, financial position and cash flows. The results reported in these consolidated financial statements should not be regarded as necessarily indicative of results that may be expected for the entire year.

## NOTE 2 - UNCERTAINTY ABOUT THE COMPANY'S ABILITY TO CONTINUE AS A GOING CONCERN

The Company is in the development stage and has not realized any revenues, has incurred losses and had negative cash flows from operations in the first six months of 2002 and each year since its inception. The Company's efforts have been focused on the development of its technologies and raising capital necessary to finance its development and administrative activities. To date, a substantial portion of its activities have been paid for by the issuance of common shares, options and warrants.

Synergy's business is the development and licensing of technologies related to the oil and gas industry. Synergy's efforts are directed to the commercial application of technologies in two areas:

1. technologies for the conversion of stranded natural gas into synthetic naphtha and diesel (GTL), including Syngen, a cold plasma technology to produce hydrogen rich streams from natural gas, gasoline and diesel; and
2. technologies for the upgrading of heavy oil to lighter oils (CPJ).

### Uncertainty Regarding Future Operations

The conditions described above raise substantial doubt about the ability of the Company to continue as a going concern. These financial statements have been prepared on the going concern basis, which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course, which would require the raising of additional capital sufficient to finance its development activities and administrative costs. However, there can be no assurance that the Company will be able to raise the necessary additional capital or successfully complete the development of its technologies. If these assumptions were determined to no longer be appropriate, the going concern basis would no longer be appropriate and the assets and liabilities would be adjusted to their liquidation values.



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### NOTE 3 - INVESTMENTS, ACQUISITIONS AND TECHNOLOGY DEVELOPMENT

Investments reported on the Consolidated Balance Sheet of the Company include the following:

|   | JUNE 30,<br>2002 | DE |
|---|------------------|----|
|   |                  |    |
| Investment in SynGen Technology (See Note 3(a) below) | \$ 3,500,000     | \$ |
| Investment in CPJ Technology (See Note 3(b) below)    | 5,064,099        |    |
| Investment in private U.S. corporation                | -                |    |
|   | \$ 8,564,099     | \$ |
|   |                  |    |

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- (a) SynGen: There were no changes during the current year.
- (b) CPJ: During the quarter ended March 31, 2002, Synergy entered into an agreement with Texas T Petroleum Ltd. (Texas T), Capital Reserve Corporation, Carbon Resources Limited (Carbon) and Pierre Jorgensen to purchase the remaining 50% of Carbon from Texas T. The details of this agreement are as follows:
- 1) Texas T transferred to Synergy all of its right, title and interest in and to the Carbon stock.
  - 2) Synergy issued to Texas T 400,000 shares common stock of Synergy.
  - 3) Synergy also issued in the name of Texas T 1,900,000 common shares of Synergy and delivered the stock to an escrow agent to be held pursuant to an escrow agreement.

Under the terms of an agreement entered into September 2000 to renegotiate the terms of the royalty agreement, the Corporation and Texas T had each issued shares to Mr. Jorgenson together with a commitment to make up the difference between the proceeds received on the sale of shares and \$1 million. As at December 31, 2001 the Corporation had accrued \$370,000 for its share of the shortfall between the value of the shares and \$500,000. In connection with the acquisition of the additional shares of Carbon, the Corporation assumed the remaining 50% of this obligation to Mr. Jorgenson, agreed to an increase in the minimum value to \$1,100,000, and issued an additional 1,491,334 shares to Mr. Jorgenson for settlement of this obligation. Shares issued to Mr. Jorgenson in excess of those required to achieve the committed resale proceeds of \$1,100,000 will be returned to the Corporation. A value of \$1,073,760 was attributed to this transaction based on the five-day average share price of \$0.72 per share. An

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additional 500,000 shares were issued in order to replace the 500,000 Capital Reserve Corporation shares that were returned to Texas T pursuant to the purchase agreement. A value of \$360,000 was attributed to this transaction based on a five-day average share price of \$0.72 per share.

This transaction closed on March 5, 2002. Up to that date the investment in Carbon was recorded using the equity method. From the closing date forward Carbon has been recorded using the consolidation method. The investment in private US corporation at December 31, 2001 was eliminated upon the closing of this agreement.

There were no changes during the current quarter.

(c) Investment in Drake Synergy Petroleum as at June 30, 2002:

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|   |          |        |
|---|----------|--------|
| o Shares of Drake Synergy Petroleum Ltd.            |          |        |
| 2,500,000 shares valued at Naira 1.00 per share     | 22,104   |        |
| o Advances to Drake Synergy Petroleum               | 121,813  |        |
| o 50% of net liabilities of Drake Synergy Petroleum | (84,197) |        |
|   |          | <hr/>  |
|   | \$       | 59,720 |

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### NOTE 4 - RELATED PARTY TRANSACTIONS

- a) During the quarter ended June 30, 2002, the Company was charged \$13,500 for consulting services by Huntingtown Associates LLC (a Connecticut corporation) of which Mr. Baumert is the sole proprietor and a member of the Company's Board of Directors. Huntingtown Associates charges consulting services provided by Mr. Baumert at a rate of \$1,500 per day plus expenses. At June 30, 2002 an amount of \$24,131 remained due and payable to Huntingtown Associates.
- b) During the quarter ended June 30, 2002, various officers and directors subscribed to a private placement offering as described in Note 8(a) in the amount of \$392,317 for 26.2 units.

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### NOTE 5 - RECEIVABLES

Certain expenses for services rendered and supplies acquired in Canada are subject to a federal Goods and Services Tax of 7% which is refundable to the Company in Canadian Dollars upon filing of a GST return. Total receivables include a GST refund due to the Company of \$4,543, as well as \$20,000 that is due from Mr. Barry Coffey by August 2002.

### NOTE 6 - CURRENT LIABILITIES

- (a) Accrued expenses: In connection with the acquisition by the Company in the first quarter of 2002 of the remaining 50% of the shares of Carbon

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it did not own, the Company agreed to issue 1,491,334 common shares to Mr. Jorgenson for resale by him. In the event that Mr. Jorgenson realizes proceeds of \$1,100,000 from the sale of these shares as well as the sale of certain other shares previously issued by the Company to Mr. Jorgenson, he is required to return any unsold shares to the Company. In the event the sale of these shares and the shares previously issued results in proceeds of less than \$1,100,000, the Company will be required to issue additional shares sufficient for Mr. Jorgenson to realize total proceeds of \$1,100,000. At June 30, 2002, the Company recorded a liability of \$415,200 to Mr. Jorgensen because, based on the closing stock price on that date of \$0.38 per share, the value of the shares held by Mr. Jorgenson on that date was \$415,200 less than our remaining obligation to Mr. Jorgenson.

- (b) Notes payable: As of July 29, 2002, holders of notes in the amount of \$1,035,000, exclusive of accrued interest, have agreed to exchange their notes for stock and warrants (Note 8(h)); holders of notes in the amount of \$210,000, exclusive of accrued interest, have elected not to exchange their notes and request repayment; and holders of notes in the amount of \$1,005,000 (Note 7), exclusive of accrued interest, have elected to hold their notes and accrue interest at the rate of 10% per annum, payable quarterly. The terms of the notes being held are unaltered, and accordingly these amounts are shown as long-term liabilities (Note 7). The \$210,000 of Convertible Promissory note's whose holders have requested repayment are included in Notes Payable. These values are reflected in the statements as of June 30, 2002.

A short-term loan from a Company employee for \$80,000 was received during the quarter. This loan bears interest at the rate of Prime plus one percent per annum and is due by December 9, 2003.

- (c) Accrued interest on notes: Interest in the amount of \$250,173, related to the Convertible promissory notes, plus \$252, related to the Company employee loan, has been accrued to June 30, 2002.

### NOTE 7 - LONG TERM LIABILITIES

- (a) The \$1,005,000 of Convertible Promissory notes that have elected to hold their notes and accrue interest at the rate of 10% per annum, payable quarterly, are included in Notes Payable. Each note will mature five years from the date of the issuance.

### NOTE 8 - COMMON STOCK

- (a) Cash proceeds of \$269,650 were received during the second quarter for the purchase of 18 units at \$0.75 per unit pursuant to an offering that commenced November 2001. An additional \$83,325 of outstanding accounts payable were converted into 5.6 units during the three months ended June 30, 2002. Each unit consists of 20,000 shares of common stock and 10,000 warrants to purchase an additional share for \$0.72, exercisable at any time three years from June 2, 2002, the closing of the offering.

The exercise price of the warrants issued during the three months ended March 31, 2002 was adjusted to \$0.72 as per the terms of the revised offering memorandum.

Pursuant to the terms of a consulting agreement with Huntington Associates LLC, of which Duane Baumert, a director of Synergy, is the

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sole proprietor, Synergy issued 407,658 options to purchase shares of common stock in consideration of services rendered during 2001 in the amount of \$103,500, all as reported in the company's annual report on Form 10-KSB for the year ended December 31, 2001. Management has renegotiated the manner of the payment due under said consulting agreement so that the options the Company agreed to issue were cancelled and the outstanding amount due was applied to the purchase of the Company's securities offered in a private placement completed in June 2002. Specifically, the \$103,500 due to

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Huntingtown Associates under the consulting agreement was settled for 6.9 units of the Company's securities consisting of an aggregate of 138,000 shares of common stock and warrants to purchase 69,000 shares of common stock at a price of \$0.72 per share through June 1, 2005.

- (b) 213,209 shares were issued to certain firms for services provided to the Company. The shares are recorded in the Consolidated Statement of Operations as a General and administrative expense at the five-day average trading value of the stock on the date of execution of the settlement agreements. A value of \$128,669 is recorded in the statements relating to these transactions.
- (c) 140,000 shares were issued to a third party for assignment of patents related to the Company's sulfur related technologies. The shares are recorded as an expense under Technology development with a value of \$84,000 based on the five-day average share price of \$0.60.
- (d) 171,433 shares were issued to a third party for settlement of loans provided to the Company. A value of \$122,022 is recorded related to this transaction at \$0.71 per share. Included in this value is an expense of \$7,637 related to the premium paid on the principal amount of the converted debt.
- (e) 247,500 shares were issued to a certain investment firm for investor relation services. A value of \$101,475 was attributed to the shares based on a five-day average share price of \$0.41 per share.
- (f) On June 20, 2002, we entered into a common stock purchase agreement with Fusion Capital Fund II, LLC pursuant to which Fusion Capital agreed to purchase on each trading day during the term of the agreement, \$10,000 of our common stock or an aggregate of \$6.0 million. We may increase the amount Fusion must purchase per trading day as the market price of our common stock achieves certain predefined levels. The \$6.0 million of common stock is to be purchased over a 30-month period, subject to a six-month extension or earlier termination at our discretion. The purchase price of the shares of common stock will be equal to a price based upon the future market price of the common stock without any fixed discount to the market price. We have the right to set a minimum purchase price at any time; however, the purchase price cannot be less than \$0.30 without the consent of Fusion Capital. We issued 424,041 shares representing a commitment fee paid upon execution of the stock purchase agreement. A value of \$173,857 was attributed to the shares based on a five-day average share price of \$0.41 per share and is recorded as a General and administrative expense in the Consolidated Statement of Operations.
- (g) On January 3, 2002, we entered into a settlement agreement with John Gradek, our former Chief Executive Officer, which extinguished a

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lawsuit filed by Mr. Gradek against us on February 27, 2001. In that suit, Mr. Gradek claimed that Synergy breached its employment agreement with him by terminating him without cause and asserted that Synergy owed him his monthly salary of \$10,000 for 32 months plus paid vacation days and attorney fees of up to \$80,000. Pursuant to the settlement agreement, we agreed to (i) pay to Mr. Gradek the sum of \$100,000 in two installments of \$50,000 each, the first on or before February 1, 2002 which sum was paid and the second by May 1, 2002 which sum was paid, and (ii) issue to Mr. Gradek 150,000 shares of common stock. In addition, each party released the other from all actions or claims with respect to Mr. Gradek's employment with Synergy.

During the second quarter, founding shareholders transferred 60,000 shares to Mr. Gradek in partial settlement of the above mentioned agreement and the Company issued the remaining 90,000 shares from treasury. The shares were recorded as an expense in the financial statements during 2001 and had been carried as a liability during 2002.

- (h) Holders of notes in the amount of \$1,252,350, inclusive of accrued interest as of June 30, 2002, have agreed to exchange their notes into securities of the Company. For every \$3 of principal and interest accrued thereon the Company issued a new unit comprised of the following:
- o 5 shares of our common stock.
  - o 3 warrants, each entitling the holder to purchase 1 share of common stock at an exercise price of \$0.90 per share for a period of 5 years after the date of issue.

In exchange for the notes mentioned above, the Company issued 2,087,250 shares and 1,252,350 warrants during the quarter. The total amount of principal and interest has been removed from the liabilities and recorded in the equity section of the Balance Sheet. In addition, a value of \$888,548 has been recorded as an

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expense in the Consolidated Statement of Operations relating to the fair value of additional securities issued to induce conversion of debt.

- (i) 50,000 warrants were issued to a consulting firm for assistance in developing a business plan. These warrants have an exercise price of \$0.02 per share for a period of 5 years after the date of issue. An expense of \$34,000 is recorded in the General and administrative section based on the Black-Scholes option-pricing model with the following assumptions: dividend yield of 0.0%, expected volatility of 18.16%, interest rate of 4.25% and expected life of one year.
- (j) 100,000 warrants were issued to a consulting firm for serving as the placement agent for the private offering of Synergy securities. These warrants have an exercise price of \$0.90 per share for a period of 3 years after the date of issue. An expense of \$5,000 is recorded in the General and administrative section based on the Black-Scholes option-pricing model with the following assumptions: dividend yield of 0.0%, expected volatility of 18.16%, interest rate of 4.25% and expected life of one year.

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(k) On June 2, 2002, we entered into a consulting agreement with William R. Engles, Jr. to serve as our Chief Financial Officer. The agreement provides that Mr. Engles would furnish consulting services to Synergy consistent with the duties and responsibilities of a Chief Financial Officer. This agreement extends through September 2, 2002, as may be extended by mutual agreement of the parties. We have agreed to pay to Mr. Engles \$2,500 per week for his services. We shall also reimburse Mr. Engles for all out-of-pocket expenses associated with the work performed pursuant to this agreement. In addition, we have agreed to pay to Mr. Engles the equivalent of \$3,500 per week in shares of our common stock as shall be calculated by dividing said amount by the average of the closing price per share over the five trading days prior to the payment date. We also have agreed to grant to Mr. Engles options representing the right to purchase 100,000 shares of common stock at an exercise price of \$0.72 per share. The options shall vest at a pro rata rate over 13 weeks from June 3, 2002 and shall have a term of 10 years. We have agreed to register all shares issued to Mr. Engles pursuant to this agreement and all shares underlying his option for public resale under the Securities Act of 1933. An expense of \$1,500 is recorded in the General and administrative section based on the Black-Scholes option-pricing model with the following assumptions: dividend yield of 0.0%, expected volatility of 18.16%, interest rate of 4.25% and expected life of one year.

### WARRANTS

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The following table summarizes the warrants issued, exercised and expired during the six months ended June 30, 2002 and the fiscal year ended December 31, 2001 and those warrants which remain outstanding as at June 30, 2002:

|  |       |
|--|-------|
| Balance at December 31, 2000                                     |       |
| Warrants issued during 2001                                      |       |
| At \$1.30 per share  | 2,    |
| At \$3.00 per Unit   | 1,    |
| At \$3.50 per share  |       |
| Warrants expired unexercised during the period, \$1.00 per share | (1    |
|  | ----- |
| Warrants to purchase common shares, balance at December 31, 2001 | 4,    |
| Warrants issued during the six months ended June 30, 2002        |       |
| At \$1.00 per share  |       |
| At \$0.02 per share (Note 8(i))                                  |       |
| At \$0.72 per share (Note 8(a))                                  |       |
| At \$0.90 per share (Note 8(h)(j))                               | 1,    |
|  | ----- |
| Outstanding at June 30, 2002                                     | 6,    |
|  | ===== |

### STOCK OPTIONS

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The Company has six stock option plans outstanding. The 2002 Stock Option Plan was approved at the special meeting on February 18, 2002 authorizing a maximum of 10,000,000 options.

On June 2, 2002, the Company offered Mr. Engles options representing the right to purchase 100,000 shares of common stock at an exercise price of \$0.72 per share. The options shall vest at a pro rata rate over 13 weeks and shall have a term of 10 years. We have agreed to register all shares underlying his option for public resale under the Securities Act of 1933. A

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value of \$1,500 is recorded in the General and administrative section based on the Black-Scholes option-pricing model with the following assumptions: dividend yield of 0.0%, expected volatility of 18.16%, interest rate of 4.25% and expected life of one year.

On May 2, 2002, the Company offered Mr. Graham H. Batcheler a position on the Company's Board of Directors along with a grant of 200,000 options at an exercise price of \$1.00 per share which vest over a three-year period and are exercisable for ten years.

Options granted to employees and directors for their services as directors and employees are accounted for using the intrinsic value method. There was no value attributed to options granted during the quarter.

The following table summarizes the status of the Company's stock options as at June 30, 2002:

|   | SHARES    | WEIGHTED<br>AVERAGE<br>EXERCISE PRI |
|---|-----------|-------------------------------------|
|   |           |                                     |
| Outstanding at end of year, December 31, 2000     | 2,795,000 | \$ 1                                |
| Granted during 2001                               | 325,000   | 1                                   |
| Cancelled during 2001                             | (335,000) | 1                                   |
| Exercised during 2001                             | (5,500)   | 1                                   |
|   |           |                                     |
| Outstanding at end of year, December 31, 2001     | 2,779,500 | \$ 1                                |
| Granted during the six months ended June 30, 2002 | 4,800,000 | 0                                   |
|   |           |                                     |
| Outstanding at June 30, 2002                      | 7,579,500 | \$ 0                                |
|   |           |                                     |

### NOTE 9 - OTHER EVENTS

In July 2002, we agreed with Nielson & Associates, Inc., an oil and gas exploration and production company of which James Nielson, one of our directors is the principal shareholder, to establish a joint venture company to finance (or cause to be financed), build and operate an approximately 1,000 or greater barrel per day heavy oil upgrading facility or facilities in Wyoming and/or Montana. The Company agreed to license the CPJ technology to the joint venture

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company, and Nielson & Associates agreed to provide the oil well or wells and necessary land or lands for the facility or facilities to the joint venture company.

On July 9, 2002, Synergy completed a \$500,000 common stock private placement with one of the company's institutional shareholders. The fund purchased 1,246,884 restricted shares of Synergy common stock at \$.401 per share. As a result of the current and two earlier private placements with Synergy, this particular institutional shareholder has made an aggregate investment of \$1.75 million in Synergy and now controls 3,118,545 shares, or 6.9 percent, of the company's 45,028,212 outstanding common shares.

### NOTE 10 - COMMITMENTS AND CONTINGENCIES

(a) Operating Lease - Effective September 1, 2000 the Company entered into a five-year non-cancelable lease which provided for monthly lease payments, including operating costs, of \$19,171. Minimum future rental payments under this lease with remaining terms in excess of one year are as follows:

|      |         |
|------|---------|
| 2002 | 115,026 |
| 2003 | 230,052 |
| 2004 | 230,052 |
| 2005 | 153,368 |

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION.

We are addressing problems that historically have affected the petroleum and petrochemical industries. We offer these industries advanced technologies and processes by which oil and gas producers can economically enter markets which heretofore have been unattractive for reasons of production costs, end price, logistics or environmental issues.

Over the past several years, we have developed our technologies to the point where we believe they are ready for commercial application. In order to accelerate the commercialization of our technologies, we hired Barry Coffey in January 2002 as our Chief Executive Officer. Mr. Coffey has a wide range of management experience with a variety of companies, from large multinational corporations to start-up companies. Mr. Coffey has served as a member of our board of directors since January 2001. We intend to selectively hire additional seasoned managers who we believe can assist in bringing our technologies to market.

To date in 2002, our efforts to commercialize our technologies have yielded the memorandums of understandings described below:

- o In April 2002, we agreed with H-Power, a well-known manufacturer of fuel cells to explore the establishment of a joint-venture company to manufacture a fuel cell system using Synergy's fuel reforming process (SynGen) and H-Power's fuel cell. We have completed a joint research and development plan to develop the fuel cell system and are currently seeking financing to begin the development activities. If the development work is successful, then the companies could begin manufacturing and marketing products in 2003.



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- o In July 2002, we agreed with Nielson & Associates, Inc., an oil and gas exploration and production company of which James Nielson, one of our directors is the principal shareholder, to establish a joint venture company to finance (or cause to be financed), build and operate an approximately 1,000 or greater barrel per day heavy oil upgrading facility or facilities in Wyoming and/or Montana. The Company agreed to license the CPJ technology to the joint venture company, and Nielson & Associates agreed to provide the oil well or wells and necessary land or lands for the facility or facilities to the joint venture company.

We are currently in discussions with various potential partners with respect to our CPJ technology, SynGen/GTL process, and hydrogen reforming technology. However, there can be no assurance that any of these discussions will lead to meaningful business opportunities for us.

### Near-Term Goals (2002)

Our immediate goal is to raise sufficient capital to further develop our technologies and commercial opportunities. Specifically, we intend to enhance our new Conroe, Texas laboratory facilities, complete development of a multi-cluster reactor to demonstrate the commercial viability and scalability of our SynGen and SulfArc technologies, complete work on our hydrogen reforming systems for the petroleum, petrochemical and fuel cell industries, and continue to improve our patent position.

Our specific goals are summarized below. Our ability to achieve these goals is contingent upon our continued ability to raise capital to fund our operations:

- o Expand and secure existing patents and file patents to cover new developments;
- o Continue to develop and refine all of our technologies;
- o Form additional research and development partnerships with fuel cell manufacturers to develop a fuel cells based on SynGen technology;
- o Identify a refinery partner to begin on-site testing of our SulfArc technology;
- o Demonstrate the viability of a scaled-up SynGen multi-cluster reactor for transforming stranded gas to syngas and begin to build or license commercial-scale facilities; and
- o Secure a long-term gas supply contract to enable us to construct a GTL facility.

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### Intermediate-Term (2003 - 2004)

Building on our near-term initiatives, our intermediate-term goals include:

- o Complete arrangements with an industry partner for the siting, design, engineering and construction of a commercial CPJ plant capable of producing

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1,000 bpd to 5,000 bpd of light synthetic crude. We believe our best chance for success in this area is with a co-development and marketing arrangement with a North, Central or South American heavy oil producer or pipeline operator.

- o Attract development and pre-production funds in partnership with additional established fuel cell systems designers and manufacturers from government or industry sources that require inexpensive, reliable, relatively sulfur free, hydrogen or carbon monoxide as fuel.
- o Complete negotiations with a large gas producer to develop a gas-to-liquids plant using our proprietary process for converting gas to liquids.

### LIQUIDITY AND CAPITAL RESOURCES

#### Summary of Working Capital and Stockholders' Equity

At June 30, 2002, we had negative working capital of \$1,677,744 and positive stockholders' equity of \$6,000,274 compared with negative working capital of \$3,594,542 and positive stockholders' equity of \$2,245,793 as of December 31, 2001. For the three-month period ended June 30, 2002, our stockholders' equity increased primarily due to the issuance of shares related to the conversion of promissory notes. For the three-months ended June 30, 2002, cash flows from operating activities were negative \$334,841, compared with positive \$17,152 for the three months ended June 30, 2001, cash flows from investing activities were negative \$6,748 compared with positive \$152, and cash flows provided by financing activities were \$349,650 compared with \$91,382 over the same periods.

#### Convertible Debentures

During June and July 2000, we sold and issued five-year promissory notes to certain persons in the aggregate principal amount of \$2,250,000 bearing interest at the rate of 10% per annum. These promissory notes provide, among other things, that on the second anniversary of their issuance, holders may demand prepayment of the principal amount of the notes and interest accrued through such date. During June 2002, we offered note holders the opportunity to exchange each \$3 of principal and interest accrued on the notes into five shares of common stock and warrants to purchase three shares of common stock at a price of \$0.90 per share. As of the date hereof, holders of notes in the amount of \$1,252,350, inclusive of accrued interest, have agreed to exchange their notes; holders of notes in the principal amount of \$254,100, inclusive of accrued interest, have elected not to exchange their notes and have requested repayment; and holders of notes in the amount of \$1,216,050, inclusive of accrued interest, have elected to hold their notes and collect interest on the principal, which, at the two-year anniversary of these notes aggregated \$211,050. We do not currently have sufficient funds to satisfy our obligations with respect to principal and interest currently payable to those holders who have elected to request repayment of their notes and with respect to interest currently payable to those holders who have elected to hold their notes. In the event we are unsuccessful in raising additional capital or negotiating a deferred payment plan with the note holders, we will not be able to meet these obligations.

#### Financing Activities

During the three months ended June 20, 2002, our primary financing activities included:

- o On June 2, 2002 we completed an offering of units consisting, in the aggregate, of 1,288,500 shares of common stock and

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warrants to purchase an additional 644,250 shares of our common stock at \$0.72 per share. We received total gross proceeds from the offering of \$966,375. The offering commenced in

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November 2001 and we received offering proceeds over the period the offering was open. We used the proceeds from this offering for working capital and general corporate purposes.

- o On July 9, 2002, we completed an offering of 1,246,884 shares of our common stock at a price of \$0.401 per share, which resulted in gross proceeds to the Company of \$500,000.

On June 20, 2002, we entered into a common stock purchase agreement with Fusion Capital Fund II, LLC pursuant to which Fusion Capital agreed to purchase on each trading day during the term of the agreement, \$10,000 of our common stock or an aggregate of \$6.0 million. We may increase the amount purchased per trading day if the market price of our common stock achieves certain pre-defined levels. The \$6.0 million of common stock is to be purchased over a 30-month period, subject to a six-month extension or earlier termination at our discretion. The purchase price of the shares of common stock will be equal to a price based upon the future market price of the common stock without any fixed discount to the market price. However, Fusion Capital is not obligated to purchase our stock in the event that purchase price is below \$0.30. Consequently, the amount and timing of proceeds to the company under the Fusion agreement, including whether we will receive any proceeds at all under the stock purchase agreement, is uncertain. Upon execution of the common stock purchase agreement, we issued 424,041 shares of our common stock to Fusion Capital as a commitment fee, in reliance upon an exemption from registration provided by Section 4(2) of the Securities Act.

The Company's ability to execute its plan significantly depends on its ability to raise additional funds from sources other than operations and under the Fusion stock purchase agreement. The Company's future liquidity and capital requirements will depend on a number of factors, including its ability to raise additional capital in a timely manner through additional investment and its ability to generate market interest in its technologies.

We expect that we will require up to \$20 million over the next three years to fully implement our business plan, which includes significant marketing efforts, the continued development of the technologies, expansion of management resources, support of day-to-day operations and the pursuit of commercialization efforts. In the past, we have been successful raising money to fund our operations through the sale of debt and equity securities. However, we cannot be sure that the additional capital we may need to finance our future operations will be available on acceptable terms, if at all. If we are unable to secure financing on acceptable terms, we may be forced to modify our business plan. In addition, we cannot be sure that we will be able to realize revenues from our technologies or that we will achieve profitability.

### FORWARD-LOOKING STATEMENTS

Our company and its representatives may from time to time make written or verbal forward-looking statements, including statements contained in this report and other Company filings with the Securities and Exchange Commission and in our reports to shareholders. Statements that relate to other than strictly

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historical facts, such as statements about our plans and strategies, expectations for future financial performance, new and existing products and technologies, and markets for our products are forward-looking statements. Generally, the words "believe," "expect," "intend," "estimate," "anticipate," "will" and other similar expressions identify forward-looking statements. The forward-looking statements are and will be based on our management's then-current views and assumptions regarding future events and operating performance, and speak only as of their dates. Investors are cautioned that such statements involve risks and uncertainties that could cause actual results to differ materially from historical or anticipated results due to many factors including, but not limited to, our company's limited revenues, accumulated deficit, future capital needs, uncertainty of capital funding, dependence on limited product line, uncertainty of market acceptance, competition, limited marketing and manufacturing experience, and other risks detailed in our company's most recent Annual Report on Form 10-KSB and other Securities and Exchange Commission filings. We undertake no obligation to publicly update or revise any forward-looking statements.

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### PART II -- OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS.

N/A

#### ITEM 2. CHANGES IN SECURITIES.

(a) N/A

(b) N/A

(c) Recent Sales of Unregistered Securities; Use of Proceeds from Registered Securities

On June 1, 2002, the Company issued 90,000 shares of Common Stock to John Gradek pursuant to terms of a settlement agreement between the parties dated January 3, 2002, as reported in the Company's annual report on Form 10-KSB for the year ended December 31, 2001. The Company issued the shares pursuant to Rule 4(2) of the Securities Act of 1933.

On June 20, 2002, the Company entered into a common stock purchase agreement with an investment fund, Fusion Capital II, LLC (Fusion Capital) for the issuance and purchase of our common stock. Under the agreement, Fusion Capital committed up to \$6 million to purchase shares of the Company's Common Stock over a thirty-month period that commences upon the effectiveness of a registration statement that the Company filed with the U.S. Securities and Exchange Commission for the underlying shares on July 26, 2002. The agreement also establishes an equity line of credit or equity draw-down facility. Once during each draw-down pricing period, the Company could request a draw, subject to a daily base amount, currently set at \$10,000. The number of shares the Company will issue to Fusion Capital in return for that money is based on the lower of (a) the closing sale price for our common stock on the day of the draw request or (b) the average of the three lowest closing sales prices during a twelve day period prior to the draw request. No shares may be sold to Fusion Capital at lower than a floor price currently set at \$0.50, but in no case below \$0.30 without Fusion Capital's prior consent. Upon execution of the common stock purchase agreement, the Company issued 424,041 shares of Common Stock to Fusion

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Capital as a commitment fee, in reliance upon an exemption from registration provided by Section 4(2) of the Securities Act.

On June 12, 2002, the Company issued 2,087,250 shares of common stock and warrants to purchase up to 1,252,350 shares of common stock upon the exchange of certain outstanding promissory notes in the aggregate principal amount of \$1,035,000 plus accrued interest of \$217,350. The Company issued these securities to 13 accredited investors (as such term is defined in Rule 501 of Regulation D promulgated under the Securities Act of 1933) pursuant to the exemption from the registration provisions of the Securities Act afforded by Section 3(a)(9). The Company did not generate any proceeds from this offering.

On June 2, 2002, Synergy completed a private placement of 1,288,500 shares of common stock and warrants to purchase an additional 644,250 shares of common at an exercise price of \$0.72 per share until June 1, 2005 pursuant to Rule 506 of Regulation D promulgated by the SEC under the Securities Act of 1933. The offering was made and sold to accredited investors (as such term is defined in Rule 501 of Regulation D promulgated under the Securities Act) to 15 persons. The Company raised an aggregate of \$966,375. Synergy paid no commissions in connection with the placement of these securities. The Company used the proceeds derived from this offering for working capital and general corporate purposes.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

N/A

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

On July 24, 2002, Synergy held its Annual General Meeting. At this meeting, the following directors were elected: Mr. Barry J. Coffey; Mr. Thomas E. Cooley; Mr. Graham H. Batcheler, Mr. Duane F. Baumert; Mr. Cameron Haworth; Mr. James E. Nielson, and Mr. James Shone.

At the meeting, the shareholders voted on each of the following matters:

- appointment of KPMG, LLP as independent auditors of Synergy;
- to elect Directors for the year end; and set the number of members of the Board of Directors at seven.

There were 30,603,916 shares represented at the meeting, representing a majority of the 39,203,477 outstanding shares, either by shareholders attending in person or by proxy. The votes for each of the matters at this meeting were as follows:

| Item                                   | Votes for  | Votes Against | Vot |
|--|------------|---------------|-----|
| 1. Appointment of Auditors             | 30,506,441 | 72,875        |     |
| 2. Election of Directors<br>Mr. Coffey | 27,736,108 | -             |     |

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|               |            |   |
|---------------|------------|---|
| Mr. Cooley    | 27,781,983 | - |
| Mr. Batcheler | 27,736,108 | - |
| Mr. Baumert   | 27,781,983 | - |
| Mr. Haworth   | 27,736,108 | - |
| Mr. Nielson   | 27,781,983 | - |
| Mr. Shone     | 27,736,108 | - |