

Converted Organics Inc.  
Form 10QSB  
November 13, 2007

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

**Quarterly Report under Section 13 or 15(d) of the Securities Exchange Act of 1934.  
For the quarterly period ended: September 30, 2007**

**Transition Report under Section 13 or 15(d) of the Securities Exchange Act of 1934.  
For the transition period from: \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number: 333-120908**

**Converted Organics Inc.**

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

**Delaware**

(State or other jurisdiction of incorporation or  
organization)

**20-4075963**

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

**7A Commercial Wharf W, Boston, MA 02110**

(Address of principal executive offices)

**(617) 624-0111**

(Issuer's telephone number)

(Former name, former address and former fiscal year, if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: YES  NO

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
YES  NO

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: As of November 12, 2007, there were 4,028,472 shares of our common stock outstanding.

Transitional Small Business Disclosure Format. YES  NO

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**Table of Contents****Item 1. Financial Statements**

**CONVERTED ORGANICS INC.**  
**(A DEVELOPMENT STAGE COMPANY)**  
**CONSOLIDATED BALANCE SHEETS**

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 343,433	\$ 66,853
Prepaid rent	216,805	67,585
Other prepaid expenses	40,483	58,685
Other current assets	79,050	15,733
Capitalized bond costs	47,669	
Deferred financing and issuance costs, net	16,340	680,958
<b>Total current assets</b>	<b>743,780</b>	<b>889,814</b>
Deposits	554,978	65,000
Restricted cash	15,698,598	
Construction in progress	3,645,216	
Capitalized bond costs, net of \$31,779 accumulated amortization	873,927	
License, net of \$70,125 and \$57,750 accumulated amortization	589,875	602,250
<b>Total assets</b>	<b>\$ 22,106,374</b>	<b>\$ 1,557,064</b>
<b>LIABILITIES AND OWNERS EQUITY (DEFICIENCY)</b>		
<b>LIABILITIES</b>		
Accounts payable	\$ 366,178	\$ 657,107
Accrued compensation - officers, directors and consultants	300,000	300,000
Accrued legal and other	71,320	369,233
Accrued interest	266,027	142,619
Demand notes payable		250,000
Term notes payable		500,000
Bridge loan payable		1,515,000
<b>Total current liabilities</b>	<b>1,003,525</b>	<b>3,733,959</b>
Term notes payable	464,170	
<b>BONDS PAYABLE</b>	<b>17,500,000</b>	
<b>Total liabilities</b>	<b>18,967,695</b>	<b>3,733,959</b>

COMMITMENTS AND CONTINGENCIES (Note 9)

OWNERS EQUITY (DEFICIENCY)

Preferred stock, \$.0001 par value, authorized 25,000,000 shares; no shares issued and outstanding

Common stock, \$.0001 par value, authorized 75,000,000 shares

Additional paid-in capital

Deficit accumulated during the development stage

Total owners equity (deficiency)

Total liabilities and owners equity (deficiency)

402	133
12,454,449	4,113,385
(9,316,172)	(6,290,413)
3,138,679	(2,176,895)
\$ 22,106,374	\$ 1,557,064

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

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**CONVERTED ORGANICS INC.**  
**(A DEVELOPMENT STAGE COMPANY)**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(UNAUDITED)**

	Three months ended		Nine months ended		Cumulative from inception (May 2, 2003) through September 30, 2007
	September 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006	
Revenues	\$	\$	\$	\$	\$
Selling, General and Administrative expenses	940,145	1,038,472	3,127,806	3,064,399	7,599,570
Research and Development	178,592	38,533	493,243	170,337	2,168,392
Amortization	24,167	47,028	55,190	85,974	198,690
Loss from operations	(1,142,904)	(1,124,033)	(3,676,239)	(3,320,710)	(9,966,652)
Other Income/(Expenses)	229,778		650,480		650,480
	(913,126)	(1,124,033)	(3,025,759)	(3,320,710)	(9,316,172)
Loss before provision for income taxes	(913,126)	(1,124,033)	(3,025,759)	(3,320,710)	(9,316,172)
Provision for Income Taxes					
Net loss	\$ (913,126)	\$ (1,124,033)	\$ (3,025,759)	\$ (3,320,710)	\$ (9,316,172)
Net loss per share, basic and diluted	\$ (0.24)	\$ (0.84)	\$ (0.92)	\$ (2.79)	
Weighted average common shares outstanding	3,838,754	1,333,333	3,292,455	1,188,480	

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

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**CONVERTED ORGANICS INC.**  
**(A DEVELOPMENT STAGE COMPANY)**  
**CONSOLIDATED STATEMENTS OF CHANGES IN OWNERS EQUITY (DEFICIENCY)**  
**Cumulative from Inception (May 2, 2003) to September 30, 2007**

	Common Stock		Additional Paid-in Capital	Deficit	Members	Total Owners Equity (Deficiency)
	Shares Issued and Outstanding	Amount		Accumulated During the Development Stage		
Balance at inception (May 2, 2003)		\$	\$	\$	\$	\$
Members contributions from inception to December 31, 2004					2,172,700	2,172,700
Members distributions from inception to December 31, 2004					(7,460)	(7,460)
Net loss - 2004				(1,934,971)		(1,934,971)
Members contributions Net loss - 2005				(628,681)	172,000	172,000 (628,681)
Recapitalization of members equity	600,000	60	2,337,180		(2,337,240)	
Issuance of common stock to founders	733,333	73				73
Issuance of stock options			1,018,705			1,018,705
Bridge loan rights			757,500			757,500
Net loss				(3,726,761)		(3,726,761)
Balance, December 31, 2006	1,333,333	133	4,113,385	(6,290,413)		(2,176,895)
Issuance of common stock and warrants in connection with the Company s initial public offering (Note 5), net of issuance costs of \$1,736,715 (unaudited)	1,800,000	180	8,163,105			8,163,285
Common shares and warrants issued in connection with bridge units	293,629	29	(29)			

(unaudited) (Note 5) Common shares issued in connection with extension of bridge financing (unaudited) (Note 5)	55,640	6	178,042		178,048
Stock dividends (unaudited)	545,870	54	(54)		
Net loss (unaudited)				(3,025,759)	(3,025,759)
Balance, September 30, 2007 (unaudited)	4,028,472	\$ 402	\$ 12,454,449	\$ (9,316,172)	\$ 3,138,679

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



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**CONVERTED ORGANICS INC.**  
**(A DEVELOPMENT STAGE COMPANY)**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**

	Nine months ended September 30,		Cumulative from inception (May 2, 2003)
	2007	2006	through September 30, 2007
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net loss	\$ (3,025,759)	\$ (3,320,710)	\$ (9,316,172)
Adjustments to reconcile net loss to net cash used in operating activities:			
Amortization of intangible asset license	12,375	12,375	70,125
Amortization of capitalized bond costs	31,779		31,779
Amortization of deferred financing fees	11,036	73,599	96,786
Amortization of discount on bridge loan		683,858	757,500
Stock option compensation expense		1,018,705	1,018,705
Compensation expense pursuant to common stock issued to founders at incorporation		73	73
Stock issued for extension of bridge financing	178,048		178,048
Changes in operating assets and liabilities: (Increase) decrease in:			
Prepaid expenses and other current assets	(194,335)	(120,625)	(401,338)
Deposits	(350,000)		(350,000)
Increase (decrease) in:			
Accounts payable and other accrued expenses	(588,843)	176,159	19,039
Accrued compensation expense officers, directors and consultants		300,000	300,000
Accrued interest	123,408	14,918	266,027
Net cash used in operating activities	(3,802,291)	(1,161,648)	(7,329,428)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Purchase of license	(139,978)		(799,978)
Construction costs	(3,345,709)		(3,345,709)
Capitalized interest	(299,507)		(299,507)
Restrictions of cash	(20,646,611)		(20,646,611)
Release of restricted cash	4,948,013		4,948,013
Net cash used in investing activities	(19,483,792)		(20,143,792)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Members contributions			2,344,700
Proceeds from term notes	89,170		589,170
Repayment of term notes	(275,000)		(275,000)

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Proceeds from demand notes			250,000
Repayment of demand notes	(100,000)		(100,000)
Proceeds from bridge loan, net		1,434,250	1,464,250
Repayment of bridge loan	(1,515,000)		(1,515,000)
Net proceeds from bond financing (Note 3)	16,546,625		16,546,625
Members distributions			(7,460)
Payments made for deferred issuance costs	(42,916)	(245,033)	(340,416)
Net proceeds from initial public offering of stock (Note 5)	8,859,784		8,859,784
Net cash provided by financing activities	23,562,663	1,189,217	27,816,653
NET INCREASE IN CASH	276,580	27,569	343,433
CASH, beginning of period	66,853	371	
CASH, end of period	\$ 343,433	\$ 27,940	\$ 343,433
Supplemental cash flow information:			
Cash paid during the period in:			
Interest	\$ 908,456	\$	\$ 908,456
Non-cash financing activities:			
Deferred financing and issuance costs	\$ 207,158	\$ 245,033	\$ 676,366
Discount for the bridge equity units		757,500	757,500
Issuance costs paid from proceeds of initial public offering	990,000		990,000
Issuance costs paid from proceeds of bond financing	953,375		953,375

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

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**CONVERTED ORGANICS INC.  
(A DEVELOPMENT STAGE COMPANY)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)**

**NOTE 1 BASIS OF PRESENTATION**

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and the rules and regulations of the Securities and Exchange Commission (the SEC) for interim financial reporting. Certain information and footnote disclosures normally included in the Company's annual financial statements have been condensed or omitted. In the Company's opinion, the unaudited interim financial statements and accompanying notes reflect all adjustments, consisting of normal and recurring adjustments that are necessary for a fair presentation of its financial position and operating results as of and for the interim periods ended September 30, 2007 and 2006 and cumulative from inception (May 3, 2003) to September 30, 2007.

The results of operations for the interim periods are not necessarily indicative of the results to be expected for the entire fiscal year. This Form 10-QSB should be read in conjunction with the audited financial statements and notes thereto included in the Company's Form 10-KSB as of and for the year ended December 31, 2006 and for the period commencing from inception (May 3, 2003) to December 31, 2006.

**NOTE 2 SIGNIFICANT ACCOUNTING POLICIES**

***NATURE OF OPERATIONS***

Converted Organics Inc. (a development stage company) (the Company) is planning to use food waste as a feedstock to manufacture, sell and distribute all-natural soil amendment products combining disease suppression and nutrition characteristics. Converted Organics of Woodbridge, LLC (Woodbridge), a New Jersey limited liability company and wholly-owned subsidiary of the Company, was formed for the purpose of owning, constructing and operating the Woodbridge, New Jersey facility. The Company's revenues are expected to come from two sources: tip fees and product sales. Waste haulers will pay the Company tip fees for accepting food waste generated by food distributors such as grocery stores, produce docks and fish markets, food processors, and hospitality venues such as hotels, restaurants, convention centers and airports. Revenue will also come from the sale of the Company's fertilizer products. The Company's products will possess a combination of nutritional, disease suppression and soil amendment characteristics. The Company's initial facility is designed to service the New York-Northern New Jersey metropolitan area. The Company has begun construction of this facility and expects it to be operational in the second quarter of 2008.

***CONSOLIDATION***

The accompanying consolidated financial statements include the transactions and balances of Converted Organics Inc. and its wholly-owned subsidiary, Converted Organics of Woodbridge, LLC. All intercompany transactions and balances have been eliminated in consolidation.

***DEVELOPMENT STAGE COMPANY***

The Company is considered a development stage company as defined by Statement of Financial Accounting Standards (SFAS) No. 7, as it has no principal operations or revenue from any source. Operations from the Company's inception have been devoted primarily to strategic planning, raising capital, developing revenue-generating opportunities and construction of an operating facility.

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**CONVERTED ORGANICS INC.**  
**(A DEVELOPMENT STAGE COMPANY)**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *CONTINUED***  
**(UNAUDITED)**

**NOTE 2 SIGNIFICANT ACCOUNTING POLICIES *CONTINUED***

***USE OF ESTIMATES***

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts and disclosures in the consolidated financial statements. Actual results could differ from those estimates.

***CASH AND CASH EQUIVALENTS***

The Company considers financial instruments with a maturity date of three months or less from the date of purchase to be cash equivalents. The Company had no cash equivalents at September 30, 2007 and December 31, 2006.

As of September 30, 2007 the Company had remaining approximately \$15,699,000 of restricted cash as required by the bond agreement (Note 3). This cash was raised by the Company in its initial public offering and bond financing on February 16, 2007 and is set aside in three separate accounts consisting of \$10,963,000 for the construction of the Woodbridge operating facility, \$1,750,000 for the working capital requirements of the Woodbridge subsidiary while the facility is under construction and \$2,986,000 in reserve for bond principal and interest payments along with a reserve for lease payments. The Company has classified this restricted cash as non-current as third party trustee approval is required for disbursement of funds.

***RESEARCH AND DEVELOPMENT COSTS***

Research and development costs include the costs of engineering, design, feasibility studies, outside services, personnel and other costs incurred in development of the Company's manufacturing facilities. All such costs are charged to expense as incurred.

***INCOME TAXES***

The Company recognizes deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the consolidated financial statements or tax returns. Deferred tax liabilities and assets are determined based on the differences between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Differences between the financial statement and tax bases of assets, liabilities, and other transactions did not result in a provision for current or deferred income taxes for the periods from January 1, 2007 to September 30, 2007 and January 4, 2006 (date of incorporation of Converted Organics Inc.) to September 30, 2007.

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 9 (FIN No. 48), on January 1, 2007. FIN No. 48 requires that the impact of tax positions be recognized in the financial statements if they are more likely than not of being sustained upon examination, based on the technical merits of the position. As discussed in the consolidated financial statements in the 2006 Form 10-KSB, the Company has a valuation allowance against the full amount of its net deferred tax assets. The Company currently provides a valuation allowance against deferred tax assets when it is more likely than not that some portion, or all of its deferred tax assets, will not be realized. There was no significant impact to the Company upon the adoption of FIN No. 48.

The Company is subject to U.S. federal income tax as well as income tax of certain state jurisdictions. The Company has not been audited by the I.R.S. or any states in connection with income taxes. The periods from inception through 2006 remain open to examination by the I.R.S. and state authorities.

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**CONVERTED ORGANICS INC.  
(A DEVELOPMENT STAGE COMPANY)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *CONTINUED*  
(UNAUDITED)**

**NOTE 2 SIGNIFICANT ACCOUNTING POLICIES *CONTINUED***

The Company recognizes interest accrued related to unrecognized tax benefits in interest expense. Penalties, if incurred, are recognized as a component of income tax expense.

***RECENT ACCOUNTING PRONOUNCEMENTS***

In February 2007, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* which is effective for fiscal years beginning after November 15, 2007. This statement permits an entity to choose to measure many financial instruments and certain other items at fair value at specified election dates. Subsequent unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. The Company is currently evaluating the potential impact of this statement.

***EARNINGS (LOSS) PER SHARE***

Basic earnings (loss) per share ( *EPS* ) is computed by dividing the net income (loss) attributable to the common stockholders (the numerator) by the weighted average number of shares of common stock outstanding (the denominator) during the reporting periods. Diluted income (loss) per share is computed by increasing the denominator by the weighted average number of additional shares that could have been outstanding from securities convertible into common stock, such as stock options and warrants (using the *treasury stock* method), and convertible preferred stock and debt (using the *if-converted* method), unless their effect on net income (loss) per share is antidilutive. Under the *if-converted* method, convertible instruments are assumed to have been converted as of the beginning of the period or when issued, if later. The effect of computing the diluted income (loss) per share is antidilutive and, as such, basic and diluted earnings (loss) per share are the same for the three months and the nine months ended September 30, 2007 and 2006.

***DEFERRED FINANCING AND ISSUANCE COSTS AND CAPITAL COSTS BOND ISSUANCE***

In connection with its \$17.5 million bond financing on February 16, 2007 (Note 3), the Company has capitalized bond issuance costs of approximately \$953,000 and is amortizing those costs over the life of the bond.

In connection with its initial public offering (IPO) on February 16, 2007 (Note 5), the Company had issuance costs totaling approximately \$1,687,000, of which approximately \$697,000 had been paid by the Company in 2006 (\$681,000) and 2007 (\$16,000), and were recorded as deferred issuance costs at that time, and approximately \$990,000 of which was netted against total proceeds received on February 16, 2007. The total issuance costs of approximately \$1,687,000 have been netted against the \$9.9 million gross proceeds of the IPO in the statements of changes in owners' equity (deficiency).

In connection with its repayment of the bridge notes (Note 3), the Company paid to the bridge lender a Letter of Credit fee of \$27,375. The fee has been recorded as a deferred financing fee and is being amortized over the life of the Letter of Credit. Accordingly deferred financing costs are \$16,340 at September 30, 2007.

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**CONVERTED ORGANICS INC.  
(A DEVELOPMENT STAGE COMPANY)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *CONTINUED*  
(UNAUDITED)**

**NOTE 2 SIGNIFICANT ACCOUNTING POLICIES *CONTINUED*  
INTANGIBLE ASSET LICENSE**

Pursuant to a license agreement with an effective date of July 15, 2003 and amended effective date of February 9, 2006, the Company entered into an exclusive license to use its enhanced Autogenous Thermophylic Aerobic Digestion process (EATAD) technology for the design, construction and operation of facilities for the conversion of food waste into solid and liquid organic material. The license is stated at cost. Amortization is provided using the straight-line method over the life of the license. Amortization expense for the nine month periods ended September 30, 2007 and 2006, and cumulative from inception (May 2, 2003) to September 30, 2007, was \$12,375, \$12,375 and \$70,125, respectively. The Company expects the license's annual amortization expense to be \$16,500 until fully amortized at the end of the 40 year license period.

In June 2007, the Company placed a deposit of \$139,978 on a second plant license with the licensor. When received, the second license will be capitalized and amortized over its future life.

***SEGMENT REPORTING***

As of September 30, 2007 the Company has no reportable segments as defined by Statement of Financial Accounting Standard (SFAS) No. 131.

**NOTE 3 DEBT**

***DEMAND NOTES***

The Company had three demand notes payable which accrued interest at 10%. These notes were repaid in May, 2007.

A schedule of outstanding principal amounts of the demand notes as of September 30, 2007 and December 31, 2006 is as follows:

	2007	2006
Demand note dated October 30, 2006	\$	\$ 200,000
Demand note dated December 29, 2006		50,000