

CHROMATICS COLOR SCIENCES INTERNATIONAL INC  
Form 10QSB  
May 20, 2002

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
-----

FORM 10-QSB

(Mark One)

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

For the quarterly period ended March 31, 2002  
-----

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 0-21168  
-----

CHROMATICS COLOR SCIENCES INTERNATIONAL, INC.  
-----  
(Exact Name of Registrant as Specified in Its Charter)

New York  
-----  
(State or Other Jurisdiction  
of Incorporation or Organization)

13-3253392  
-----  
(I.R.S. Employer  
Identification Number)

2500 Johnson Avenue, Riverdale, New York 10463  
-----  
(Address of principal executive offices)

(212) 717-6544  
-----  
(Registrant's Telephone Number, Including Area Code)

-----  
(Former Name, Former Address and Former Fiscal Year,  
if Changed Since Last Report)

Indicate by check whether the issuer (1) has filed all reports required to be  
filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the  
preceding 12 months (or for such shorter period that the issuer was required to  
file such reports), and (2) has been subject to such filing requirements for the  
past 90 days. Yes  No

Edgar Filing: CHROMATICS COLOR SCIENCES INTERNATIONAL INC - Form 10QSB

-----  
-----  
APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY  
PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check whether the issuer has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by court. Yes            No            N/A  
-----            -----

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 20,989,550.

- i -

CHROMATICS COLOR SCIENCES INTERNATIONAL, INC.  
FORM 10-QSB FOR THE QUARTER ENDED MARCH 31, 2002

INDEX

PART I	FINANCIAL INFORMATION	
Item 1	Financial Statements	Page
	Condensed Consolidated Balance Sheets as of March 31, 2002 (unaudited) and December 31, 2001.....	2
	Condensed Consolidated Statements of Operations (unaudited) for the Three Months Ended March 31, 2002 and 2001.....	3
	Condensed Consolidated Statements of Changes in Stockholders' Equity (Deficiency) (unaudited) for the three months ended March 31, 2002.....	4
	Condensed Consolidated Statements of Cash Flows (unaudited) for the Three Months Ended March 31, 2002 and 2001.....	5
	Notes to Condensed Consolidated Financial Statements (unaudited).....	6
Item 2	Management's Discussion and Analysis of Financial Condition and Results of Operations.....	9
Item 3	Quantitative and Qualitative Disclosure of Market Risk.....	11
PART II	OTHER INFORMATION.....	11
	Signatures.....	13

-1-

PART I -- FINANCIAL INFORMATION

Item 1. Financial Statements

CHROMATICS COLOR SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

	March 31, 2002	Decemb
	-----	-----
	(unaudited)	
ASSETS		
CURRENT ASSETS:		
Cash and equivalents	\$ 73,000	\$
Accounts receivable	2,000	
Inventories	350,000	
Prepaid expenses and other current assets	28,000	
	-----	-----
Total Current Assets	453,000	
Property and equipment, net	139,000	
Deferred financing costs	787,000	
	-----	-----
	\$ 1,379,000	\$
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable and accrued expenses:		
Attorneys and accountants	\$ 1,105,000	\$
Consultants	470,000	
Trade	289,000	
Severance payable	725,000	
Due to related parties	303,000	
Notes payable	1,849,000	
Notes payable - officer/stockholder	250,000	
Advance from investor	25,000	
	-----	-----
Total Current Liabilities	5,016,000	
	-----	-----
COMMITMENTS AND OTHER MATTERS		
SHAREHOLDERS' EQUITY (DEFICIENCY)		
Preferred Stock	12,015,000	
Common Stock: Authorized - 550,000,000 shares		
\$.001 par value; issued and outstanding 20,989,550	21,000	
Additional paid-in capital	47,173,000	
Accumulated deficit	(62,846,000)	
	-----	-----
	(3,637,000)	
	-----	-----
	\$ 1,379,000	\$
	=====	=====

Edgar Filing: CHROMATICS COLOR SCIENCES INTERNATIONAL INC - Form 10QSB

See accompanying notes to condensed consolidated financial statements

- 2 -

CHROMATICS COLOR SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(UNAUDITED)

	Three Months Ended March 31,	
	2002	2001
Revenues:		
Sales	\$ -	\$ -
COSTS AND EXPENSES:		
Sales, marketing and trade show costs	-	244,000
Medical regulatory expenses	3,000	276,000
Research and development	45,000	305,000
Patent application costs	23,000	136,000
Provision for estimated payments for terminated employees	-	1,045,000
General and administrative:		
Compensation - Officers, employees and consultants	120,000	404,000
Legal fees	47,000	154,000
Accounting fees	90,000	40,000
Rent and storage	23,000	92,000
Insurance	32,000	73,000
Repairs and maintenance	6,000	21,000
Depreciation and amortization	16,000	126,000
Taxes	8,000	27,000
Stock administrative fees	4,000	30,000
Public relations	-	40,000
Other	33,000	66,000
	450,000	3,079,000
OPERATING LOSS	(450,000)	(3,079,000)
OTHER INCOME (EXPENSE):		
Interest income	-	3,000
Non-cash interest expense and financing costs	(400,000)	-
	(400,000)	3,000
LOSS FROM CONTINUING OPERATIONS	(850,000)	(3,076,000)
LOSS FROM DISCONTINUED OPERATIONS (Note 3)	-	(540,000)

Edgar Filing: CHROMATICS COLOR SCIENCES INTERNATIONAL INC - Form 10QSB

NET LOSS	\$ (850,000)	\$ (3,616,000)
=====		
NET LOSS TO COMMON STOCKHOLDERS:		
LOSS FROM CONTINUING OPERATIONS	\$ (850,000)	\$ (3,076,000)
DEEMED DIVIDEND ON CONVERTIBLE PREFERRED STOCK	211,000	
-----		
LOSS FROM CONTINUING OPERATIONS TO COMMON SHAREHOLDERS	(1,061,000)	(3,076,000)
LOSS FROM DISCONTINUED OPERATIONS (Note 3)	-	(540,000)
-----		
NET LOSS TO COMMON STOCKHOLDERS	\$ (1,061,000)	\$ (3,616,000)
=====		
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	20,989,550	19,033,300
=====		
BASIC AND DILUTED LOSS PER SHARE:		
LOSS FROM CONTINUING OPERATIONS	\$ (0.05)	\$ (0.16)
LOSS FROM DISCONTINUED OPERATIONS	-	(0.03)
-----		
NET LOSS TO COMMON STOCKHOLDERS	\$ (0.05)	\$ (0.19)
=====		

See accompanying notes to condensed consolidated financial statements

- 3 -

CHROMATICS COLOR SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENT OF CHANGES  
IN STOCKHOLDERS' EQUITY (DEFICIENCY)  
Three Months Ended March 31, 2002

	Preferred Stock	Number of Shares Outstanding	Common Stock Par Value	Additio in Ca
	-----	-----	-----	-----
Balances, December 31, 2001	\$ 11,804,000	20,989,550	\$ 21,000	\$ 46,984,
Three Months Ended March 31, 2000:				
Net Loss		--	--	
Warrants issued with notes payable		--	--	400,
Deemed dividend on convertible preferred stock	211,000	--	--	(211,

Edgar Filing: CHROMATICS COLOR SCIENCES INTERNATIONAL INC - Form 10QSB

Balances, March 31, 2002	\$ 12,015,000	20,989,550	\$ 21,000	\$ 47,173,
--------------------------	---------------	------------	-----------	------------

See accompanying notes to condensed consolidated financial statements

- 4 -

CHROMATICS COLOR SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

	Three Months Ended March 31,	
	2002	2001
CASH FLOWS FROM OPERATING ACTIVITIES:		
Loss from continuing operations	\$ (850,000)	\$ (3,076,
Loss from discontinued operations	-	(540,
Adjustments to reconcile net loss to net cash flows from operating activities:		
Non-cash impairment charge and net change in net assets of discontinued operations	-	540,
Depreciation and amortization	16,000	126,
Compensation cost relating to options granted to consultants	-	
Non-cash interest and financing costs	400,000	
Changes in operating assets and liabilities:		
Accounts receivable	2,000	
Inventories	-	30,
Prepaid expenses and other assets	10,000	(131,
Accounts payable and accrued expenses	81,000	1,682,
Net cash flows from continuing operating activities	(341,000)	(1,369,
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment		(3,
Net cash flows from investing activities		(3,
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds (payments) of notes payable and warrants	400,000	
Financing costs	(41,000)	
Net cash flows from financing activities	359,000	

Edgar Filing: CHROMATICS COLOR SCIENCES INTERNATIONAL INC - Form 10QSB

	-----	
NET CHANGE IN CASH AND EQUIVALENTS	18,000	(1,372,
CASH AND EQUIVALENTS, BEGINNING OF PERIOD	55,000	1,379,
	-----	-----
CASH AND EQUIVALENTS, END OF PERIOD	\$ 73,000	\$ 7,
	=====	=====
SUPPLEMENTAL DISCLOSURE OF NONCASH FINANCING ACTIVITIES:		
Deemed dividends	\$ 211,000	\$ 278,
Warrants issued with notes payable	\$ 400,000	

See accompanying notes to condensed consolidated financial statements

- 5 -

CHROMATICS COLOR SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Basis of Presentation:

Nature of Report - The condensed consolidated balance sheet at the end of the preceding fiscal year has been derived from the audited consolidated balance sheet contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001 and is presented for comparative purposes. All other condensed financial statements are unaudited. In the opinion of management, all adjustments, which include only normal recurring adjustments necessary to present fairly the financial position, results of operations and changes in cash flows, for all periods presented have been made. The results of operations for interim periods are not necessarily indicative of the operating results for the full year.

Footnotes - Certain footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted in accordance with the published rules and regulations of the Securities and Exchange Commission. These condensed consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001.

Note 2 - Commitments and Contingencies:

Business Risks - Since its formation in 1984, the Company has been principally engaged in color science technology research and development and licensing activities, seeking mass market applications for its proprietary technology and instrumentation. The Company's business encompasses all of the risks inherent in the establishment of a new business enterprise, including a limited operating history with significant competition possessing substantially greater resources. Current and future operations also depend upon the continued employment of certain key executives, the ability to further commercialize its proprietary technology and products and the Company's ability to obtain sufficient revenues and outside financing.

## Edgar Filing: CHROMATICS COLOR SCIENCES INTERNATIONAL INC - Form 10QSB

Operating Difficulties - Since 1989, the Company has incurred losses from operations and net cash outflows from operations. The Company expects to license its patents and proprietary technology, sell its equipment and market its related services and products to ultimately overcome these difficulties.

Although the Company has taken steps to substantially reduce personnel and ongoing operating expenses, the Company expects that it will continue to incur costs in connection with the required research and development on its new LED instrument and technology, complete filings, administration and maintenance for certain intellectual properties and regulatory requirements; supply updated products and sales support to its medical distributor; complete FDA filings for upgrades to its medical products, and explore the possibility of either renegotiating its current distribution agreement for its medical products or selling the exclusive rights to its medical products and technology. In the event that the Company is successful in selling the rights to its medical technology, then \$1,200,000 of the currently outstanding notes payable will be repaid from the first \$1,200,000 of such proceeds. There can be no assurance the Company will not continue to incur such losses or will ever generate revenues at levels sufficient to support profitable operations.

The Company anticipates that it will continue to incur net losses for the foreseeable future as expenses are incurred in implementing its long-term business plan.

The Company is currently taking steps to improve operating results and has significantly reduced operating costs. The Company is experiencing a major liquidity crisis and requires an immediate infusion of cash to continue operations. The Company is seeking additional capital to facilitate liquidity and is currently reviewing various financing proposals. If the Company is unable to obtain such financing, or sell its assets to obtain a cash infusion, it may be forced to seek protection from its creditors in bankruptcy.

Even if the Company is successful in obtaining this cash infusion, the Company will require additional future financing to further execute its long range business plan. If the Company is not able to attract additional future financing, generate significant revenue from operations and/or successfully market its products and technologies, it may have to significantly curtail and/or cease operations and be forced to seek protection from its creditors in bankruptcy.

- 6 -

Legal Proceedings - On January 16, 2001, a lawsuit was commenced against the Company and Darby Macfarlane in the federal district court for the Southern District of New York entitled Richard Sommers and Linda Sommers v. Chromatics Color Sciences International, Inc. and Darby S. Macfarlane. The plaintiffs allege that certain statements purportedly made by or on behalf of the Company concerning the Company's success, the extent of use of the ColorMate (Registered Trademark) System and the Company's cash flow constituted violations of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 promulgated thereunder and Section 12(a)(2) of the Securities Act of 1933 as well as common law claims alleging fraudulent misrepresentation, concealment and nondisclosure and seek unspecified damages in an amount to be proven at trial. On March 1,



## Edgar Filing: CHROMATICS COLOR SCIENCES INTERNATIONAL INC - Form 10QSB

2001, the defendants moved to dismiss the complaint for failure to state a claim upon which relief can be granted, for failure to plead fraud with requisite particularity and for failure to comply with the statutory requirements for federal securities fraud claims. Oral argument was held before the Court in January 2002 and the court entered an order granting the defendants' motion and dismissing the case without prejudice, but with leave for the plaintiffs to refile. A second amended complaint was filed in February 2002 and the defendants intend to vigorously defend this action. The Company's financial statements do not include any provision for the outcome of this matter.

### Note 3 - Discontinued Operations

On June 2, 2000, the Company acquired the common stock and assumed certain debt of Gordon, a privately held formulator and manufacturer of cosmetics, hair care and other personal care products. The acquisition was for a purchase price of \$609,000 in cash used to repay Gordon debt and 721,231 shares of the Company's common stock, valued for financial reporting purposes at \$6.29 per share, which approximated the market value of the Company's common stock at the acquisition date. An additional \$653,000 was payable to the former shareholders of Gordon to complete the purchase in the form shares of the Company's common stock. As a result of a post closing adjustment the Company issued 22,894 shares of common stock in 2001, valued at \$144,000, in full consideration of the obligation and the purchase price was reduced by \$509,000. The acquisition was accounted for under the purchase method of accounting for business combinations.

Due to the Company's deteriorating financial condition and inability to continue to support Gordon's operations, the Company decided in early 2001 to sell Gordon. On July 3, 2001, pursuant to the Share Subscription and Redemption Agreement, dated as of June 19, 2001 (the "Purchase Agreement"), among the Company, Abilene Investments Corp. ("Abilene"), GAC- Labs, LLC ("GAC- Labs" and collectively with Abilene, the "Purchasers") and Gordon Acquisition Corp., a wholly-owned subsidiary of the Company ("Gordon"), Gordon issued 200 shares of common stock, par value \$.001 per share, of Gordon ("Gordon Stock") to Abilene and 800 shares of Gordon Stock to GAC-Labs for an aggregate purchase price of \$1,000,000. Simultaneously, the shares of Gordon Stock that were outstanding immediately prior to the closing of this transaction, all of which were owned by the Company, were redeemed for one dollar. In addition, the Company assigned to the Purchasers its right, title and interest in the indebtedness of Gordon and/or H.B. Gordon Manufacturing Co., Inc., its wholly-owned subsidiary, owed to the Company in the ratio of 20% to Abilene and 80% to GAC-Labs.

As part of the same transaction, pursuant to the Purchase Option Agreement, dated as of July 3, 2001 (the "Option Agreement"), among the Company, Abilene and GAC-Labs, the Company was granted the option to purchase from the Purchasers the shares of Gordon Stock issued to them and the indebtedness assigned to them under the Purchase Agreement within one year for an aggregate purchase price of \$1,000,000 plus interest thereon at the rate of 14% per annum, subject to reduction under certain conditions, as described below.

Furthermore, the Company granted to the Purchasers one-year warrants (the "Warrants") to purchase (i) an aggregate of 2,000,000 shares of common stock, par value \$.001 per share, of the Company ("CCSI Stock") at the exercise price of \$.50 per share, if the Company does not consummate a rights offering/ private placement by the Company of its securities prior to the one year expiration of such warrants, or alternatively (ii) an aggregate of 11,200,000 shares of CCSI Stock at the exercise price of \$.10 per share and 4,800,000 shares at \$.001 per share, subject to price adjustment, if the Company consummates a rights offering/private placement by the Company of its securities prior to the one year expiration of such warrants and obtains shareholder approval with respect to such rights offering/private placement by the Company of its securities and

## Edgar Filing: CHROMATICS COLOR SCIENCES INTERNATIONAL INC - Form 10QSB

such increase in warrants. The fair market value of the 2,000,000 warrants was immaterial. If the alternative additional warrants are issued at a later date, the fair market value of such warrants will be recorded as a further loss on the disposal of Gordon.

If (i) pursuant to the Option Agreement the Company exercises its option to purchase from the Purchasers the shares of Gordon Stock issued to them and the indebtedness assigned to them under the Purchase Agreement, (ii) the Company has not effected a reverse stock split of the CCSI Stock in a ratio greater than ten to one, (iii) the Company has consummated a rights offering/private placement by the Company of its securities and (iv) the market price of CCSI Stock exceeds \$1.00 per share

- 7 -

for at least ten consecutive trading days from and after the date of exercise under the Option Agreement, the Warrants will be subject to mandatory exercise. In the event of such a mandatory exercise, the Company will accept as payment of the aggregate exercise price the shares of Gordon Stock that the Purchasers acquired under the Purchase Agreement, and the exercise price under the Option Agreement will be reduced to one dollar. The Warrants are also subject to mandatory exercise if (i) a registration statement filed by the Company with respect to the shares of CCSI Stock issuable upon exercise of the Warrants has been declared effective by the Securities and Exchange Commission, (ii) the Company has not effected a reverse stock split of the CCSI Stock in a ratio greater than ten to one, (iii) the Company has consummated a rights offering/private placement by the Company of its securities and (iv) the market price of CCSI Stock exceeds \$1.00 per share for at least ten consecutive trading days from and after the effective date of such registration statement. In the event of such a mandatory exercise, the Company will accept payment of the aggregate exercise price through the means of a broker's cashless exercise transaction.

The Company does not intend to exercise its option to repurchase Gordon and has not had any influence on Gordon's operations since the sale in July 2001. An officer and director of the Company, who is a former shareholder and Chairman of Gordon, has maintained the title of President of Gordon and provides limited consulting to Gordon's new management. Additionally, certain of the Purchasers are stockholders of the Company. The financial statements for 2000 have been retroactively changed to reflect Gordon's net assets and operations as discontinued operations. The net assets of Gordon were written down to \$1,000,000 as of December 31, 2000. As a result of a post closing adjustment to the purchase price, an adjustment was made in 2001 to reduce goodwill and the amount payable for the purchase of Gordon by \$509,000. Gordon incurred a loss of \$540,000 during the three months ended March 31, 2001.

Net sales and loss from the discontinued operation are as follows for the three months ended March 31, 2001:

Net sales	\$	1,167,000
		=====
Loss from discontinued operation	\$	(540,000)
		=====

Net assets of Gordon at December 31, 2000 were:

Edgar Filing: CHROMATICS COLOR SCIENCES INTERNATIONAL INC - Form 10QSB

Cash	\$	79,000
Accounts receivable		887,000
Inventory		896,000
Property and equipment		814,000
Other assets		2,705,000
		-----
		5,381,000
		-----
Accounts payable and accrued expenses		1,234,000
Debt		3,147,000
		-----
		4,381,000
		-----
Net assets	\$	1,000,000
		=====

Note 4 - Potential Common Shares

The Company has a substantial number of warrants, options and preferred shares outstanding which may result in a substantial number of dilutive common shares being issued in the future. See notes to consolidated financial statements in the Company's December 31, 2001 annual 10-K filing.

- 8 -

Note 5 - Notes payable

In the first quarter of 2002 the Company received \$400,000 in connection with the issuance of notes payable. The notes bear interest at 6% per annum and are due in one year. In connection with the debt the Company issued an aggregate of 23,075,000 five year warrants with exercise prices of \$0.02 to \$0.10 per share. Deferred financing costs were recorded for \$400,000 in connection with the warrants and \$41,000 paid to a finder. Such costs are being charged to expense over the term of the notes.

Note 6 - Subsequent Event

Subsequent to March 31, 2002, the Company received an additional \$25,000 of financing and issued notes payable and 1,250,000 warrants at \$0.02 per share.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

The Company incurred net losses from continuing operations of \$850,000 and \$3,076,000 for the three months ended March 31, 2002 and 2001, respectively. Loss per common share from continuing operations were \$0.05 for 2002 and \$0.16 for 2001. The reduction in net loss is primarily a result of the Company paring back its expenses to preserve cash and the completion of the developmental stage

## Edgar Filing: CHROMATICS COLOR SCIENCES INTERNATIONAL INC - Form 10QSB

of its medical product, and a reduced impact from continued operations.

Sales, marketing and trade show costs were not incurred in 2002 primarily attributable to Datex-Ohmeda, the Company's distributor, taking over these responsibilities. The Company incurred \$244,000 of Sales, marketing and trade show costs in 2001.

Medical regulatory expenses were \$3,000 in 2002 as compared to \$276,000 in 2001. The decrease was primarily attributable to Datex-Ohmeda, the Company's distributor, assuming some of the regulatory expenses and the completion of the majority of the expenses for FDA applications.

Research and development costs were \$45,000 in 2002 as compared to \$305,000 in 2001. The decrease in 2002 is primarily a result of the completion of the majority of the work for FDA applications for upgrades to the TLc-BiliTest (R) medical instrument in 2001, and pairing back expenses on further research and development required on the LED instrument. The LED Instrument is a significantly lower cost instrument made using low cost light emitting diodes (LEDs) to measure color. This instrument allows the Company to offer lower cost instruments for use in mass market applications where cost per instrument is critical to mass marketing such as in the beauty industry for salons, door-to-door or retail sales of cosmetics and hair color, for dentist offices, or home use by the consumer.

In 2001, the Company recorded a provision for estimated payments for terminated employees of \$1,045,000.

General and administrative costs were \$379,000 in 2002 as compared to \$1,073,000 in 2001.

Compensation - Officers, employees and consultants were \$120,000 in 2002 compared to \$404,000 in 2001. The decrease in these costs in 2002 is a result of the reduction of personnel, including executive and senior level personnel to pare back its expenses to preserve cash.

There were also significant decreases in legal fees, rent and storage, insurance, depreciation and amortization and public relations.

Interest and financing costs were \$400,000 in 2002 with no related cost in 2001. The increase is due to the amortization of deferred finance costs.

Due to the sale of Gordon in 2001 the operations of Gordon, which was acquired in June 2000, was retroactively treated as a discontinued operation. The loss from discontinued operations in 2001 was \$540,000 for the three month period ended March 31, 2001.

Although the Company has substantially reduced personnel and ongoing operating expenses, the Company expects that it will continue to incur costs in connection with the required research and development on its new LED instrument and technology, complete filings, administration and maintenance for certain intellectual properties and regulatory requirements; supply updated products and sales support to its medical distributor; complete FDA filings for upgrades to its medical products, and explore the possibility of either renegotiating its current distribution agreement for its medical products or selling the exclusive rights to its medical products and technology.

The Company anticipates that it will continue to incur new losses for the foreseeable future as expenses are incurred in implementing its long-term business plan.

Liquidity and Capital Resources

Current Assets were \$453,000 at March 31, 2002 as compared to \$447,000 at December 31, 2001. Current Liabilities were \$5,016,000 at March 31, 2002 as compared to \$4,449,000 at December 31, 2001. The increase is primarily due to increases in Bridge financing.

With respect to the Bridge financing received in 2001 and 2002 notes payable totaling \$2,099,000, are payable in one year and carry annual interest charges of 6% to 14%.

As indicated in the Condensed Consolidated Statement of Cash Flows, the Company continues to experience significant negative net cash flows from operating activities. The 2002 net cash outflow from operating activities is primarily attributed to the Company's net loss partially offset by non cash interest and financing costs.

The Company lacks funds to continue its operations and business plan, including funds and necessary personnel to complete research and development on its new LED instrument and technology which it became aware of during its first mass manufacturing process; complete filings, administration and maintenance for certain intellectual properties and regulatory requirements and supply upgraded products and sales support to its medical distributor. After completion of the first mass manufacturing prototype of the LED Instrument, the first mass manufacturing run of products was attempted. During this process, the batch to batch variability of the light emitting diodes caused errors in accuracy of the instruments. This can be corrected in a number of ways, including additional calibration procedures, which require more research and development to complete.

Additional funding is required to complete this research and development. The Company's inability to complete required filings, administration and maintenance related to its intellectual property would result in the loss of these related sections of its intellectual property.

The Company's current objective with regard to its medical business is to arrive at acceptable revised terms of the existing agreement with the distributor or to identify a strategic partner in the medical industry to whom the Company could sell, for an up-front fee and ongoing royalty, the exclusive market rights to the ColorMate(R) TLC-BiliTest(R) System.

The Independent Auditors' Reports on the December 31, 2001 and December 31, 2000 financial statements describe conditions that raise substantial doubt about the Company's ability to continue as a going concern.

The Company's business plan is to maintain reduced operating costs while seeking additional financing and attempting to either arrive at acceptable revised business arrangements with its current medical distributor or to sell to a strategic partner the exclusive rights to its medical technology for monitoring infant jaundice for an up-front fee and ongoing royalties. If it is successful in these efforts to raise funds for continued operations, then the Company plans to hire new management, continue its research and development on the LED instrument and implement its business plan for marketing its technology and instruments to the beauty industry including cosmetics, fashion and hair color markets.

The Company is experiencing a major liquidity crisis and requires an immediate infusion of cash to continue operations. The Company is seeking additional capital to facilitate liquidity and is reviewing various potential financings proposals and has taken steps to significantly reduce costs. If the Company is unable to obtain such financing, or sell its assets to obtain a cash infusion,

## Edgar Filing: CHROMATICS COLOR SCIENCES INTERNATIONAL INC - Form 10QSB

it may be forced to seek protection from its creditors in bankruptcy.

Even if the Company is successful in obtaining this cash infusion, the Company will require additional future financing to further execute its long range business plan. If the Company is not able to attract additional future financing, generate significant revenue from operations and/or successfully market its products and technologies, it may have to significantly curtail and/or cease operations and be forced to seek protection from its creditors in bankruptcy.

In August 2001, the Company retained Janssen Partners, Inc. to serve as its placement agent in connection with an offering of 10,333,333 shares of common stock and warrants to raise \$620,000 in proceeds, of which \$25,000 has been subscribed to as of April 22, 2002. Attached to each share is a Series A Common Stock Purchase Warrant which vests immediately, has a five-year life and is exercisable at \$0.10 per share after registration of the underlying shares. Upon the exercise of each

- 10 -

Series A Common Stock Purchase Warrant, the holder will receive a Series B Common Stock Purchase Warrant which vests immediately, has a five-year life from date of issuance and is exercisable at \$0.15 per share after registration of the underlying shares.

The Company is contemplating issuing an additional proxy to obtain stockholder approval for an additional proposed private placement by the Company involving potential issuance of additional shares of common stock by the Company in an aggregate amount in excess of 20% of the Company's common stock outstanding immediately prior to such private placement at a price per share less than the market value of the common stock.

On October 31, 2001, at a special shareholder meeting an amendment to the Company's Certificate of Incorporation to increase the number of authorized shares of common stock, \$.001 par value per share, from 50,000,000 to 550,000,000 was approved. Additionally, an amendment to the Company's Certificate of Incorporation to effect a one share for up to forty shares reverse stock split of the Company's issued and outstanding shares of common stock, as determined by the Company's Board of Directors was approved. Due to the delisting of the Company's securities from NASDAQ SmallCap market, the Company's Board of Directors does not see the necessity to execute a reverse split in the Company's common stock at this time, but reserves the right to reconsider this action at a later date within time frames proposed in the Proxy which were approved by the Company's shareholders at the October 31, 2001 Special Meeting of the Shareholders.

Some of the information presented herein constitutes "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Although the Company believes that its expectations are based on reasonable assumptions, within the bounds of its knowledge of its business and operations, there can be no assurance that actual results will not differ materially from its expectations. Factors that could cause actual results to differ from expectations including, among other things: (i) the inability of the Company to resolve the current liquidity crisis, (ii) the inability of the Company to secure additional financing, (iii) the failure of the Company to implement its business plan for various applications of its technologies, including medical and industrial technologies, (iv) government regulation and (v) the loss of key personnel.

## Edgar Filing: CHROMATICS COLOR SCIENCES INTERNATIONAL INC - Form 10QSB

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

No disclosure is required under this Item 3.

## PART II - OTHER INFORMATION

### Item 1. Legal Proceedings

On January 16, 2001, a lawsuit was commenced against the Company and Darby Macfarlane in the federal district court for the Southern District of New York entitled Richard Sommers and Linda Sommers v. Chromatics Color Sciences International, Inc. and Darby S. Macfarlane. The plaintiffs allege that certain statements purportedly made by or on behalf of the Company concerning the Company's success, the extent of use of the ColorMate (Registered Trademark) System and the Company's cash flow constituted violations of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 promulgated thereunder and Section 12(a)(2) of the Securities Act of 1933 as well as common law claims alleging fraudulent misrepresentation, concealment and nondisclosure and seek unspecified damages in an amount to be proven at trial. On March 1, 2001, the defendants moved to dismiss the complaint for failure to state a claim upon which relief can be granted, for failure to plead fraud with requisite particularity and for failure to comply with the statutory requirements for federal securities fraud claims. Oral argument was held before the Court in January 2002 and the court entered an order granting the defendants' motion and dismissing the case without prejudice, but with leave for the plaintiffs to refile. A second amended complaint was filed in February 2002 and the defendants intend to vigorously defend this action.

### Item 2. Changes in Securities and Use of Proceeds.

None.

- 11 -

### Item 3. Defaults Upon Senior Securities.

None.

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

None.

### Item 5. Other Information.

On September 13, 2001, the Company received Food and Drug Administration (FDA) clearance of its 510(k) premarket application to commercially market its upgraded Colormate(R) TLc-BiliTest(R) System for non-invasive monitoring of infant jaundice. The TLc-BiliTest(R) System upgrade includes faster, more user

Edgar Filing: CHROMATICS COLOR SCIENCES INTERNATIONAL INC - Form 10QSB

friendly test programs with many new or improved features requested by healthcare providers, such as test result transfer capability to a central server via the internet. This most recent FDA clearance also confirmed the safety and effectiveness of the TLc-BiliTest(R) System for infants of all races and gestational ages before, during and after phototherapy, other than infants with discoloration at a required measurement site. The Company believes these features will provide a state-of-the art monitoring system for aiding physicians and healthcare providers in monitoring bilirubin for newborn infants.

Item 6. Exhibits and Reports on Form 8-K.

Reports on Form 8-K:

None.

-12-

SIGNATURES

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

CHROMATICS COLOR SCIENCES INTERNATIONAL, INC.

Date: May 20, 2002

By: /s/ Darby S. Macfarlane

-----  
Darby S. Macfarlane  
Chairperson of the Board

Date: May 20, 2002

By: /s/ Brian T. Fitzpatrick

-----  
Brian T. Fitzpatrick  
Acting Chief Executive Officer  
and President

- 13 -