

Edgar Filing: CIRTRAN CORP - Form 10QSB

CIRTRAN CORP
Form 10QSB
August 19, 2004

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

FORM 10-QSB

(Mark One)

/ X / QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2004

OR

/ / 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 0-26059

CIRTRAN CORPORATION

(Exact name of registrant as specified in its charter)

Nevada

(State or other jurisdiction of
incorporation or organization)

68-0121636

(I.R.S. Employer Identification No)

4125 South 6000 West
West Valley City, Utah

(Address of Principal Executive Offices)

84128

(Zip Code)

(801) 963-5112
(Registrant's telephone number)

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 proceeding 12 months and (2) has been subject to such filing requirements
for the past 90 days. Yes X No

The number of shares outstanding of the registrant's common stock as of August
18, 2004: 411,123,012.

Transitional Small Business Disclosure Format (check one): Yes _____ NO X
--

Edgar Filing: CIRTRAN CORP - Form 10QSB

Table of Contents

	Page
PART I - FINANCIAL INFORMATION	
Item 1 Condensed Consolidated Financial Statements	
Balance Sheets as of June 30, 2004, (unaudited) and December 31, 2003	3
Statements of Operations for the Three ended June 30, 2004, (unaudited) and 2003 (unaudited)	4
Statements of Cash Flows for the Three Months ended June 30, 2004, (unaudited) and 2003 (unaudited)	5
Notes to Condensed Consolidated Financial Statements (unaudited)	7
Item 2 Management's Discussion and Analysis of or Plan of Operation	17
Item 3 Evaluation of Controls and Procedures	21
PART II - OTHER INFORMATION	
Item 1 Legal Proceedings	22
Item 2 Changes in Securities	27
Item 6 Exhibits and Reports on Form 8-K	28
Signatures	28

CIRTRAN CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

CIRTRAN CORPORATION AND SUBSIDIARY
CONSOLIDATED BANANCE SHEETS

	June 30, 2004	December 31, 2003
ASSETS		
Current Assets		

Edgar Filing: CIRTRAN CORP - Form 10QSB

Cash and cash equivalents	\$	35,089	\$	54,1
Trade accounts receivable, net of allowance for doubtful accounts of \$28,876		1,038,259		89,1
Inventory		1,590,014		1,247,4
Other		179,334		165,0
		-----		-----
Total Current Assets		2,842,696		1,555,8
		-----		-----
Property and Equipment, Net		704,198		577,6
Investment in Securities at Cost		300,000		
Other Assets, Net		13,247		10,3
Deferred Offering Costs		96,000		26,0
		-----		-----
Total Assets	\$	3,956,141	\$	2,169,8
		-----		-----
LIABILITIES AND STOCKHOLDERS' DEFICIT				
Current Liabilities				
Checks written in excess of cash in bank	\$	-	\$	9,6
Accounts payable		944,159		1,300,5
Accrued liabilities		3,886,477		3,615,2
Current maturities of long-term notes payable		2,731,199		1,964,0
Notes payable to stockholders		86		31,8
Notes payable to related parties		409,256		163,7
		-----		-----
Total Current Liabilities		7,971,177		7,085,0
		-----		-----
Long-Term Notes Payable, Less Current Maturities		-		
		-----		-----
Commitments and Contingencies				
Stockholders' Deficit				
Common stock, par value \$0.001; authorized 750,000,000 shares; issued and outstanding shares: 411,123,012 and 349,087,699 net of 3,000,000 shares held in treasury at no cost at March 31, 2004 and December 31, 2003, respectively		411,123		349,0
Additional paid-in capital		14,660,707		12,876,9
Accumulated deficit		(19,086,866)		(18,141,2
		-----		-----
Total Stockholders' Deficit		(4,015,036)		(4,915,2
		-----		-----
Total Liabilities and Stockholders' Deficit	\$	3,956,141	\$	2,169,8
		-----		-----

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

Edgar Filing: CIRTRAN CORP - Form 10QSB

CIRTRAN CORPORATION AND SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2004	2003	2004	2003
Net Sales	\$ 1,924,242	\$ 416,762	\$ 2,603,604	\$ 686,536
Cost of Sales	(1,562,788)	(271,211)	(1,996,547)	(456,927)
Gross Profit	361,454	145,551	607,057	229,609
Operating Expenses				
Selling, general and administrative expenses	650,759	559,545	1,364,576	1,115,099
Non-cash employee compensation expense	45,000	-	78,750	72,500
Total Operating Expenses	695,759	559,545	1,443,326	1,187,599
Loss From Operations	(334,305)	(413,994)	(836,269)	(957,990)
Other Income (Expense)				
Interest	(233,031)	(138,284)	(314,593)	(249,027)
Other, net	(61)	-	(157)	-
Gain on forgiveness of debt	205,433	-	205,433	-
Total Other Expense, Net	(27,659)	(138,284)	(109,317)	(249,027)
Net Loss	\$ (361,964)	\$ (552,278)	\$ (945,586)	\$ (1,207,017)
Basic and diluted loss per common share	\$ (0.00)	\$ (0.00)	\$ (0.00)	\$ (0.00)
Basic and diluted weighted-average common shares outstanding	402,089,809	256,305,246	387,597,854	253,676,241

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

Edgar Filing: CIRTRAN CORP - Form 10QSB

CIRTRAN CORPORATION AND SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

For the Six Months Ended June 30,	200

Cash flows from operating activities	
Net loss	\$ (945,58)
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization	116,22
Loss on disposal of equipment	2,30
Gain on forgiveness of debt	(205,43)
Non-cash compensation expense	
Settlement expense	60,00
Loan costs and interest paid from loan proceeds	145,00
Options exercised in lieu of board compensation	78,75
Options issued to attorneys and consultants for services	143,60
Changes in assets and liabilities:	
Trade accounts receivable	(949,07)
Inventories	(342,58)
Prepaid expenses and other assets	(17,10)
Accounts payable	355,45
Accrued liabilities	427,14

Total adjustments	(185,70)

Net cash used in operating activities	(1,131,29)

Cash flows from investing activities	
Purchase of investment	(300,00)
Purchase of property and equipment	(245,12)

Net cash used in investing activities	(545,12)

Cash flows from financing activities	
Change in checks written in excess of cash in bank	(9,62)
Payments for deferred offering costs	
Proceeds from notes payable to stockholders	
Payments on notes payable to stockholders	(31,75)
Proceeds from notes payable, net of cash paid for offering costs	2,927,00
Principal payments on notes payable	(290,50)
Proceeds from notes payable to related parties	1,895,23
Payment on notes payable to related parties	(2,913,43)
Proceeds from exercise of options and warrants to purchase common stock	80,00
Exercise of options issued to attorneys and consultants for services	45

Net cash provided by financing activities	1,657,37

Edgar Filing: CIRTRAN CORP - Form 10QSB

Net increase in cash and cash equivalents	(19,04)
Cash and cash equivalents at beginning of year	54,13

Cash and cash equivalents at end of year	\$ 35,08

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

F-4

CIRTRAN CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) (CONTINUED)

For the Six Months Ended June 30,	200

Supplemental disclosure of cash flow information	
Cash paid during the period for interest	\$ 59,26
Noncash investing and financing activities	
Notes issued for accounts payable and capital lease obligations	\$ 711,89
Common stock issued for settlement of note payable	\$ 30,00
Common stock issuance in which proceeds were retained as payment of notes payable	\$ 1,450,00
Common stock issued for accrued compensation	\$
Accrued interest converted to notes payable	\$ 9,16
Stock options exercised for settlement of accrued interest and accrued compensation	\$ 61,00
Note issued for settlement of notes payable and accrued interest	\$ 551,81
Fees withheld from notes payable for Equity Line Agreement	\$ 58,00
Deferred offering costs withheld from notes payable proceeds	\$ 128,00

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

F-5

CIRTRAN CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Edgar Filing: CIRTRAN CORP - Form 10QSB

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Condensed Financial Statements -- The accompanying unaudited condensed consolidated financial statements include the accounts of CirTran Corporation and its subsidiaries (the "Company"). These financial statements are condensed and, therefore, do not include all disclosures normally required by accounting principles generally accepted in the United States of America. These statements should be read in conjunction with the Company's annual financial statements included in the Company's Annual Report on Form 10-KSB/A. In particular, the Company's significant accounting principles were presented as Note 1 to the consolidated financial statements in that Report. In the opinion of management, all adjustments necessary for a fair presentation have been included in the accompanying condensed consolidated financial statements and consist of only normal recurring adjustments. The results of operations presented in the accompanying condensed consolidated financial statements for the three and six months ended June 30, 2004, are not necessarily indicative of the results that may be expected for the full year ending December 31, 2004.

Principles of Consolidation -- In June 2004, the Company incorporated CirTran-Asia, Inc., a Utah corporation, as a wholly owned subsidiary. CirTran-Asia was formed to manufacture, either directly or through foreign subcontractors, certain products under an exclusive manufacturing agreement. Other such agreements will be sought in the future.

The condensed consolidated financial statements include the accounts of CirTran Corporation, and its wholly owned subsidiaries, Racore Technology Corporation and CirTran-Asia Inc. All significant intercompany transactions have been eliminated in consolidation.

Stock-Based Compensation -- At June 30, 2004, the Company has one stock-based employee compensation plan, which is described more fully in Note 8. The Company accounts for the plan under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, ("APB 25") and related interpretations. During the six months ended June 30, 2004 and 2003, the Company recognized compensation expense relating to stock options and warrants of \$78,750 and \$72,500, respectively. The following table illustrates the effect on net loss and basic and diluted loss per common share as if the Company had applied the fair value recognition provisions of Financial Accounting Standards Board ("FASB") Statement No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation:

	Three Months Ended June 30,		
	2004	2003	
Net loss, as reported	\$ (361,964)	\$ (552,278)	\$ (9)
Add: Stock-based employee compensation expense included in net loss	45,000	-	
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	(168,993)	57,863	(3)
Pro forma net loss	\$ (485,957)	\$ (494,415)	\$ (1,1)

Edgar Filing: CIRTRAN CORP - Form 10QSB

	-----	-----	-----
Basic and diluted loss per common share as reported	\$ (0.00)	\$ (0.00)	\$
	-----	-----	-----
Basic and diluted loss per common share pro forma	\$ (0.00)	\$ (0.00)	\$
	-----	-----	-----

NOTE 2 - REALIZATION OF ASSETS

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of

6

America, which contemplate continuation of the Company as a going concern. However, the Company sustained losses of \$945,586 and \$2,910,978 for the six months ended June 30, 2004 and the year ended December 31, 2003, respectively. As of June 30, 2004 and December 31, 2003, the Company had an accumulated deficit of \$19,086,866 and \$18,141,280, respectively, and a total stockholders' deficit of \$4,015,036 and \$4,915,251, respectively. In addition, the Company used, rather than provided, cash in its operations in the amounts of \$1,131,294 and \$1,123,818 for the six months ended June 30, 2004, and the year ended December 31, 2003, respectively.

Since February of 2000, the Company has operated without a line of credit. Many of the Company's vendors stopped credit sales of components used by the Company to manufacture products, and as a result, the Company converted certain of its turnkey customers to customers that provide consigned components to the Company for production. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

In addition, the Company is a defendant in numerous legal actions (see Note 5). These matters may have a material impact on the Company's financial position, although no assurance can be given regarding the effect of these matters in the future.

In view of the matters described in the preceding paragraphs, recoverability of a major portion of the recorded asset amounts shown in the accompanying consolidated balance sheets is dependent upon continued operations of the Company, which in turn is dependent upon the Company's ability to meet its financing requirements on a continuing basis, to maintain or replace present financing, to acquire additional capital from investors, and to succeed in its future operations. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence.

Abacas Ventures, Inc. ("Abacas") purchased the Company's line of credit from the lender. During 2002, the Company entered into agreements whereby the Company has issued common stock to certain principals of Abacas in exchange for a portion of the debt. The Company's plans include working with vendors to convert trade payables into long-term notes payable and common stock, and to cure defaults with lenders through forbearance agreements that the Company will be able to service. During the six months ended June 30, 2004, and the year ended December 31, 2003, the Company successfully converted trade payables, notes payable, and accrued interest of approximately \$1,263,713 and \$2,986, respectively, into

Edgar Filing: CIRTRAN CORP - Form 10QSB

notes. Accrued interest of \$27,020 associated with the notes payable was not converted to the note payable with Abacus; therefore, a gain on forgiveness of debt was recorded for \$27,020 for the six months ended June 30, 2004. The Company intends to continue to pursue this type of debt conversion going forward with other creditors. As discussed in Note 7, the Company has entered into an equity line of credit agreement with a private investor. Realization of additional proceeds under the equity line of credit is not assured.

NOTE 3 - INVESTMENT IN SECURITIES AT COST

On April 13, 2004, the Company entered into a stock purchase agreement with an unrelated party under which the Company purchased 400,000 shares of the investee's Series B Preferred Stock (the "Preferred Shares") for an aggregate purchase price of \$300,000 cash. This purchase was made at fair value. The Preferred Shares are convertible, at the Company's option, into an equivalent number of shares of investee common stock, subject to adjustment. The Preferred Shares are not redeemable by the investee. As a holder of the Preferred Shares, the Company has the right to vote the number of shares of investee common stock

7

into which the Preferred Shares are convertible at the time of the vote. The investment represents less than a 5% interest in the investee.

Separate from the purchase of the Preferred Shares, the Company and the investee also entered into a Preferred Manufacturing Agreement. Under this agreement, the Company will perform exclusive "turn-key" manufacturing services handling most of the investee's manufacturing operations from material procurement to complete finished box-build of all of investee products. The initial term of the agreement is three years, continuing month to month thereafter unless terminated by either party.

NOTE 4 - RELATED PARTY TRANSACTIONS

Stockholder Notes Payable -- The Company had amounts due to stockholders from two separate notes. The balance due to stockholders at June 30, 2004, and December 31, 2003, was \$86 and \$31,838, respectively. Interest associated with amounts due to stockholders is accrued at 10 percent. Unpaid accrued interest was \$7,178 and \$6,900 at June 30, 2004, and December 31, 2003, respectively, and is included in accrued liabilities. These notes are due on demand.

Related Party Notes Payable -- The Company had amounts due to Abacas Ventures, Inc., a related party, under the terms of a note payable and a bridge loan.

During 2002, the Company entered into a bridge loan agreement with Abacas. This agreement allows the Company to request funds from Abacas to finance the build-up of inventory relating to specific sales. The loan bears interest at 24% and is payable on demand. There are no required monthly payments. During the six months ended June 30, 2004, and the year ended December 31, 2003, the Company was advanced \$3,158,946 and \$350,000, respectively, and made cash payments of \$2,913,431 and \$875,000, respectively, for an outstanding balance on the bridge loan of \$409,256 and \$163,742, respectively.

The balance due to Abacas related to the note payable was paid in full at December 31, 2002. The note accrued interest at 10%. The amounts owed were due on demand with no required monthly payments. This note was collateralized by assets of the Company.

The total principal amount owed to Abacas between the note payable and the bridge loan was \$409,256 and \$163,742 as of March 31, 2004, and December 31,

Edgar Filing: CIRTRAN CORP - Form 10QSB

2003, respectively. The total accrued interest owed to Abacas between the note payable and the bridge loan was \$325,916 and \$230,484 as of June 30, 2004, and December 31, 2003, respectively, and is included in accrued liabilities.

NOTE 5 - COMMITMENTS AND CONTINGENCIES

Settlement of Litigation -- During January 2002, the Company settled a lawsuit that had alleged a breach of facilities sublease agreement involving facilities located in Colorado. The Company's liability in this action was originally estimated to range up to \$2.5 million. The Company had filed a counter suit in the same court for an amount exceeding \$500,000 for missing equipment.

Effective January 18, 2002, the Company entered into a settlement agreement which required the Company to pay the plaintiff the sum of \$250,000. Of this amount, \$25,000 was paid upon execution of the settlement, and the balance, together with interest at 8% per annum, was payable by July 18, 2002. As security for payment of the balance, the Company executed and delivered to the plaintiff a Confession of Judgment and also issued 3,000,000 shares of common stock, which are currently held in escrow and have been treated as treasury stock recorded at no cost. The fair value of the 3,000,000 shares was less than the carrying amount of the note payable. Because 75 percent of the balance had

8

not been paid by May 18, 2002, the Company was required to prepare and file with the Securities & Exchange Commission, at its own expense, a registration statement with respect to the escrowed shares. The remaining balance has not been paid, and the registration statement with respect to the escrowed shares has not been declared effective and the Company has not replaced the escrowed shares with registered free-trading shares pursuant to the terms of the settlement agreement; therefore, the plaintiff filed the Confession of Judgment and proceeded with execution thereon. The Company is currently negotiating with the plaintiff to settle this obligation without the release of the shares held in escrow.

In connection with a separate sublease agreement of these facilities, the Company received a settlement from the sublessee during May 2002, in the amount of \$152,500, which has been recorded as other income. The Company did not receive cash from this settlement, but certain obligations of the Company were paid directly. \$109,125 of the principal balance of the note related to the settlement mentioned above was paid. Also, \$7,000 was paid to the Company's legal counsel as a retainer for future services. The remaining \$36,375 was paid to the above mentioned plaintiff as a settlement of rent expense.

During September 2002, the plaintiff filed a claim that the \$109,125 portion of the payment was to be applied as additional rent expense rather than a principal payment on the note payable. The Company estimates that the probability of the \$109,125 being considered additional rent expense is remote and disputes the claim. The Company intends to vigorously defend the action.

On April 14, 2004 an unrelated party filed a claim against the Company alleging that the Company stopped paying amounts due under a note entered into in June 1998. The suit seeks \$90,500 plus fees and costs. During May 2004, the Company settled this claim by issuing 1,000,000 shares of common which resulted in a settlement expense of \$60,000.

Litigation - During 2000, the Company settled a lawsuit filed by a vendor by issuing 5,281,050 shares of the Company's common stock valued at \$324,284, paying \$83,000 in cash and issuing two notes payable totaling \$239,000. During 2002, the vendor filed a confession of judgement claiming that the Company

Edgar Filing: CIRTRAN CORP - Form 10QSB

defaulted on its agreement and claims the 2000 lawsuit was not properly satisfied. At December 31, 2003, the Company owed \$60,133 of principal under the terms of the remaining note payable. The Company denies the vendor's claims and intends to vigorously defend itself against the confession of judgement.

During 2003, an investment firm filed suit in the U.S. District Court, District of Utah seeking finders fees, consisting of common stock valued at \$350,000 for allegedly introducing the Company to the Equity Line Investor. The case was previously dismissed in a New York court. The Company estimates that the risk of loss is remote, therefore no accrual has been made.

In December 1999, a vendor of the Company filed a lawsuit that alleges breach of contract and seeks payment in the amount of approximately \$213,000 of punitive damages from the Company related to the Company's non-payment for materials provided by the vendor. Judgment was entered against the Company in May 2002 in the amount of \$213,718. During 2004, this claim was purchased by Abacus and recorded as an increase to the amount owed to Abacus under the terms of the bridge loan.

During October 1999, a former vendor of the Company brought action against the Company alleging that the Company owed approximately \$199,600 for materials and services and pursuant to the terms of a promissory note. The Company entered a settlement agreement under which the Company is to pay \$6,256 each month until the obligation and interest thereon are paid. This did not represent the forgiveness of any obligation, but rather the restructuring of the terms of the previous agreement. At December 31, 2003, the Company owed \$183,429 for this

9

settlement. The Company has defaulted on its payment obligations under the settlement agreement. During 2004, this claim was purchased by Abacus and recorded as an increase to the amount owed to Abacus under the terms of the bridge loan.

Judgment was entered in favor of a vendor during March 2002, in the amount of \$181,342 for nonpayment of costs of goods or services provided to the Company. At December 31, 2003, the Company had accrued the entire amount of the claim. During 2004, this claim was purchased by Abacus and recorded as an increase to the amount owed to Abacus under the terms of the bridge loan.

In December 1999, a vendor of the Company filed a lawsuit that seeks payment in the amount of \$44,269 for the cost of goods provided to the Company. The Company admits owing certain amounts to the vendor and has accrued the entire amount claimed as of December 31, 2003. During 2004, this claim was purchased by Abacus and recorded as an increase to the amount owed to Abacus under the terms of the bridge loan.

During 2002, a vendor of the Company filed a lawsuit that seeks payment in the amount of \$31,745 for the cost of goods provided to the Company. The Company has accrued the entire amount claimed. No trial date has been set. During 2004, this claim was purchased by Abacus and recorded as an increase to the amount owed to Abacus under the terms of the bridge loan.

An individual filed suit during January 2001, seeking to recover the principal sum of \$135,941, plus interest on a promissory note. During 2004, this claim was purchased by Abacus and recorded as an increase to the amount owed to Abacus under the terms of the bridge loan.

During March 2000, a vendor brought suit against the Company under allegations that the Company owed approximately \$97,000 for the cost of goods or services

Edgar Filing: CIRTRAN CORP - Form 10QSB

provided to the Company for the Company's use and benefit. The Company issued a note payable to the vendor in settlement of the amount owed and is required to pay the vendor \$1,972 each month until paid. At December 31, 2003, the Company owed \$87,632 on this settlement agreement. During 2004, this claim was purchased by Abacus and recorded as an increase to the amount owed to Abacus under the terms of the bridge loan.

A financial institution brought suit against the Company during February 2000, alleging that the Company owed approximately \$439,000 for a loan provided to the Company for the Company's use and benefit. Judgment was entered against the Company and certain guarantors in the amount of \$427,292 plus interest at the rate of 8.61% per annum from June 27, 2000. The Company has made payments to the financial institution, reducing the obligation to \$215,516 at December 31, 2003, plus interest accruing from January 1, 2002. The Company has settled this claim in full as discussed in Note 5.

Suit was brought against the Company during April 2001, by a former shareholder alleging that the Company owed \$121,825 under the terms of a promissory note. A Stipulation for Settlement and for Entry of Judgment was executed by the parties wherein the Company agreed to arrange for payment of a principal amount of \$145,000 in 48 monthly installments. The Company made seven payments and then failed to make subsequent payments, at which time the shareholder obtained a consent judgment against the Company. The Company is currently in settlement negotiations with the former shareholder regarding the judgment.

Various vendors have notified the Company that they believe they have claims against the Company totaling \$127,236. None of these vendors have filed lawsuits in relation to these claims. The Company has accrued the entire amount of these claims and it is included in accounts payable.

10

The Company is the defendant in numerous legal actions, primarily resulting from nonpayment of vendor invoices for goods and services received, that it has determined the probability of realizing any loss is remote. The total amount of these legal actions is \$102,447. The Company has made no accrual for the legal actions and is currently in the process of negotiating the dismissal of these claims with the various vendors.

The Company is also the defendant in numerous immaterial legal actions primarily resulting from nonpayment of vendors for goods and services received. The Company has accrued the payables and is currently in the process of negotiating settlements with these vendors.

Registration Rights - In connection with the conversion of certain debt to equity during 2000, the Company has granted the holders of 5,281,050 shares of common stock the right to include 50% of the common stock of the holders in any registration of common stock of the Company, under the Securities Act for offer to sell to the public (subject to certain exceptions). The Company has also agreed to keep any filed registration statement effective for a period of 180 days at its own expense.

Additionally, in connection with the Company's entering into an Equity Line of Credit Agreement (described in Note 6), the Company granted to the equity line investor (the "Equity Line Investor") registration rights, in connection with which the Company is required to file a registration statement covering the resale of shares put to the Equity Line Investor under the equity line. The Company is also required to keep the registration statement effective until two years following the date of the last advance under the equity line. The Company has not yet filed such registration statement.

Edgar Filing: CIRTRAN CORP - Form 10QSB

Accrued Payroll Tax Liabilities -- As of June 30, 2004, the Company had accrued liabilities in the amount of \$2,125,183 for delinquent payroll taxes, including interest estimated at \$437,042 and penalties estimated at \$230,927. Of this amount, approximately \$308,847 was due the State of Utah. During 2002, the Company negotiated a monthly payment schedule of \$4,000 to the State of Utah, which did not provide for the forgiveness of any taxes, penalties or interest. Approximately \$1,805,397 was owed to the Internal Revenue Service as of June 30, 2004. During 2002, the Company negotiated a payment schedule with respect to this amount, pursuant to which monthly payments of \$25,000 were required. The Company is currently renegotiating the terms of the payment schedule with the Internal Revenue Service. Approximately \$10,939 was owed to the State of Colorado as of June 30, 2004.

NOTE 6 - NOTES PAYABLE

In March 2004, the Company settled a note payable with a financial institution. The outstanding loan balance and accrued interest at the time of settlement was \$189,663. The balance was settled for \$90,000 in cash and 542,495 shares of common stock valued at \$30,000. A gain on forgiveness of debt of \$61,370 was recorded on this transaction.

In April 2004, the Company settled three notes payable with a financing company. The outstanding loan balances and accrued interest at the time of settlement was \$192,043. The balance was settled for \$75,000 in cash. A gain on forgiveness of debt of \$117,043 was recorded on this transaction.

Notes Payable to Equity Line Investor -- At December 31, 2003, the Company owed \$650,000 to Cornell Capital Partners, LP, pursuant to prior unsecured promissory notes. During the six months ended June 30, 2004, the Company borrowed an additional \$3,200,000 from Cornell, pursuant to four additional unsecured promissory notes. In lieu of interest, the Company paid fees at closing of 4% to

11

5% of the loan amount to an affiliate of the lender. These fees have been recorded as interest expense. The fees were negotiated in each instance and agreed upon by the Company and by the lender and its affiliate. The notes were repayable over periods ranging from 88 days to 193 days. Each of the notes stated that if the Company did not repay the notes when due, a default interest rate of 24% would apply to the unpaid balance. Through June 30, 2004, the Company directed the repayment of \$1,450,000 of these notes from proceeds generated under the Amended Equity Line Agreement, discussed in Note 7 below. At June 30, 2004, the balance owing on these notes was \$2,400,000 and the Company had not incurred the 24% penalty interest rate.

NOTE 7 - STOCKHOLDER'S EQUITY

Common Stock Issuance -- As discussed in Note 6, the Company issued 542,495 shares of common stock valued at \$30,000 as part of a settlement agreement for a note payable.

As discussed in Note 5, during May 2004, the Company settled a legal claim by issuing 1,000,000 shares of common which resulted in a settlement expense of \$60,000.

Equity Line of Credit Agreement - In conjunction with efforts to improve the results of operations, discussed above, on November 5, 2002, the Company entered into an Equity Line of Credit Agreement with Cornell Capital Partners, LP, a private investor ("Cornell"). The Company subsequently terminated the original Equity Line of Credit Agreement, and on April 8, 2003, the Company entered into

Edgar Filing: CIRTRAN CORP - Form 10QSB

an amended equity line agreement (the "Equity Line Agreement") with Cornell. Under the Equity Line Agreement, the Company has the right to draw up to \$5,000,000 from Cornell against an equity line of credit (the "Equity Line"), and to put to Cornell shares of the Company's common stock in lieu of repayment of the draw. The number of shares to be issued is determined by dividing the amount of the draw by the lowest closing bid price of our common stock over the five trading days after the advance notice is tendered. Cornell is required under the Equity Line Agreement to tender the funds requested by the Company within two trading days after the five-trading-day period used to determine the market price.

During the six months ended June 30, 2004, the Company drew an aggregate amount of \$1,450,000 under the Equity Line Agreement, pursuant to draws on the equity line, net of fees of \$58,000, and issued a total of 43,542,818 shares of common stock to Cornell under the Equity Line Agreement. At the Company's direction, Cornell retained the proceeds of the draws under the Equity Line Agreement and applied them as payments on the notes to Cornell, discussed in Note 6 above.

Pursuant to the Equity Line Agreement, in connection with each draw the Company agreed to pay a fee of 4% of the amount of the draw to Cornell as consideration for its providing the Equity Line. Total fees paid for the six months ended June 30, 2004 were \$128,000. Of these payments, \$32,000 was offset against additional paid-in capital as shares were issued under the Equity Line Agreement and \$96,000 was classified as deferred offering costs at June 30, 2004. These deferred offering costs will be offset against additional paid-in capital as shares are issued under the Equity Line Agreement subsequent to June 30, 2004.

From January 1, 2004 through August 18, 2004, the Company drew an aggregate of \$2,150,000 under the Equity Line Agreement, net of deferred offering costs of \$86,000 and issued 57,464,386 shares of common stock to Cornell under the Equity Line Agreement. At the Company's direction, Cornell has applied the proceeds of the draws under the Equity Line Agreement as payments on the notes to Cornell, discussed in Note 6 above.

12

NOTE 8 - STOCK OPTIONS AND WARRANTS

Stock-Based Compensation - The Company accounts for stock options issued to directors, officers and employees under APB No. 25 and related interpretations. Under APB 25, compensation expense is recognized if an option's exercise price on the measurement date is below the fair value of the Company's common stock. For options that provide for cashless exercise or that have been modified, the measurement date is considered the date the options are exercised or expire. Those options are accounted for as variable options with compensation adjusted each period based on the difference between the market value of the common stock and the exercise price of the options at the end of the period. The Company accounts for options and warrants issued to non-employees at their fair value in accordance with Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123").

Stock Option Plan - During February 2003, the Company adopted the 2002 Stock Option Plan (the "2002 Plan") with 25,000,000 shares of common stock reserved for issuance there under. Also, during November 2003, the Company adopted the 2003 Stock Option Plan (the "2003 Plan") with 35,000,000 shares of common stock reserved for issuance there under. The Company's Board of Directors administers the plans and has discretion in determining the employees, directors, independent contractors and advisors who receive awards, the type of awards

Edgar Filing: CIRTRAN CORP - Form 10QSB

(stock, incentive stock options or non-qualified stock options) granted, and the term, vesting, and exercise prices.

Non-Employee Grants - During the six months ended June 30, 2004, the Company granted options to purchase 4,000,000 shares of common stock to attorneys for services at exercise prices of \$0.0001 per share. The options were all five year options and vested on the dates granted. The weighted average fair value of the options on the grant dates was \$0.048, which resulted in a fair value of \$143,701 which reduced the amount owed for prior services provided. The attorneys exercised the 4,000,000 options for cash proceeds of \$400. An additional 500,000 of previously issued options were exercised for cash proceeds of \$50.

Employee Grants - During the six months ended June 30, 2004, the Company granted options to purchase 13,200,000 shares of common stock to directors and employees of the Company pursuant to the 2003 Plan. These options are five year options that vested on the date of grant. The related exercise prices range from \$0.01 to \$0.03 per share. 12,450,000 of these options were exercised during the six months ended June 30, 2004 for \$80,000 of cash, \$78,750 of compensation and \$61,000 of accrued compensation.

13

A summary of the stock option activity for the six months ended June 30, 2004, is as follows:

	Shares	Weighted Average Exercise Price
Outstanding at December 31, 2003	3,850,500	\$ 0.02
Granted	17,200,000	\$ 0.01
Exercised	(16,950,000)	\$ 0.01
Cancelled	-	-
Outstanding at June 30, 2004	4,100,500	\$ 0.03
Excercisable at June 30, 2004	4,100,500	\$ 0.03

The fair value of stock options was determined at the grant dates using the Black-Scholes option-pricing model with the following weighted-average assumptions for the six months ended June 30, 2004:

	2004
Expected dividend yield	-
Risk free interest rate	3.25%
Expected volatility	216%
Expected life	.07 years
Weighted average fair value per share	\$ 0.02

14

Edgar Filing: CIRTRAN CORP - Form 10QSB

NOTE 9 -SEGMENT INFORMATION

Segment information has been prepared in accordance with SFAS No. 131, "Disclosure About Segments of an Enterprise and Related Information." The Company has three reportable segments: electronics assembly, Ethernet technology, and contract manufacturing. The electronics assembly segment manufactures and assembles circuit boards and electronic component cables. The Ethernet technology segment designs and manufactures Ethernet cards. The contract manufacturing segment manufactures, either directly or through foreign subcontractors, certain products under an exclusive manufacturing agreement. The accounting policies of the segments are consistent with those described in the summary of significant accounting policies. The Company evaluates performance of each segment based on earnings or loss from operations. Selected segment information is as follows:

	Electronics Assembly	Ethernet Technology	Contract Manufacturing
June 30, 2004			
Sales to external customers	\$ 1,594,976	\$ 42,816	\$
Intersegment sales	11,325	167	
Segment loss	(553,362)	(123,166)	
Segment assets	3,653,509	206,677	
Depreciation and amortization	115,069	1,159	

June 30, 2003			
Sales to external customers	\$ 552,442	\$ 134,094	\$
Intersegment sales	52,242	-	
Segment loss	(1,128,351)	(78,666)	
Segment assets	2,259,617	243,254	
Depreciation and amortization	154,354	2,800	

	June 30,	
Sales	2004	2003
Total sales for reportable segments	\$ 2,615,096	\$ 738,778
Elimination of intersegment sales	(11,492)	(52,242)
Consolidated net sales	\$ 2,603,604	\$ 686,536

	June 30,	
Total Assets	2004	2003

Edgar Filing: CIRTRAN CORP - Form 10QSB

Total assets for reportable segments	\$ 3,956,141	\$ 2,502,871	
Adjustment for intersegment amounts	-	-	
	-----	-----	
Consolidated total assets	\$ 3,956,141	\$ 2,502,871	
	-----	-----	

15

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

This discussion should be read in conjunction with Managements' Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-KSB/A for the year ended December 31, 2003.

Overview

We provide a mixture of high- and medium volume turnkey manufacturing services using surface mount technology, ball-grid array assembly, pin-through-hole and custom injection molded cabling for leading electronics original equipment manufactures ("OEMs") in the communications, networking, peripherals, gaming, law enforcement, consumer products, telecommunications, automotive, medical, and semiconductor industries. Our services include pre-manufacturing, manufacturing, and post-manufacturing services. Through our subsidiary, Racore Technology Corporation, we design and manufacture Ethernet technology products. Our goal is to offer customers the significant competitive advantages that can be obtained from manufacture outsourcing, such as access to advanced manufacturing technologies, shortened product time-to-market, reduced cost of production, more effective asset utilization, improved inventory management, and increased purchasing power.

During 2004, we have established a new division, CirTran-Asia, Inc., which has contributed to a large portion of the increase in revenue for the three months ended June 30, 2004. This new division CirTran-Asia is our Asian-based wholly-owned subsidiary of CirTran Corporation and provides a myriad of manufacturing services to the direct response and retail consumer markets. Our experience and expertise in manufacturing enables CirTran-Asia to enter a project at any phase; engineering and design, product development and prototyping, tooling, and hi-volume manufacturing.

CirTran has established a dedicated satellite office for CirTran-Asia, and has retained Mr. Charles Ho to lead the new division. Having proven the value and reliability of its core products, CirTran Corporation has chosen to expand into previously untapped product lines. CirTran-Asia will pursue manufacturing relationships beyond printed circuit board assemblies, cables, harnesses and injection molding systems by establishing complete "box-build" or "turn-key" relationships in the electronics, retail and direct consumer markets.

We have been preparing for more than a year for this strategic move into the

Edgar Filing: CIRTRAN CORP - Form 10QSB

Asian market. Management anticipates that this new division will elevate CirTran to an international contract manufacturer status of multiple products in a wide variety of industries, and will, in short order, allow us to target large-scale contracts. We anticipate that our new clients will be leading manufacturing and marketing firms in the retail and direct consumer markets.

Significant Accounting Policies

Financial Reporting Release No. 60, which was recently released by the Securities and Exchange Commission, requires all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. Note 1 of the Notes to the Financial Statements contained in our Annual Report on form 10-KSB/A includes a summary of the significant accounting policies and methods used in the preparation of our Financial Statements. The following is a brief discussion of the more significant accounting policies and methods used by us.

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. These principles require us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Estimated amounts may differ under different assumptions or conditions, and actual results could differ from the estimates.

Revenue Recognition

Revenue is recognized when products are shipped. Title passes to the customer or independent sales representative at the time of shipment. Returns for defective items are repaired and sent back to the customer. Historically, expenses experienced with such returns have not been significant and have been recognized as incurred.

Inventories

Inventories are stated at the lower of average cost or market value. Costs include labor, material, and overhead costs. Overhead costs are based on indirect costs allocated among cost of sales, work-in-process inventory, and finished goods inventory. Indirect overhead costs have been charged to cost of sales or capitalized as inventory based on management's estimate of the benefit of indirect manufacturing costs to the manufacturing process.

16

When there is evidence that the inventory's value is less than original cost, the inventory is reduced to market value. The Company determines market value on current resale amounts and whether technological obsolescence exists. The Company has agreements with most of its customers that require the customer to purchase inventory items related to their contracts in the event that the contracts are cancelled. The market value of related inventory is based upon those agreements. The Company typically orders inventory on a customer-by-customer basis. In doing so the Company enters into binding agreements that the customer will purchase any excess inventory after all orders are complete. Almost 80% of the total inventory is secured by these agreements.

Checks Written in Excess of Cash in Bank

Historically, banks have temporarily lent funds to us by paying out more funds

Edgar Filing: CIRTRAN CORP - Form 10QSB

than were in our accounts, under existing lines of credit with those banks. Subsequent to May 2000, when Abacas purchased our line of credit obligation, the Company no longer had lines of credit with banks, and those loans were no longer available or made to us. The Company acquired an equity line of credit effective as of June of 2003, described more fully under "Liquidity and Financing Arrangements."

Under our cash management system, checks issued but not presented to banks frequently result in overdraft balances for accounting purposes. These overdrafts are included as a current liability in the balance sheets.

Related Party Transactions

Certain transactions involving Abacas Ventures, Inc., the Saliba Private Annuity Trust and the Saliba Living Trust are regarded as related party transactions under FAS 57. Disclosure concerning these transactions is set out in this Item 6 under "Liquidity and Capital Resources - Liquidity and Financing Arrangements," and in "Item 5 - Other Information."

Results of Operations - Comparison of Periods Ended June 30, 2004 and 2003

Sales and Cost of Sales

Net sales increased to \$1,924,242 for the three-month period ended June 30, 2004, as compared to \$416,762 during the same period in 2003 for an increase of 361.7%. The second quarter sales increase can be attributed to several factors, including the strengthening of the overall market economy. Industry-wide, we are seeing more OEMs release larger order commitments with extended time tables. The second significant factor directly related to CirTran is our marketing approach. Most contract manufacturers approach customers on a job-by-job basis. CirTran approaches customers on a partner basis. We have developed a program where we can be more effective when we control the material procurement, purchasing, and final assembly, providing the customer a final quality product delivered on time and at a lower market cost. And the biggest factor is establishing a new division CirTran-Asia, which has contributed to a large portion of the increase in revenue. This new division CirTran-Asia, is our Asian based wholly-owned subsidiary of CirTran Corporation provides a myriad of manufacturing services to the Direct Response and Retail consumer markets. Our vast experience and expertise in manufacturing enables CirTran-Asia to enter a project at any phase; Engineering and Design, Product Development and Prototyping, Tooling, Hi-Volume Manufacturing etc.. Cost of sales increased by 476.2%, from \$271,211 during the three-month period ended June 30, 2003, to \$1,562,788 during the same period in 2004. The increase in cost of sale is due to increase in revenue. Our gross profit margin for the three-month period ended June 30, 2004, was 18.8%, down

17

from 34.9% for the same period in 2003. The decrease is due to the increase of cost of sales for CirTran-Asia sales that have smaller gross margin.

Inventory

We use just-in-time manufacturing, which is a production technique that minimizes work-in-process inventory and manufacturing cycle time, while enabling us to deliver products to customers in the quantities and time frame required. This manufacturing technique requires us to maintain an inventory of component parts to meet customer orders. Inventory at June 30, 2004, was \$1,590,014, as compared to \$1,247,248 at December 31, 2003. The increase in inventory is required to facilitate the increase in turnkey sales.

Edgar Filing: CIRTRAN CORP - Form 10QSB

Selling, General and Administrative Expenses

During the quarter ended June 30, 2004, selling, general and administrative expenses were \$650,759 versus \$559,545 for the same period in 2003, a 16.3% increase. The increase was due to a \$315,000 increase in our acquisition and organizational costs in starting up CirTran-Asia division, along with our efforts to aggressively market our products during a period of economic downturn. Selling, general and administrative expenses as a percentage of sales as of June 30, 2004 were 33.8% as compared to 134.3% during the same period in 2003. This decrease is due in part to an increase in sales and better management of expenses.

Interest Expense

Interest expense for quarter ended June 30, 2004, was \$233,031 as compared to \$138,284 for the same period in 2003, an increase of 68.5%. The increase is primarily due to interest expense related to notes payable to the Equity Line Investor. As of June 30, 2004, and December 31, 2003, the amount of our liability for delinquent state and federal payroll taxes and estimated penalties and interest thereon was \$2,125,183 and \$2,107,930, respectively.

As a result of the above factors, our overall net loss decreased 34.5% to \$361,964 for the quarter ended June 30, 2004, as compared to \$552,278 for the quarter ended June 30, 2003. This decrease was in part attributed to a substantial increase in sales and better cost controls.

Liquidity and Capital Resources

Our expenses are currently greater than our revenues. We have had a history of losses, and our accumulated deficit was \$19,086,866 at June 30, 2004, and \$18,141,280 at December 31, 2003. Our net operating loss for the quarter ending June 30, 2004, was \$361,964, compared to \$552,278 for the quarter ended June 30, 2003. Our current liabilities exceeded our current assets by \$5,128,208 as of June 30, 2004, and \$5,529,244 as of December 31, 2003. The decrease was mostly attributable to decreasing account payables, and in increase in accounts receivable and inventory. For the six months ended June 30, 2004 and 2003, we had negative cash flows from operations of \$1,131,294 and \$370,588, respectively.

Cash

We had cash on hand of \$35,089 at June 30, 2004, and \$54,135 at December 31, 2003.

Net cash used in operating activities was \$1,131,294 for the six months ended June 30, 2004. During six months ended June 30, 2004, net cash used in operations was primarily attributable to \$945,586 in net losses from operations and an increase in accounts receivable of \$949,072, partially offset by increases in accrued liabilities and accounts payable of \$427,143 and \$355,456,

respectively. The non-cash charges were for depreciation and amortization of \$166,228 and loan costs and interest paid from loan proceeds of \$145,000.

Net cash used in investing activities during the six months ended June 30, 2004, consisted of equipment purchases of \$245,128 and a purchase of investment securities I the amount of \$300,000.

Edgar Filing: CIRTRAN CORP - Form 10QSB

Net cash provided by financing activities was \$1,657,376 during the six months ended June 30, 2004. Principal sources of cash were proceeds of \$1,895,233 from notes payable to related parties, proceeds from notes payable of \$2,927,000, and proceeds from the exercise of options to purchase common stock of \$80,000. These proceeds were offset by principal payments on notes payable to related parties in the amount of \$2,913,432.

Accounts Receivable

At June 30, 2004, we had receivables of \$1,038,259, net of a reserve for doubtful accounts of \$28,876, as compared to \$89,187 at December 31, 2003, net of a reserve of \$28,876. This increase was primarily attributed to sales having substantially increased in the last month of the second quarter as compared to the last two months in 2003.

Accounts Payable

Accounts payable were \$944,159 at June 30, 2004, as compared to \$1,300,597 at December 31, 2003. This decrease is primarily attributed to conversions of accounts payable to notes payable in relation to settlements made by Abacas Ventures.

Liquidity and Financing Arrangements

We have a history of substantial losses from operations and using rather than providing cash in operations. We had an accumulated deficit of \$19,086,866 and a total stockholders' deficit of \$3,956,141 at June 30, 2004. As of June 30, 2004, our monthly operating costs and interest expenses averaged approximately \$280,000 per month.

Significant amounts of additional cash will be needed to reduce our debt and fund our losses until such time as we are able to become profitable. At June 30, 2004, we were in default of notes payable whose principal amount, not including the amount owing to Abacas Ventures, Inc., was approximately \$320,000. In addition, the principal amount of notes that either mature in 2004 or are payable on demand was approximately \$2,410,000.

In conjunction with our efforts to improve our results of operations, discussed above, we are also actively seeking infusions of capital from investors and are seeking to replace our operating line of credit. It is unlikely that we will be able, in our current financial condition, to obtain additional debt financing; and if we did acquire more debt, we would have to devote additional cash flow to paying the debt and securing the debt with assets. We may therefore have to rely on equity financing to meet our anticipated capital needs. There can be no assurances that we will be successful in obtaining such capital. If we issue additional shares for debt and/or equity, this will dilute the value of our common stock and existing shareholders' positions.

Subsequent to our acquisition of Circuit in July 2000, we took steps to increase the marketability of our shares of common stock and to make an investment in our company by potential investors more attractive. These efforts consisted primarily of seeking to become current in our filings with the Securities and Exchange Commission and of seeking approval for quotation of our stock on the NASD Over the Counter Electronic Bulletin Board. NASD approval for quotation of our stock on the Over the Counter Electronic Bulletin Board was obtained in July 2002.

Edgar Filing: CIRTRAN CORP - Form 10QSB

Notes Payable to Equity Line Investor -- At December 31, 2003, we owed \$650,000 to Cornell Capital Partners, LP, pursuant to prior unsecured promissory notes. During the six months ended June 30, 2004, we borrowed an additional \$3,200,000 from Cornell, pursuant to four additional unsecured promissory notes. In lieu of interest, we paid fees at closing of 5% of the loan amount to an affiliate of the lender. These fees have been recorded as interest expense. The fees were negotiated in each instance and agreed upon by us and by the lender and its affiliate. The notes were repayable over periods ranging from 88 days to 193 days. Each of the notes stated that if we did not repay the notes when due, a default interest rate of 24% would apply to the unpaid balance. Through June 30, 2004, we directed the repayment of \$1,450,000 of these notes from proceeds generated under the Equity Line Agreement, discussed below. At June 30, 2004, the balance owing on these notes was \$2,400,000. All notes were paid when due or before, and at no time did we incur the 24% penalty interest rate.

There can be no assurance that we will be successful in obtaining more debt and/or equity financing in the future or that our results of operations will materially improve in either the short- or the long-term. If we fail to obtain such financing and improve our results of operations, we will be unable to meet our obligations as they become due. That would raise substantial doubt about our ability to continue as a going concern.

In conjunction with efforts to improve the results of our operations, discussed above, on November 5, 2002, we entered into an Equity Line of Credit Agreement with Cornell Capital Partners, LP, a private investor ("Cornell"). We subsequently terminated that agreement, and on April 8, 2003, we entered into an amended equity line agreement (the "Equity Line Agreement") with Cornell. Under the Equity Line Agreement, we have the right to draw up to \$5,000,000 from Cornell against an equity line of credit (the "Equity Line"), and to put to Cornell shares of our common stock in lieu of repayment of the draw. The number of shares to be issued is determined by dividing the amount of the draw by the lowest closing bid price of our common stock over the five trading days after the advance notice is tendered. Cornell is required under the Equity Line Agreement to tender the funds requested by us within two trading days after the five-trading-day period used to determine the market price.

During the three months ended June 30, 2004, we drew an aggregate amount of \$800,000 under the Equity Line Agreement, pursuant to draws on the Equity Line, net of fees of \$32,000, and issued a total of 13,467,303 shares of common stock to Cornell under the Equity Line Agreement. At our direction, Cornell retained the proceeds of the draws under the Equity Line Agreement and applied them as payments on the notes to Cornell, discussed above.

Pursuant to the Equity Line Agreement, in connection with each draw, we agreed to pay a fee of 4% of the amount of the draw to Cornell as consideration for its providing the Equity Line. Total fees paid for the three months ended June 30, 2004 were \$68,000. Of these payments, \$32,000 was offset against additional paid-in capital as shares were issued under the Equity Line Agreement and \$36,000 was recorded as deferred offering costs for total deferred offering costs of \$96,000 at June 30, 2004. These deferred offering costs will be offset against additional paid-in capital as shares are issued under the Equity Line Agreement subsequent to June 30, 2004.

From January 1, 2004 through August 18, 2004, we drew an aggregate of \$2,150,000 under the Equity Line Agreement, net of deferred offering costs of \$86,000 and issued 57,464,386 shares of common stock to Cornell under the Equity Line Agreement. At our direction, Cornell has applied the proceeds of the draws under the Equity Line Agreement as payments on the notes to Cornell, discussed above.

Forward-looking statements

All statements made in this report, other than statements of historical fact, which address activities, actions, goals, prospects, or new developments that we expect or anticipate will or may occur in the future, including such things as expansion and growth of operations and other such matters, are forward-looking statements. Any one or a combination of factors could materially affect our operations and financial condition. These factors include competitive pressures, success or failure of marketing programs, changes in pricing and availability of parts inventory, creditor actions, and conditions in the capital markets. Forward-looking statements made by us are based on knowledge of our business and the environment in which we currently operate. Because of the factors listed above, as well as other factors beyond our control, actual results may differ from those in the forward-looking statements.

Item 3. Evaluation of Disclosure Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures. The Company's chief executive officer and chief financial officer, after evaluating the effectiveness of the Company's "disclosure controls and procedures" (as defined in the Securities Exchange Act of 1934, Rules 13a-14(c) and 15-d-14(c)) as of the end of the period covered by this report (the "Evaluation Date"), have concluded that, as of the Evaluation Date, the Company's disclosure controls and procedures were adequate and designed to ensure that material information relating to the Company and its consolidated subsidiaries would be made known to them by others within those entities.

(b) Changes in Internal Controls. There were no significant changes in the Company's internal controls, or, to the Company's knowledge, in other factors that could significantly affect these controls subsequent to the Evaluation Date.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

As of June 30, 2004, the Company had accrued liabilities in the amount of \$2,125,183 for delinquent payroll taxes, including interest estimated at \$437,042 and penalties estimated at \$230,927. Of this amount, approximately \$308,847 was due the State of Utah. During the first quarter of 2003, no payments were made to the State of Utah. During the third and fourth quarter of 2003, partial payments were made to the State of Utah. Approximately \$1,805,397 was owed to the Internal Revenue Service as of December 31, 2003. The Company, in response to collection notices, filed a due process appeal with the Internal Revenue Service's Appeals Office. The appeal was resolved by an agreement with the Appeals Office that allowed the Company to file an offer in compromise of all federal tax liabilities owed by the Company based on its ability to pay. The Company filed its offer in compromise with the IRS, and the IRS is in the process of reviewing the offer. Further, the Utah State Tax Commission has entered into an agreement to allow the Company to pay the liability owing to the State of Utah in equal monthly installments over an extended period of time, yet to be determined. Approximately \$10,939 was owed to the State of Colorado as of June 30, 2004.

We (as successor to Circuit Technology, Inc.) were a defendant in an action in El Paso County, Colorado District Court, brought by Sunborne XII, LLC, a Colorado limited liability company, for alleged breach of a sublease agreement

Edgar Filing: CIRTRAN CORP - Form 10QSB

involving facilities located in Colorado. Effective January 18, 2002, we entered into a settlement agreement with Sunborne with respect to the above-described litigation. The settlement agreement required us to pay Sunborne the sum of

21

\$250,000. Of this amount, \$25,000 was paid upon execution of the agreement, and the balance of \$225,000, together with interest at 8% per annum, was payable by July 18, 2002. As security for payment of the balance, we executed and delivered to Sunborne a Confession of Judgment and also issued to Sunborne 3,000,000 shares of our common stock, which are held in escrow and have been treated as treasury stock recorded at no cost. Because 75% of the balance owing under the agreement was not paid by May 18, 2002, we were required to prepare and file a registration statement to register the resale of the escrowed shares.

As of May 16, 2003, the Company was in default of its obligations under the settlement agreement with Sunborne, i.e., the total payment due thereunder had not been made, a registration statement with respect to the escrowed shares was not filed, and the Company had not replaced the escrowed shares with registered, free-trading shares as per the terms of the agreement. Accordingly, Sunborne filed a foreign judgment in Salt Lake City and proceeded with execution thereon. The Company is continuing to negotiate with Sunborne in an attempt to settle the remaining obligation.

Pursuant to a Termination of Sublease Agreement dated as of May 22, 2002 among the Company, Sunborne and other parties, the sublease agreement that was the subject of the Colorado litigation with Sunborne was terminated and a payment of approximately \$109,000 was credited against the amount owed by the Company to Sunborne under the settlement agreement. Sunborne has filed a claim that this amount was to be an additional rent expense rather than a payment on the note payable. The Company disputes this claim and intends to vigorously defend the action.

We also assumed certain liabilities of Circuit Technology, Inc. in connection with our transactions with that entity in the year 2000, and as a result we are defendant in a number of legal actions involving nonpayment of vendors for goods and services rendered. We have accrued these payables and have negotiated settlements with respect to some of the liabilities, including those detailed below, and are currently negotiating settlements with other vendors.

Contact East has notified the Company that it believes it has a claim against the Company in the amount of \$32,129.89 for the cost of goods or services provided to the Company for the Company's use and benefit. The Company is reviewing its records in an effort to confirm the validity of the claims and has been involved in settlement negotiations.

C/S Utilities has notified the Company that it believes it has a claim against the Company in the amount of \$32,472 regarding utilities services. The Company is reviewing its records in an effort to confirm the validity of the claims and has been involved in settlement negotiations.

Future Electronics Corp v. Circuit Technology Corporation, Civil No. 000900296, Third Judicial District Court, Salt Lake County, State of Utah. Suit was brought against the Company on or about January 12, 2000, under allegations that the Company owed \$646,283.96 for the cost of goods or services provided to the Company for the Company's use and benefit. Claims were asserted for breach of contract, fraud, negligent misrepresentation, unjust enrichment, account stated and dishonored instruments. The Company answered the complaint, admitting that it owed certain sums for conforming goods and services and denying all other claims. Partial Summary Judgment was entered in the amount of \$646,783.96

Edgar Filing: CIRTRAN CORP - Form 10QSB

as to certain claims against the Company. Negotiations for settlement resulted in an agreement for settlement of all claims of Future against the Company subject to performance by the Company under the agreement. The Company also issued to Future 352,070 shares of its restricted common stock. The Company did not perform its obligations under the settlement agreement, and a Confession of Judgment was entered in January 2002 in the amount of \$519,052.00. The Company disputes the amount of the judgment entered. No collection efforts have been made. The Company is negotiating settlement.

22

Molex has notified the Company that it believes it has a claim against the Company in the amount of \$90,000.00 for the cost of goods or services provided to the Company for the Company's use and benefit. The Company is reviewing its records in an effort to confirm the validity of the claims and has been involved in settlement negotiations.

Signal Transformer Co., Inc., has notified the Company that it believes it has a claim against the Company in the amount of \$38,989 for the cost of goods or services provided to the Company for the Company's use and benefit. Negotiations for settlement of this claim have resulted in an agreement in principal whereby the Company will arrange for a cash payment to this creditor. The parties are presently negotiating the terms of the settlement documents. However, until the settlement documents are executed and delivered, there can be no assurance that the creditor's claims will be settled nor that the terms will be favorable to the Company.

SuhTech Electronics adv. Circuit Technology Corporation, Civil No. 00L14505, Circuit Court of Cook County Department, Law Division, State of Illinois. Suit was brought against the Company on or about December 23, 1999, under allegations that the Company owed \$213,717.70 for the cost of goods or services provided to the Company for the Company's use and benefit. Claims are asserted for breach of contract, unjust enrichment and account stated. The Company has answered, admitting that it owed certain sums for conforming goods and services and denying all other claims. Judgment was subsequently entered against the Company on May 29, 2002. The parties subsequently entered into a settlement agreement, and the Company has paid the amounts required. Under the settlement agreement, SuhTech is required to dismiss the case, but as of the date of this Report, the case had not been dismissed.

University of Utah v. CirTran Corporation, Third District Court, Salt Lake County, Civil No. 020900494. The University of Utah filed a claim against the Company on January 18, 2002, seeking \$37,473.10 in damages. Summary judgment was entered against the Company. The Company entered into a settlement agreement on September 16, 2003, under which the Company is required to make monthly payments of \$5,185.47. The total settlement amount under the agreement is \$62,225.64. The Company has made all of the required payments, and the University of Utah has agreed to dismiss the case. As of the date of this Report, the case had not been dismissed.

Volt Temporary Services has notified the Company that it believes it has a claim against the Company in the amount of \$30,986 for the cost of goods or services provided to the Company for the Company's use and benefit. The Company is reviewing its records in an effort to confirm the validity of the claims and has been involved in settlement negotiations.

George M. Madanat, Civil No. KC 035616, Superior Court of the State of California for the County of Los Angeles, East District. Suit was brought against the company on or about April 2, 2001, under allegations that the

Edgar Filing: CIRTRAN CORP - Form 10QSB

company owed \$121,824.90 under the terms of a promissory note. A Stipulation for Settlement and for Entry of Judgment was executed by the parties wherein the Company agreed to arrange for payment of a principal amount of \$145,000 in 48 monthly installments. The Company subsequently defaulted on its obligations under the settlement agreement, and judgment was entered against the Company. The Company is attempting to settle this matter with Mr. Madanat.

Cardio Pulmonary Technologies, Inc., vs. Patrick M. Volz, Peripheral Systems, Inc., and CirTran Corporation, Civil No. 03090501B, Third Judicial District Court, Salt Lake County, State of Utah. On April 4, 2003, suit was brought against the Company and two other named defendants by plaintiff Cardio Pulmonary Technologies ("CPT"), alleging a breach of contract between CPT and the other two named defendants. Plaintiff's claims against the Company arise out of an alleged breach of an alleged agreement between the Company and Peripheral Systems, Inc. The Company answered the Complaint. Cardio Pulmonary Technologies

23

has voluntarily agreed to dismiss the claims against the Company without prejudice. As of the date of this Report, the case had not been dismissed.

Howard Salamon, dba Salamon Brothers vs. CirTran Corporation, Civil No. 2:03-00787, U.S. District Court, District of Utah. Howard Salamon originally filed suit against the Company in the U.S. District Court, Eastern District of New York, seeking finders fees, consisting of shares of the Company's common stock valued at \$350,000, allegedly owed in connection with Salamon's introducing the Company to Cornell Capital Partners, L.P., the Equity Line Investor. The Company disputes the claims in the complaint. The case was dismissed in New York and refiled in Utah. The Company has filed its answer in the Utah case and the lawsuit is proceeding. The Company is also currently conducting settlement negotiations.

P R Newswire Association, Inc., v. CirTran, Superior Court of New Jersey, DC-000359-04. On March 9, 2004, a judgment was entered against CirTran in the amount of \$5,106.28, with fees of \$171.13. The Parties are presently negotiating settlement of this matter.

RecovAR Group, LLC vs. CirTran Corporation, Inc., District Court of Maryland. This matter arises from an agreement between the Company and United Parcel Services, Inc. ("UPS"). UPS alleges that the Company owes approximately \$8,024 for services rendered. RecovAR Group, LLC, brought the action on behalf of UPS. The Company is in settlement negotiations with RecovAR Group, LLC.

Item 2. Changes in Securities

Recent Sales of Unregistered Securities

Pursuant to the Equity Line of Credit Agreement (discussed above), the Company is entitled to put to the Equity Line Investor, in lieu of repayment of amounts drawn on the Equity Line, shares of the Company's common stock. Although the Company has filed a registration statement to register the resale by the Equity Line Investor of the shares put to it by the Company, the issuances of shares to the Company are made in reliance on Section 4(2) of the Securities Act of 1933 as a transaction not involving any public offering. No advertising or general solicitation was employed in offering the securities, and the shares have been and will be issued to only one investor which has represented that it is an "accredited investor" as that term is defined in Regulation D promulgated pursuant to the Securities Act of 1933. During the quarter ended June 30, 2004, we have issued 13,467,303 shares of common stock to the Equity Line Investor in

Edgar Filing: CIRTRAN CORP - Form 10QSB

connection with draws on the Equity Line.

Item 5. Other Information

Abacas Ventures

Abacas Ventures, Inc. ("Abacas") purchased the Company's line of credit from the lender. During 2002, the Company entered into agreements whereby the Company has issued common stock to certain principals of Abacas in exchange for a portion of the debt. The Company's plans include working with vendors to convert trade payables into long-term notes payable and common stock, and to cure defaults with lenders through forbearance agreements that the Company will be able to service. During the six months ended June 30, 2004, and the year ended December 31, 2003, the Company successfully converted trade payables, notes payable, and accrued interest of approximately \$1,263,713 and \$2,986, respectively, into notes. Accrued interest of \$27,020 associated with the notes payable was not converted to the note payable with Abacus; therefore, a gain on forgiveness of debt was recorded for \$27,020 for the six months ended June 30, 2004. The Company intends to continue to pursue this type of debt conversion

24

going forward with other creditors. As discussed above, the Company has entered into an equity line of credit agreement with a private investor. Realization of any proceeds under the equity line of credit is not assured.

Item 6. Exhibits and Reports on Form 8-K

Reports on Form 8-K: The following reports on Form 8-K were filed by us during the three-month period ended March 31, 2004:

(i) None.

Exhibits:

- 31 Certification
- 32 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

25

SIGNATURES

In accordance with the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CIRTRAN CORPORATION

Date: August 19, 2004

By: /s/ Iehab Hawatmeh

Edgar Filing: CIRTRAN CORP - Form 10QSB

Iehab J. Hawatmeh
President and Chief Financial Officer