

POWER EFFICIENCY CORP  
Form 10QSB  
August 14, 2003  
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**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-QSB**

**(Mark One)**

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2003

**OR**

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0331805

**POWER EFFICIENCY CORPORATION**

(Exact Name of Small Business Issuer as Specified in its Charter)

**Delaware**

(State or Other Jurisdiction of  
Incorporation or Organization)

**22-3337365**

(I.R.S. Employer  
Identification No.)

**4220 Varsity Drive, Suite E**

**Ann Arbor, MI 48108**

(Address of Principal Executive Offices)

**(734) 975-9111**

(Issuer's Telephone Number,  
Including Area Code)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 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

The number of shares outstanding of the Issuer's Common Stock, \$.001 Par Value, as of August 12, 2003 was 8,967,296.

Transitional Small Business Disclosure Format (check one):

Yes                      No

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Certification of Chief Executive Officer as Adopted

Certification of Chief Financial Officer as Adopted

Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Certification of Chief Financial Officer Pursuant to Section 906 of the  
Sarbanes-Oxley Act of 2002

[Back to Index](#)**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****POWER EFFICIENCY CORPORATION  
CONDENSED BALANCE SHEET**

|   | <b>Unaudited<br/>June 30, 2003</b> |
|---|------------------------------------|
| <b>ASSETS</b>   |                                    |
| <b>CURRENT ASSETS:</b>  |                                    |
| Cash and cash equivalents   | \$ 218,024                         |
| Accounts receivable, net  | 77,024                             |
| Inventory   | 411,958                            |
| Prepaid expenses  | 61,369                             |
|   | <hr/>                              |
| Total Current Assets  | 768,375                            |
|   | <hr/>                              |
| PROPERTY AND EQUIPMENT, Net   | 98,100                             |
|   | <hr/>                              |
| <b>OTHER ASSETS:</b>  |                                    |
| Deposits  | 15,500                             |
| Patents, net  | 14,499                             |
| Goodwill, net   | 1,929,963                          |
| Customer contracts, manuals and sales literature, net   | 89,733                             |
| Website and customer list, net  | 6,415                              |
|   | <hr/>                              |
| Total Other Assets  | 2,056,110                          |
|   | <hr/>                              |
| Total Assets  | \$ 2,922,585                       |
|   | <hr/>                              |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                                    |
| <b>CURRENT LIABILITIES:</b>   |                                    |
| Notes Payable   | 450,000                            |
| Accounts payable and accrued expenses   | 431,833                            |
| Accrued salaries and payroll taxes  | 221,536                            |
|   | <hr/>                              |
| Total Current Liabilities   | \$ 1,103,369                       |
| <b>LONG-TERM LIABILITIES</b>  |                                    |
| Stockholder and former officers' loans payable  | 429,362                            |
|   | <hr/>                              |
| Total Liabilities   | 1,532,731                          |
|   | <hr/>                              |
| <b>STOCKHOLDERS' EQUITY:</b>  |                                    |
| Preferred Stock, \$.001 par value, 10,000,000 shares authorized,<br>2,346,233 shares issued and outstanding | 2,346                              |
| Common stock, \$.001 par value, 50,000,000 shares authorized,<br>8,122,740 issued and outstanding           | 8,123                              |
| Additional paid-in capital  | 12,314,238                         |
| Accumulated deficit   | (10,934,853)                       |

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|  |                     |
|--|---------------------|
| Total Stockholders' Equity                 | <u>1,389,854</u>    |
| Total Liabilities and Stockholders' Equity | <u>\$ 2,922,585</u> |

Accompanying notes are an integral part of the financial statements

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**POWER EFFICIENCY CORPORATION**  
**CONDENSED STATEMENTS OF OPERATIONS**  
**Unaudited**

|   | For the three months<br>ended June 30, |              | For the six months ended<br>June 30, |              |
|---|--|--------------|--------------------------------------|--------------|
|   | 2003                                   | 2002         | 2003                                 | 2002         |
| REVENUES  | \$ 95,283                              | \$ 109,304   | \$ 256,126                           | \$ 248,446   |
| COSTS AND EXPENSES  |  |              |                                      |              |
| Cost of sales   | 58,557                                 | 53,783       | 133,265                              | 125,728      |
| Manufacturing costs   | 57,188                                 | 44,924       | 111,986                              | 97,775       |
| Research and development  | 85,947                                 | 84,554       | 184,412                              | 168,101      |
| Selling, general and<br>administration                              | 499,353                                | 437,511      | 833,444                              | 670,951      |
| Depreciation and amortization                                       | 30,825                                 | 28,185       | 64,410                               | 59,614       |
| Total costs and expenses  | 731,870                                | 648,957      | 1,327,517                            | 1,122,169    |
| LOSS FROM OPERATIONS  | (636,587)                              | (539,653)    | (1,071,391)                          | (873,723)    |
| OTHER (EXPENSE)   |  |              |                                      |              |
| Interest expense  | (14,493)                               | □□           | (19,181)                             | □□           |
| Total Other Expenses  | (14,493)                               | □□           | (19,181)                             | □□           |
| NET LOSS  | \$ (651,080)                           | \$ (539,653) | \$ (1,090,572)                       | \$ (873,723) |
| BASIC AND DILUTED LOSS PER<br>COMMON SHARE                          | \$ (.09)                               | \$ (.08)     | \$ (.16)                             | \$ (.13)     |
| WEIGHTED AVERAGE COMMON<br>SHARES OUTSTANDING, BASIC<br>AND DILUTED | 7,100,794                              | 6,548,120    | 6,818,190                            | 6,548,120    |

Accompanying notes are an integral part of the financial statements

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**POWER EFFICIENCY CORPORATION**  
**CONDENSED STATEMENTS OF CASH FLOWS**  
**Unaudited**

|  | <b>For the six months ended<br/>June 30,</b> |              |
|--|--|--------------|
|  | <b>2003</b>                                  | <b>2002</b>  |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |  |              |
| Net loss   | \$ (1,090,572)                               | \$ (873,723) |
| Adjustments to reconcile net loss to net cash from operating activities used for operating activities: |  |              |
| Depreciation and amortization  | 64,410                                       | 59,614       |
| Compensation expense   | 33,158                                       | □□           |
| Changes in assets and liabilities: (increase) decrease   |  |              |
| Issuance of stock for services and options   | □□   | 167,500      |
| Accounts receivable, net   | 10,213                                       | (97,570)     |
| Inventory  | 92,064                                       | 90,353       |
| Prepaid expenses   | (51,740)                                     | (8,682)      |
| Increase (Decrease) in:  |  |              |
| Accounts payable and accrued expenses  | (133,619)                                    | (95,520)     |
| Accrued salaries and payroll taxes   | 43,627                                       | □□           |
|  | (1,032,459)                                  | (758,028)    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>  |  |              |
| Purchase of fixed assets   | (6,160)                                      | (1,505)      |
|  | (6,160)                                      | (1,505)      |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>   |  |              |
| Proceeds (payments) from line of credit  | 450,000                                      | (220,000)    |
| Proceeds from issuance of equity securities, net of costs  | 538,560                                      | 2,380,000    |
| Loans from stockholders and former officers  | 10,375                                       | (2,187)      |
|  | 998,935                                      | 2,157,813    |
| (Decrease) Increase in cash and cash equivalents   | (39,684)                                     | 1,398,280    |
| Cash and cash equivalents at beginning of period   | 257,708                                      | 35,245       |
| Cash and cash equivalents at end of period   | \$ 218,024                                   | \$ 1,433,525 |

Accompanying notes are an integral part of the financial statements

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**POWER EFFICIENCY CORPORATION**  
**NOTES TO THE CONDENSED FINANCIAL STATEMENTS**  
**(Unaudited)**

**NOTE 1 □ BASIS OF PRESENTATION**

The accompanying financial statements have been prepared by the Company, without an audit. In the opinion of management, all adjustments have been made, which include normal recurring adjustments necessary to present fairly the condensed financial statements. Operating results for the six months ended June 30, 2003 are not necessarily indicative of the operating results for the full year. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. The Company believes that the disclosures provided are adequate to make the information presented not misleading. Certain amounts in the financial statements have been reclassified from prior period presentations. These unaudited condensed financial statements should be read in conjunction with the audited financial statements and related notes included in the Company's Annual Report for the year ended December 31, 2002 on Form 10-KSB.

The preparation of condensed financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

**NOTE 2 □ GOING CONCERN:**

The accompanying financial statements have been prepared assuming the Company is a going concern, which assumption contemplates the realization of assets and satisfaction of liabilities in the normal course of business. The Company has suffered recurring losses from operations, and there is a deficiency in tangible net worth of approximately \$(651,000). The Company experienced a \$(1,032,459) deficiency from operations, continues to have negative cash flow from operations and lacks sufficient liquidity to continue operations. The Company has secured a \$1,000,000 line of credit that was partially utilized during the second quarter. These factors raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amount of liabilities that might be necessary should the Company be unable to continue in existence. Continuation of the Company as a going concern is dependent upon achieving profitable operations. Management's plans to achieve profitability include developing new products, obtaining new customers and increasing sales to existing customers. Management also plans to raise additional capital through equity issuance or other types of financing. Management has raised additional equity capital through issuance of Common Stock in the amount of approximately \$539,000 to investors during the first half of this fiscal year.

**NOTE 3 □ NET LOSS PER SHARE**

Basic per share amounts are computed by dividing the net loss available to common stockholders by the weighted average number of common shares outstanding during the year. Diluted per share amounts incorporate the incremental shares issuable upon the assumed exercise of the Company's stock options and warrants and assumed conversion of convertible securities. Such incremental amounts have been excluded from the calculation since their effect would be anti-dilutive. Such stock options, warrants and conversions could potentially dilute earnings per share in the future.

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**POWER EFFICIENCY CORPORATION**  
**NOTES TO THE CONDENSED FINANCIAL STATEMENTS**  
**(Unaudited)**

**NOTE 4 □ STOCKHOLDERS □ EQUITY:**

During the second quarter of this fiscal year, the Company received approximately \$472,000 from a private sale of 1,422,448 shares of the Company's Common Stock as part of a private placement that the company is currently conducting.

**NOTE 5 □ CHANGES IN CONTROL OF REGISTRANT**

Two recent events have caused a change in control of the Company. These events have caused Summit Energy Ventures, LLC to obtain voting control of the Company.

Summit purchased 2,346,233 shares of Series A-1 Convertible Preferred Stock from the Company in June of 2002. The shares of Series A Preferred Stock vote together with the Common Stock as a single class. The initial conversion rate allowed Summit to convert its Series A-1 Convertible Preferred Stock into Common Stock at the rate of two shares of Common Stock for each share of Series A-1 Convertible Preferred Stock. However, according to the terms of this transaction, Summit's ability to vote its shares was limited. Summit was only entitled to vote such number of shares of Series A-1 Convertible Preferred Stock that equaled 28% of the outstanding shares of Common Stock entitled to vote on the date of such stockholder vote.

On May 8, 2003, the Company entered into a financing transaction whereby Summit provided the Company with a \$1,000,000 line of credit. As part of that transaction, the limitation on Summit's ability to vote its shares described above was removed. As a result, each share of Series A-1 Convertible Preferred Stock is entitled to such number of votes equal to the number of shares of Common Stock each share of Series A-1 Convertible Preferred Stock is convertible into.

The second event that increased Summit's voting power was the Company's issuance of Common Stock in a private placement. The Company has recently entered into a stock purchase agreement whereby the Company agreed to sell shares to a foreign company in sales exempt from registration under the Securities Act of 1933, as amended, pursuant to Regulation S. These sales are to take place at various times and at various prices. The price per share will in no case be less than \$0.25. The lowest price at which stock has been sold so far has been approximately \$0.25 per share. The terms of the Series A-1 Convertible Preferred Stock owned by Summit provide for an adjustment of the conversion price in the event the Company issues stock at a price less than \$0.53 per share. As a result of the sale of stock at approximately \$0.25, each share of Series A-1 Convertible Preferred Stock is now convertible into approximately 4.25 shares of Common Stock. This change in the conversion ratio also increases the voting power of the Series A-1 Convertible Preferred Stock to approximately 4.25 votes per share.

The shares of Series A Preferred Stock vote together with the Common Stock as a single class. As a result of these two recent events, the voting power of the Series A-1 Convertible Preferred Stock held by Summit entitles Summit to approximately 58 percent of the votes that may be cast.



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## NOTE 6 □ LINE OF CREDIT FINANCING

On May 8, 2003, the Company closed on a \$1 million line of credit from Summit Energy Ventures, LLC.

**Security Interest.** To secure the repayment of the outstanding balance (including all principal, interest and fees) due under the Note, the Company granted Summit a security interest in all of the Company's assets, both tangible and intangible. The outstanding balance of the Note is due on the earlier of (i) December 31, 2003, or (ii) at such time that an event of default occurs. Various conditions would constitute an event of default under the Note. These events are detailed in the 8-K filed with the SEC on May 23, 2003.

**Convertibility.** Summit has the ability at any time to give the Company notice of its desire to convert any portion of the balance of the Note into Series A-1 Convertible Preferred Stock. At that time, the Company will have seven days to repay Summit the amount Summit has indicated it desires to convert. In the event that the amount is not repaid in seven days, Summit will receive Series A-1 Convertible Preferred Stock. The conversion features of the Note and the Series A-1 Convertible Preferred Stock work together so that Summit would effectively be getting the right to acquire Common Stock at \$0.183 per share.

Also upon conversion, the warrant the Company issued to Summit in June of 2002 would be expanded. Currently, according to the terms of the Warrant, Summit has the right to purchase such number of shares of stock in the Company that would give Summit a 51% interest in the Company. Upon conversion, the warrant would be expanded to give Summit the right to purchase an approximately 60% interest in the Company. The purchase price of the shares purchasable under the warrant is determined by a formula, which is a function of the Company's earnings and may be zero.

**Fees and Interest on the Note.** As consideration for the line of credit, the Company paid Summit a \$50,000 fee, which was paid with the proceeds of the Company's first draw under the Note. The Company has a current outstanding balance on the Note of \$450,000. The outstanding balance on the Note accrues interest at 15% annually.

## NOTE 7 □ RECENT MANAGEMENT CHANGES

The board of directors of the Company recently appointed a new chief executive officer. Effective June 12, 2003, Richard Koch became the Company's chief executive officer and Raymond J. Skiptunis, the Company's former chief executive officer, became the Company's chief financial officer. Mr. Koch has experience leading a \$300 million (sales) wholesale/retail seller of used heavy-duty trucks and was a senior vice president at a publisher of regional business journals. In addition to operations and sales experience, Mr. Koch is an attorney and has worked as a certified public accountant.

The Company entered into an employment and compensation agreement with Mr. Koch dated June 9, 2003. The agreement is for a base term of five years and is thereafter renewable for additional periods of one year unless the Company gives notice to the contrary not less than 90 days prior to the expiration of the term or any extension. In accordance with the terms of the agreement, the base salary for 2002 is \$240,000, with annual increases and bonuses at the discretion of the compensation committee of the board of directors. During the first year of the Agreement, an amount equal to \$60,000 of the base salary shall be accrued and paid at such time as the net cash provided by operating activities of the Company is greater than zero for a period of three consecutive months. The agreement with Mr. Koch also provides, among other things, for reimbursement of certain moving, living and automobile expenses and for certain payments to be made to Mr. Koch in the event of a change of control or termination of Mr. Koch without cause. Mr. Koch also received 1,000,000 stock options, which will vest over a five-year period and have exercise prices of \$.81 and \$.95. Additional compensation expense related to this agreement of approximately \$33,000 was recognized in the second quarter of 2003. This additional compensation expense is included in Selling, general and administration. The agreement also provides for certain non-competition and nondisclosure covenants. A copy of Mr. Koch's employment agreement is filed as an exhibit to a previously issued 8-K, filed on May 23, 2003.

The Company also entered into an employment and compensation agreement with Mr. Skiptunis dated June 9, 2003 and Mr. Skiptunis executed a release thereby releasing the Company from its obligations under Mr. Skiptunis' prior employment agreement dated November 7, 2002. The agreement is for a base term of 90 days and provides for, among other things, a base salary of \$10,000 per month, immediate vesting of all of Mr.

Skiptunis' 700,000 stock options and a discretionary performance bonus. The agreement also provides for certain non-competition and nondisclosure covenants. A copy of Mr. Skiptunis' employment agreement was filed as an exhibit in a previously issued 8-K, filed on June 12, 2003.

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**NOTE 8 □ RECENT SALES OF EQUITY SECURITIES**

Subsequent to June 30, 2003, the Company sold 844,554 shares of its Common Stock in a private placement for approximately \$249,723.

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

### **Special Note Regarding Forward-Looking Statements**

We may, in discussions of our future plans, objectives and expected performance in periodic reports filed by us with the Securities and Exchange Commission (or documents incorporated by reference therein) and in written and oral presentations made by us, include projections or other forward-looking statements within the meaning of Section 27A of the Securities Exchange Act of 1933 or Section 21E of the Securities Act of 1934, as amended. Such projections and forward-looking statements are based on assumptions, which we believe are reasonable but are, by their nature, inherently uncertain. In all cases, results could differ materially from those projected. Some of the important factors that could cause actual results to differ from any such projections or other forward-looking statements are discussed below, and in other reports filed by us under the Securities Exchange Act of 1934, including under the caption "Risk Factors" in our Annual Report on Form 10-KSB. Our forward looking statements are based on information available to us today, and except as required by law, we undertake no obligation to update any forward looking statement, whether as a result of new information, future events or otherwise.

### **OVERVIEW**

The Company generates revenues from a single business segment: the design, development, marketing and sale of proprietary solid state electrical components designed to reduce energy consumption in alternating current induction motors.

The Company began generating revenues from sales of its patented Power Commander line of motor controllers in late 1995. As of June 30, 2003, the Company had total stockholders' equity of \$1,270,813 primarily due to the Company's sale of 2,346,233 shares of Series A-1 Convertible Preferred stock to Summit Energy Ventures, LLC in June 2002, as well as the private sale of securities amounting to approximately \$472,000 in the first half of 2003. In addition, in August 2000, the Company purchased the assets of Percon, formerly the largest distributor of the Company's products. The transaction was accounted for as a purchase and the Company's Statements of Operations includes Percon's results of operations since the date of acquisition. The consolidation of the operations of both entities allowed the Company to integrate the administrative, sales, marketing and manufacturing operations of Percon. Percon had developed sales contacts with major OEM's in the elevator/escalator industry and transferred those agreements to the Company as part of the Asset Agreement.

### **RESULTS OF OPERATIONS: FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2003 AND 2002**

#### **REVENUES**

Revenues for the three months ended June 30, 2003, were \$95,283 compared to \$109,304 for the three months ended June 30, 2002, a decrease of \$14,021 or 12.8%.

Revenues for the six months ended June 30, 2003, were \$256,126 compared to \$248,446 for the six months ended June 30, 2002, an increase of \$7,680, or 3.1%.

#### **COST OF REVENUES**

Cost of revenues, which includes costs related to raw materials and manufacturing costs, for the three months ended June 30, 2003, increased \$17,038 to \$115,745 from \$98,707 or a 17.3% increase as compared to the three months ended June 30, 2002. The increase in cost of revenues was primarily attributed to the increase in manufacturing costs, primarily due to a recording of an additional inventory reserve and partially offset by lower material costs related to the lower sales.

For the six months ended June 30, 2003, cost of revenues increased \$21,748 to \$245,251 from \$223,503 or a 9.7% increase as compared to the six months ended June 30, 2002. The increase in cost of revenues was primarily attributed to the increase in revenues and the inventory reserve and offset by an overall reduction in the cost of materials from the Company's suppliers.



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## **OPERATING EXPENSES**

### **Research and Development Expenses**

Research and development expenses were \$85,947 for the three months ended June 30, 2003, as compared to \$84,554, representing a \$1,393 or a 1.6%, increase compared to the same period ended June 30, 2002. The development of the low cost, low horsepower Platform A product family, the single-phase controller, and the fast-reaction integrator board continues to contribute to the higher costs of research and development costs.

Research and development expenses were \$184,412 for the six months ended June 30, 2003, as compared to \$168,101, representing a \$16,311 or a 9.7%, increase compared to the same period ended June 30, 2002. The development of the low cost, low horsepower Platform A product family, the single-phase controller, and the fast-reaction integrator board continues to contribute to the higher costs of research and development costs.

### **Selling, General and Administrative Expenses**

Selling, general and administrative expenses were \$499,353 for the three months ended June 30, 2003, an increase of \$61,842 or 14.1% as compared to the three months ended June 30, 2002. The increase in selling, general and administrative expenses was due primarily to higher sales and marketing expenses related to the Company's efforts to continue aggressively selling and promoting its proprietary product line, offset by significantly lower legal and professional fees.

Selling, general and administrative expenses were \$833,444 for the six months ended June 30, 2003, an increase of \$162,493 or 24.2% as compared to the six months ended June 30, 2002. The increase in selling, general and administrative expenses was due to: 1) the increase in sales and marketing expenses as discussed above, and 2) the recognition of deferred compensation expense, offset by significantly lower legal and consulting fees.

## **NET LOSS**

For the three months ended June 30, 2003, net loss totaled \$651,080 or \$0.09 per share, as compared to a net loss of \$539,653 or \$0.08 per share, for the same period in the prior fiscal year. For the six months ended June 30, 2003, net loss totaled \$1,090,572 or \$0.16 per share, as compared to a net loss of \$873,723 or \$0.13 per share, for the same period in the prior fiscal year.

## **FINANCIAL CONDITION, CAPITAL RESOURCES AND LIQUIDITY**

Since our inception we have incurred significant losses and negative cash flow (assuming the positive cash flow from capital transactions are excluded). At June 30, 2003, we had an accumulated deficit of approximately \$11.1 million and our principal source of liquidity was approximately \$218,000 in cash and cash equivalents and a secured credit line for \$1 million of which approximately \$540,000 remained available. The Company has financed its operations primarily through the sale of its equity securities and by bank borrowings. As of June 30, 2003, the Company has received a total of approximately \$5.3 million from public and private offerings of its equity securities.

Cash used for operating activities for the six months ended June 30, 2003 was \$1,032,459, which primarily consisted of: a net loss of \$1,090,572; less depreciation and amortization of \$64,410, offset by a decrease in inventory of \$92,064; and decreases in accounts payable and accrued expenses of \$133,619. Net cash used for operating activities in the six months ended June 30, 2002 was \$758,028, which primarily consisted of: a net loss of \$873,723; less depreciation and amortization of \$59,614, increases in accounts receivable of \$97,570 and prepaid expenses of \$8,682, offset by a decrease in inventory of \$90,353; and decreases in accounts payable and accrued expenses of \$95,520. Cash used in investing activities for the first six months of the current fiscal year was \$6,160, compared to \$1,505 in the first six months of last fiscal year. The amounts for both years consisted of the purchase of fixed assets. Net cash provided by financing activities for the first half of fiscal year 2003 was \$998,935, which primarily consisted of proceeds from the issuance of equity securities and from the line of credit of \$450,000. During the first half of fiscal year 2002, net cash provided from financing activities was \$2,157,813, which consisted of proceeds from the issuance of equity securities and offset by a repayment of a note payable for \$220,000.



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The Company expects to experience growth in its operating expenses, particularly in research and development and selling expenses, for the foreseeable future in order to execute its business strategy. As a result, the Company anticipates that operating expenses will constitute a material use of any cash resources.

Since capital resources are insufficient to satisfy the Company's liquidity requirements, management intends to sell additional equity or debt securities or obtain debt financing. During the second quarter of 2003 the Company has secured a \$1,000,000 debt facility with Summit Energy Ventures, LLC. According to the terms of the financing, the outstanding balance accrues interest at a rate of 15 percent and is convertible into Series A Preferred Stock at a price per share of \$0.183 if, after seven (7) days notice by Summit, the outstanding balance is not paid off. The outstanding balance is due on December 31, 2003 and is secured by all of the Company's assets. The registrant is also currently meeting with many different potential equity investors and believes it can raise additional funds through private placements of equity.

### **Cash Requirements and Need for Additional Funds**

The Company anticipates a substantial need for cash to fund its working capital requirements. In accordance with the Company's prepared expansion plan, it is the opinion of management that approximately \$1.3 million will be required to cover operating expenses, including, but not limited to, marketing, sales and operations during the next six months.

## **ITEM 3. CONTROLS AND PROCEDURES**

**(a) Evaluation of Disclosure Controls and Procedures.** The Company's Chief Executive Officer and Chief Financial Officer have reviewed and evaluated the effectiveness of our disclosure controls and procedures, as defined in Rules 240.13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934 (Exchange Act), as of a date within ninety days before the filing date of this quarterly report. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that the Company's disclosure controls and procedures are adequate and effective to ensure that information that the Company is required to disclose under the Exchange Act is recorded, processed, summarized and reported on a timely basis.

**(b) Changes in Internal Controls.** There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, nor were there any significant deficiencies or material weaknesses in the Company's internal controls. Accordingly, no corrective actions were required or undertaken.

## **PART II OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

Following the Company's earlier termination of his employment agreement, on October 10, 2002, Stephen Shulman, the former President and Chief Executive Officer of the Company, filed a demand for arbitration with the American Arbitration Association (AAA) requesting payments from the Company aggregating approximately \$528,653 pursuant to the provisions of his employment agreement with the Company. The AAA has established hearing dates for September 2003. The Company has accrued approximately \$131,000 related to deferred wages, loans outstanding and expenses. The Company believes that it has meritorious defenses to a significant portion of these claims.



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## **ITEM 2. □ CHANGES IN SECURITIES AND USE OF PROCEEDS**

In March 2003, the Company issued 132,500 shares of the Company's Common Stock for \$74,000 in private placement transactions. The sales were made to accredited investors and were exempt from registration under the Securities Act pursuant to Rule 506 of Regulation D. The purchasers were primarily holders of the Company's warrants that were issued in connection with a private placement the Company conducted in 2000.

During the second fiscal quarter, the Company issued 1,409,618 shares of its Common Stock for approximately \$465,000 in private placement transactions. The sales were made to accredited investors and were exempt from registration under the Securities Act pursuant to Rule 506 of Regulation D.

On May 8, 2003, as part the line of credit financing agreement, (See disclosure in Notes to the financial statements, Note 6- Line of Credit Financing) Summit has the ability at any time to give the Company notice of its desire to convert any portion of the balance of the Note into Series A-1 Convertible Preferred Stock. At that time, the Company will have seven days to repay Summit the amount Summit has indicated it desires to convert. In the event that the amount is not repaid in seven days, Summit will receive Series A-1 Convertible Preferred Stock. The conversion features of the Note and the Series A-1 Convertible Preferred Stock work together so that Summit would effectively be getting the right to acquire Common Stock at \$0.183 per share.

Also upon conversion, the warrant the Company issued to Summit in June of 2002 would be expanded. Currently, according to the terms of the Warrant, Summit has the right to purchase such number of shares of stock in the Company that would give Summit a 51% interest in the Company. Upon conversion, the warrant would be expanded to give Summit the right to purchase an approximately 60% interest in the Company. The purchase price of the shares purchasable under the warrant is determined by a formula, which is a function of the Company's earnings and may be zero.

## **ITEM 3. □ DEFAULTS UPON SENIOR SECURITIES**

None.

## **ITEM 4 □ SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

The Company obtained the written consent of the shareholders to amend the Certificate of Designation of Series A Convertible Preferred Stock in connection with the \$1 million line of credit the Company received from Summit Energy Ventures, LLC. The amendment lifted certain restrictions on Summit to votes the shares of Series A Convertible Preferred Stock owned by it. The removal of the restriction is described in the 8-K filed with the SEC on May 23, 2003. Shareholders representing 6,236,951 shares of Common Stock, on an as converted basis, signed the consent to approve the amendment. On the date the written consent was executed, the number of shares of Common Stock eligible to vote, on an as converted basis, was 10,664,606. Therefore, the consent was executed by shareholders representing more than 50% of the eligible voting shares and the Certificate of Designation was amended by written consent in lieu of a meeting.

## **ITEM 5 □ OTHER INFORMATION**

The board of directors of the Company has appointed a new chief executive officer. Effective June 12, 2003, Richard Koch became the Company's chief executive officer and Raymond J. Skiptunis, the Company's former chief executive officer, became the Company's chief financial officer. Mr. Koch has experience leading a \$300 million (sales) wholesale/retail seller of used heavy-duty trucks and was a senior vice president at a publisher of regional business journals. In addition to operations and sales experience, Mr. Koch is an attorney and has worked as a certified public accountant.

The Company entered into an employment and compensation agreement with Mr. Koch dated June 9, 2003. The agreement is for a base term of five years and is thereafter renewable for additional periods of one year unless the Company gives notice to the contrary not less than 90 days prior to the expiration of the term or any extension. In accordance with the terms of the agreement, the base salary for 2002 is \$240,000, with annual increases and bonuses at the discretion of the compensation committee of the board of directors. During the first year of the Agreement, an amount equal to \$60,000 of the base salary shall be accrued and paid at such time as

the net cash provided by operating activities of the Company is greater than zero for a period of three consecutive months. The agreement with Mr. Koch also provides, among other things, for reimbursement of certain moving, living and automobile expenses and for certain payments to be made to Mr. Koch in the event of a change of control or termination of Mr. Koch without cause. Mr. Koch also received 1,000,000 stock options, which will vest over a five-year period and have exercise prices of \$.81 and \$.95. The agreement also provides for certain non-competition and nondisclosure covenants. A copy of Mr. Koch's employment agreement is filed as an exhibit to a previously issued 8-K, filed on May 23, 2003.

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The Company also entered into an employment and compensation agreement with Mr. Skiptunis dated June 9, 2003 and Mr. Skiptunis executed a release thereby releasing the Company from its obligations under Mr. Skiptunis' prior employment agreement dated November 7, 2002. The agreement is for a base term of 90 days and provides for, among other things, a base salary of \$10,000 per month, immediate vesting of all of Mr. Skiptunis' 700,000 stock options and a discretionary performance bonus. The agreement also provides for certain non-competition and nondisclosure covenants. A copy of Mr. Skiptunis' employment agreement was filed as an exhibit in a previously issued 8-K, filed on June 12, 2003.

**ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K**

(a) Exhibits.

[31.1 Section 302 Certifications by the Chief Executive Officer.](#)

[31.2 Section 302 Certifications by the Chief Financial Officer.](#)

[32.1 Certification by the Chief Executive Officer pursuant to U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.](#)

[32.2 Certification by the Chief Financial Officer pursuant to U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.](#)

(b) Reports on Form 8-K.

On May 23, 2003, the Company filed a current report on Form 8-K reporting (i) an Item 1. event regarding changes in control of the Company, and (ii) an Item 2. event regarding a security interest placed on the Company's assets in connection with a line of credit obtained by the Company.

On June 12, 2003, the Company filed a current report on Form 8-K reporting Item 5 events regarding (i) the appointment of a new chief executive officer, and (ii) the Company's former chief executive officer became the Company's chief financial officer.

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**SIGNATURES**

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

POWER EFFICIENCY CORPORATION  
(Registrant)

Date: August 14, 2003

By: /s/ Richard Koch  
President and Chief Executive Officer

Date: August 14, 2003

By: /s/ Raymond J. Skiptunis  
Chief Financial Officer (Principal Financial and Accounting Officer)