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CLEAN SYSTEMS TECHNOLOGY GROUP LTD
Form 10QSB
June 02, 2003

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

FORM 10-QSB

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

For the quarterly period ended MARCH 31, 2003

^{or}
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE EXCHANGES ACT

For the transition period from _____ to _____

Commission file number 000-14646

CLEAN SYSTEMS TECHNOLOGY GROUP, LTD.
(Exact name of Small Business Issuer as Specified in Its Charter)

NEW YORK

(State or other jurisdiction of
incorporation or organization)

06-1113228

(I.R.S. Employer
Identification Number)

4 Ashlagan Street, P.O. Box 8624,
Kiryat Gat, Israel

82021

(Address of principal executive offices)

(Zip Code)

011 972 8 660 2108 (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 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

The number of shares outstanding of the registrant's Common Stock, \$0.01
Par Value, on May 30, 2003 was 42,766,540 shares.

Transitional Small Business Disclosure Format (check one):

Yes _____ No _____

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-QSB contains forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements, which are other than statements of historical facts. These statements are subject to uncertainties and risks including, but not limited to, product and service demand and acceptance, changes in technology, economic conditions, the impact of competition and pricing, government regulation, and other risks defined in this document and in statements filed from time to time with the Securities and Exchange Commission. These cautionary statements and any other cautionary statements that may accompany the forward-looking statements expressly qualify all such forward-looking statements. In addition, Clean Systems Technology Group, Ltd. disclaims any obligation to update any forward-looking statements to reflect events or circumstances after the date hereof.

PART I - FINANCIAL INFORMATION

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CLEAN SYSTEMS TECHNOLOGY GROUP, LTD.

CONSOLIDATED BALANCE SHEET AS OF MARCH 31, 2003.

(UNAUDITED)

(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

ASSETS:

CURRENT ASSETS:

| | |
|----------------------------|-------|
| Cash and cash equivalents | \$ 15 |
| Accounts receivable - net | 2,529 |
| Inventory | 2,442 |
| Refundable value added tax | 108 |
| Employee advances | 18 |
| Deferred taxes | 39 |
| Other | 148 |
| | ----- |

| | |
|----------------------|-------|
| TOTAL CURRENT ASSETS | 5,299 |
|----------------------|-------|

| | |
|------------------------------|-------|
| PROPERTY AND EQUIPMENT - NET | 1,634 |
|------------------------------|-------|

| | |
|--------------|-------|
| OTHER ASSETS | 219 |
| | ----- |

| | |
|--------------|----------|
| TOTAL ASSETS | \$ 7,152 |
| | ===== |

LIABILITIES AND SHAREHOLDERS' DEFICIT:

CURRENT LIABILITIES:

| | |
|---------------------------------|--------|
| Short-term bank borrowings | \$ 562 |
| Bank line of credit | 520 |
| Accounts payable | 2,091 |
| Accrued compensation | 632 |
| Accrued expenses | 348 |
| Short-term loans | 372 |
| Short-term loan - related party | 103 |
| Other liabilities | 68 |
| | ----- |

| | |
|---------------------------|-------|
| TOTAL CURRENT LIABILITIES | 4,696 |
|---------------------------|-------|

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| | |
|---|----------|
| CONVERTIBLE NOTES | 1,361 |
| LONG-TERM BANK DEBT | 1,366 |
| COMMITMENTS AND CONTINGENCIES | -- |
| SHAREHOLDERS' DEFICIT: | |
| Common stock, \$.01 par value, 110,000,000 shares authorized, 42,766,087, issued and outstanding | 428 |
| Additional paid-in capital | 428 |
| Accumulated deficit | (1,127) |
| TOTAL SHAREHOLDERS' DEFICIT | (271) |
| TOTAL LIABILITIES AND SHAREHOLDERS' DEFICIT | \$ 7,152 |

See Notes to the Consolidated Financial Statements.

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CLEAN SYSTEMS TECHNOLOGY GROUP, LTD.
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

| | THREE MONTHS ENDED MARCH 31, | |
|-------------------------------------|---------------------------------|----------|
| | 2 0 0 3 | 2 0 0 2 |
| | ----- | ----- |
| REVENUES | \$ 1,352 | \$ 3,099 |
| COST OF REVENUE | 779 | 1,757 |
| | ----- | ----- |
| GROSS PROFIT | 573 | 1,342 |
| OPERATING EXPENSES: | | |
| Selling, general and administrative | 327 | 515 |
| | ----- | ----- |

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| | | |
|--|------------|------------|
| INCOME FROM OPERATIONS | 246 | 827 |
| INTEREST EXPENSE | 170 | 36 |
| OTHER (EXPENSE) | (21) | (275) |
| | ----- | ----- |
| INCOME BEFORE PROVISION FOR INCOME TAXES | 55 | 516 |
| PROVISION FOR INCOME TAXES | 7 | 10 |
| | ----- | ----- |
| NET INCOME | \$ 48 | \$ 506 |
| | ===== | ===== |
| NET INCOME PER SHARE - BASIC | \$ -- | \$.01 |
| | ===== | ===== |
| NET INCOME PER SHARE - DILUTED | \$ -- | \$.01 |
| | ===== | ===== |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES - BASIC | 42,766,087 | 42,766,087 |
| | ===== | ===== |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES - DILUTED | 44,321,516 | 43,809,087 |
| | ===== | ===== |

See Notes to the Consolidated Financial Statements.

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CLEAN SYSTEMS TECHNOLOGY GROUP, LTD.

CONSOLIDATED STATEMENT OF SHAREHOLDERS' DEFICIT
(UNAUDITED)
(IN THOUSANDS, EXCEPT NUMBER OF SHARE DATA)

| | COMMON STOCK NUMBER OF SHARES | AMOUNT | ADDITIONAL PAID-IN CAPITAL | ACCUMULATED DEFICIT | TOTAL SHAREHOLDERS' DEFICIT |
|---------------------------|-------------------------------------|--------|----------------------------------|------------------------|-----------------------------------|
| BALANCE DECEMBER 31, 2002 | 42,766,087 | \$ 428 | \$ 428 | \$ (1,175) | \$ (319) |
| Net Income | -- | -- | -- | 48 | 48 |
| | ----- | ----- | ----- | ----- | ----- |

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| | | | | | | | | | |
|------------------------|------------|----|-------|----|-------|----|---------|----|-------|
| BALANCE MARCH 31, 2003 | 42,766,087 | \$ | 428 | \$ | 428 | \$ | (1,127) | \$ | (271) |
| | ===== | | ===== | | ===== | | ===== | | ===== |

See Notes to the Consolidated Financial Statements.

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CLEAN SYSTEMS TECHNOLOGY GROUP, LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

| | THREE MONTHS ENDED MARCH 31, | |
|---|---------------------------------|---------|
| | 2 0 0 3 | 2 0 0 2 |
| | ----- | ----- |
| OPERATING ACTIVITIES: | | |
| Net income | \$ 48 | \$ 506 |
| Adjustments to reconcile net income to net cash (used for) operating activities: | | |
| Amortization and depreciation | 85 | 65 |
| Gain from the sale of property and equipment | 10 | -- |
| Change in accrued severance pay - net | (9) | 6 |
| Other | 27 | 7 |
| Changes in assets and liabilities: | | |
| (Increase) decrease in: | | |
| Accounts receivable - net | (802) | (306) |
| Accounts receivable - related party | -- | 103 |
| Inventory | (35) | 33 |
| Costs incurred in excess of billings on contracts in progress | -- | (992) |
| Refundable value added tax | 16 | (10) |
| Employee advances | 3 | 7 |
| Deferred taxes | (2) | (2) |
| Other current assets | (46) | (55) |
| Increase (decrease) in: | | |
| Accounts payable | 363 | (106) |
| Accrued compensation | (95) | (29) |
| Accrued expenses | 31 | (76) |
| Other liabilities | 20 | 36 |
| | ----- | ----- |
| NET CASH - OPERATING ACTIVITIES | (386) | (813) |
| | ----- | ----- |
| INVESTING ACTIVITIES: | | |
| Acquisition of property and equipment | -- | (331) |

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| | | |
|---|--------|---------|
| Proceeds from sale of property and equipment | 44 | -- |
| Investment in unconsolidated subsidiary | -- | (94) |
| Other assets | (3) | (2) |
| | ----- | ----- |
| NET CASH - INVESTING ACTIVITIES | 41 | (427) |
| | ----- | ----- |
| FINANCING ACTIVITIES: | | |
| Proceeds from short-term loans | 382 | -- |
| Proceeds from convertible notes | -- | 673 |
| Changes in bank line of credit - net | 3 | 623 |
| Repayment of short-term loans - net | -- | (68) |
| Repayment of short-term bank borrowings | (48) | -- |
| Deferred loan costs | -- | (72) |
| | ----- | ----- |
| NET CASH - FINANCING ACTIVITIES | 337 | 1,156 |
| | ----- | ----- |
| NET [DECREASE] IN CASH AND CASH EQUIVALENTS - FORWARD | \$ (8) | \$ (84) |

See Notes to the Combined Financial Statements.

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CLEAN SYSTEMS TECHNOLOGY GROUP, LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

| | THREE MONTHS ENDED | |
|---|--------------------|---------|
| | MARCH 31, | |
| | 2 0 0 3 | 2 0 0 2 |
| | ----- | ----- |
| NET [DECREASE] IN CASH AND CASH EQUIVALENTS - FORWARD | \$ (8) | \$ (84) |
| CASH AND CASH EQUIVALENTS - BEGINNING OF PERIODS | 23 | 107 |
| | ----- | ----- |
| CASH AND CASH EQUIVALENTS - END OF PERIODS | \$ 15 | \$ 23 |
| | ===== | ===== |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | |
| Cash paid for: | | |
| Interest | \$ 106 | \$ 33 |
| Income taxes | \$-- | \$-- |

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See Notes to the Consolidated Financial Statements.

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CLEAN SYSTEMS TECHNOLOGY GROUP, LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)
(ALL AMOUNTS IN THOUSANDS, EXCEPT SHARE AND
PER SHARE DATA OR AS OTHERWISE NOTED)

[1] BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of Clean Systems Technology Group, Ltd. (the "Company") have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-QSB and Item 310(b) of Regulation S-B. Accordingly, they do not include all information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments [consisting of normal recurring accruals] considered necessary in order to make the interim financial statements not misleading have been included. Results for the three months ended March 31, 2003 are not necessarily indicative of the results that may be expected for the year ended December 31, 2003. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto of the Company and management's discussion and analysis of financial condition and results of operations included in the Company's annual report on Form 10-KSB for the year ended December 31, 2002.

On October 17, 2001, Entertainment International Ltd. ("ENTI"), through its wholly-owned subsidiary ENTI Acquisition I Corp., closed a transaction (the "Transaction") providing for the acquisition of CSTI Hi-Tec, Ltd. an Israeli corporation. All of the issued and outstanding shares of CSTI Hi-Tec, Ltd. were exchanged for shares of ENTI's unregistered restricted common stock. Simultaneously with the closing, the Board of Directors authorized a one for twenty reverse stock split of all ENTI's issued and outstanding common stock. All references in the accompanying consolidated financial statements to the number of shares have been restated to reflect the reverse stock split.

For accounting purposes, the Transaction has been treated as a recapitalization of CSTI Hi-Tec, Ltd., with CSTI Hi-Tec, Ltd. as the acquirer. The shares issued in the Transaction are treated as being issued for cash and are shown as outstanding for all periods presented in the same manner as for a stock split. The consolidated financial statements reflect the results of operations of CSTI Hi-Tec, Ltd. and its subsidiaries and ENTI as of and for the three months ended March 31, 2003 and 2002. Pro forma information on the Transaction is not presented as, at the date of the Transaction, ENTI was considered a public shell and accordingly, the Transaction was not considered a business combination. On December 27, 2001, ENTI amended its certificate of incorporation to change its name from Entertainment International, Ltd. to Clean Systems Technology Group, Ltd. (the "Company" or "CSTI").

[2] SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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The accounting policies followed by the Company are set forth in Note 2 to the Company's consolidated financial statements included in the Company's Form 10-KSB for the year ended December 31, 2002.

USE OF ESTIMATES - The preparation of 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 of assets and liabilities, the disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Significant estimates include the Company's estimate of allowance for doubtful accounts and its revenue recognition policy using the percentage of completion method of accounting for contracts.

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CLEAN SYSTEMS TECHNOLOGY GROUP, LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)
(ALL AMOUNTS IN THOUSANDS, EXCEPT SHARE AND
PER SHARE DATA OR AS OTHERWISE NOTED)

[2] SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES [CONTINUED]

REVENUE RECOGNITION - The Company follows the percentage-of-completion method of accounting for contracts that extend for periods in excess of one year. Accordingly, income is recognized in the ratio that costs incurred bears to estimated total costs. Where contracts in progress are subject to negotiation and it is probable that the additional costs will be recovered, none of the costs are recognized in the income statement until pricing has been approved. Similarly, the revenue is not recognized until realization is assured beyond a reasonable doubt. Adjustments to cost estimates are made periodically, and losses expected to be incurred on contracts in progress are charged to operations in the period such losses are determined. The aggregate of cost incurred on contracts in progress in excess of related billings is shown as a current asset, and the aggregate of billings on contracts in progress in excess of related costs incurred as shown as a current liability.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS - In April 2003, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" ("SFAS 149"), which clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. The Company expects that the adoption of SFAS 149 will not have a significant impact on its financial statements.

In May 2003 SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity was issued. The Statement improves the accounting for certain financial instruments that under previous guidance, issuers could account for as equity. The new Statement requires that those instruments be classified as liabilities in statements

of financial position.

SFAS No. 150 affects the issuer's accounting for three types of freestanding financial instruments. One type is mandatorily redeemable shares, which the issuing company is obligated to buy back in exchange for cash or other assets. A second type, which includes put options and forward purchase contracts, involves instruments that do or may require the issuer to buy back some of its shares in exchange for cash or other assets. The third type of instruments that are liabilities under this Statement is obligations that can be settled with shares, the monetary value of which is fixed, tied solely or predominantly to a variable such as a market index, or varies inversely with the value of the issuers' shares.

Most of the guidance in Statement SFAS No. 150 is effective for all financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. It is not possible to quantify the impact on its financial statements until the newly issued statement has been studied.

[3] INVENTORY

Inventory, which consists of raw materials, is valued at the lower of cost or market. Cost is determined by the weighted average method.

[4] NET INCOME PER SHARE

Earnings per share are calculated in accordance with the provisions of Statement of Accounting Standards No. 128, "Earnings per Share" ("SFAS 128"). SFAS 128 requires the reporting of both basic earnings per share, which is the weighted-average number of common shares outstanding, and diluted earnings per share, which includes the weighted-average number of common shares outstanding and all dilutive potential common shares outstanding, utilizing the treasury stock method. For the three months ended March 31, 2003 and 2002, the shares issued in the Transaction are treated as outstanding for all periods presented. For the three months ended March 31, 2003 and 2002, dilutive potential common shares outstanding reflect shares issuable under convertible notes [See Note 5]. Share and per share amounts reflect the effect of the one for twenty reverse stock split in October 2001.

[5] CONVERTIBLE NOTES

Principal amounts of the notes may be converted by the holder after eighteen months into shares of Company common stock, at a conversion price of \$0.875 per share, at any time from issuance until eighteen months have passed since issuance. The notes automatically convert into shares of Company common stock at a price equal to \$0.875, subject to adjustment. The adjustment entitles the noteholders to receive consideration at least equal to the original principal amount of the note plus accrued interest at eight percent per annum from the date of issuance. The consideration may be paid in cash or common stock at the sole discretion of the Company. At March 31, 2003, the outstanding balance plus accrued interest aggregated \$1,361.

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CLEAN SYSTEMS TECHNOLOGY GROUP, LTD.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 (UNAUDITED)
 (ALL AMOUNTS IN THOUSANDS, EXCEPT SHARE AND
 PER SHARE DATA OR AS OTHERWISE NOTED)

[6] OTHER (EXPENSE)

Aggregate amounts in other (expense) are primarily the result of foreign currency translation adjustments. Substantially all of the Company's sales are made in U.S. dollars. In addition, a substantial portion of the Company's costs are incurred in U.S. dollars. Since the U.S. dollar is the primary currency in the economic environment in which the Company operates, the U.S. dollar is its functional currency.

During the three months ended March 31, 2003, certain assets and liabilities were denominated in NIS while the payments to suppliers were linked to the U.S. dollar.

[7] GEOGRAPHIC REPORTING

Revenues by geographic classifications are as follows:

| | [IN U.S. \$ THOUSANDS] | | | | |
|-------------------------------------|------------------------|-------|-------|--------|---------|
| | ISRAEL | ITALY | INDIA | FRANCE | TOTAL |
| For the period ended March 31, 2003 | \$1,110 | \$ 15 | \$ -- | \$ 227 | \$1,352 |
| For the period ended March 31, 2002 | \$3,007 | \$ 74 | \$ 18 | \$ -- | \$3,099 |

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

When used in this Form 10-QSB and in future filings by Clean Systems with the Securities and Exchange commission, the words or phrases "will likely result" and "the company expects," "will continue," "is anticipated," "estimated," "project," or "outlook" or similar expressions are intended to identify "forward-looking statements." Clean Systems wishes to caution readers not to place undue reliance on any such forward-looking statements, each of which speak only as of the date made. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. Clean Systems has no obligation to publicly release the result of any revisions which may be made to any forward-looking statements to reflect anticipated or unanticipated

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events or circumstances occurring after the date of such statements.

OVERVIEW

CSTI designs, engineers, manufactures, installs and services ultra high purity systems for transportation of clean gases and liquids from the source, where the gases and liquids are stored, to the point of use for the following processing industries:

- o Micro-electronics (semi conductors);
- o Optical fibers;
- o Pharmaceuticals and Bio-technology; and
- o Metal Blades.

CSTI product lines provide a total solution for the four major gas and chemical systems from source to the point of use referenced above. Since the gases and the chemicals are pure and extremely dangerous, the systems that CSTI manufactures must have the highest levels of safety and quality.

CSTI products are divided into three main categories:

- o Systems for ultra high purity gases from source to point of use;
- o Pre-manufactured products sub-systems; and
- o System upgrades.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

This discussion and analysis of the Company's financial condition and results of operations are based on its consolidated financial statements that have been prepared under accounting principles generally accepted in the United States of America. The preparation of 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, the disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. All significant accounting policies are disclosed in note 2 to the consolidated financial statements included in Form 10-KSB. The consolidated financial statements and the related notes thereto should be read in conjunction with the following discussion of the Company's critical accounting policies. Critical accounting policies and estimates are:

- o Revenue Recognition
- o Use of Estimates

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REVENUE RECOGNITION - The Company follows the percentage-of-completion method of accounting for contracts that extend for periods in excess of one year. Accordingly, income is recognized in the ratio that costs incurred bears to estimated total costs. Where contracts in progress are subject to negotiation and it is probable that the additional costs will be recovered, none of the costs are recognized in the income statement until pricing has been approved. Similarly, the revenue is not recognized until realization is assured beyond a reasonable doubt. Adjustments to cost estimates are made periodically, and

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losses expected to be incurred on contracts in progress are charged to operations in the period such losses are determined. The aggregate of cost incurred on contracts in progress in excess of related billings is shown as a current asset, and the aggregate of billings on contracts in progress in excess of related costs incurred as shown as a current liability.

USE OF ESTIMATES - The preparation of 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 of assets and liabilities, the disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS - In April 2003, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" ("SFAS 149"), which clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. The Company expects that the adoption of SFAS 149 will not have a significant impact on its financial statements.

RESULTS OF OPERATIONS

The following table sets forth, as a percentage of total revenue, certain consolidated statements of operations data for the periods indicated. These operating results are not necessarily indicative of the results for any future period.

| | THREE MONTHS ENDED MARCH 31, | |
|------------------------------------|------------------------------|---------|
| | 2 0 0 3 | 2 0 0 2 |
| Revenues | 100 % | 100 % |
| Cost of Revenues | 58 % | 57 % |
| Gross Profit | 42 % | 43 % |
| Selling General and Administrative | 24 % | 16 % |
| Income from Operations | 18 % | 27 % |
| Interest Expense | 12 % | 1 % |
| Other (Expense) | (2) % | (9) % |
| Income Before Taxes on Income | 4 % | 17 % |
| Income Taxes | -- % | -- % |
| Net Income | 4 % | 17 % |

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THREE MONTHS ENDED MARCH 31, 2003 COMPARED WITH THREE MONTHS ENDED
MARCH 31, 2002
(AMOUNTS IN THOUSANDS UNLESS OTHERWISE INDICATED)

REVENUES

Revenues in 2003 of \$1,352 decreased \$1,747 (or 57%) from \$3,099 in 2002. Management's strategic decision is to continue to be a premier industry leader in Israel as well as to continue to gain market share in the European and Central Asian markets. During the three months ended March 31, 2003 and 2002, revenues to customers in Israel amounted to \$1,110 and \$3,007, respectively. Revenues to non-domestic customers amounted to \$242 and \$92 for the three months ended March 31, 2003 and 2002, respectively. In general, the Company is not dependent upon any single customer or group of customers. The nature of the Company's business is such that it works on several large contracts at any one time. Therefore, several customers may comprise a significant portion of CSTI's revenues during any fiscal period. Once the Company installs a system for its customer, the customer is generally dependent on the Company for future upgrades of that system.

COST OF REVENUES

The following table sets forth a comparison of the costs of revenues for the periods indicated:

| | THREE MONTHS ENDED | |
|---|--------------------|----------|
| | MARCH 31, | |
| | 2 0 0 3 | 2 0 0 2 |
| | ----- | ----- |
| Cost of materials and inventory | \$243 | \$862 |
| Salaries, Subcontractors and related expenses | 279 | 696 |
| Cost of service abroad | 55 | 39 |
| Rent and taxes | 49 | 22 |
| Vehicles and transportation | 53 | 74 |
| Equipment maintenance and insurance | 42 | 9 |
| Depreciation and Amortization | 52 | 44 |
| Miscellaneous | 6 | 11 |
| | ---- | ---- |
| Cost of Revenues | \$ 779 | \$ 1,757 |
| | ===== | ===== |

Cost of revenues has decreased by \$0.98 million (or 55.7%) to \$0.78 million in 2003 from \$1.76 million in 2002. The decrease is in line with the overall decline in Company revenues. The purchase cost of materials did not significantly increase in 2003 over 2002. Materials, inventory costs and labor as a percentage of revenues was 39% in 2003 as compared to 50% in 2002. The average number of employees during 2003 was 65 as compared to 145 for 2002. Other costs such as rent and taxes, transportation, equipment maintenance and insurance and depreciation have changed in relative proportion to the decrease in revenues.

GROSS PROFIT

Gross profit has decreased by \$769 (or 57%) to \$573 in 2003 from \$1,342 in 2002. Gross profit margins remained consistent at 42% in 2003 versus 43% in 2002.

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SELLING, GENERAL AND ADMINISTRATIVE

The following table sets forth details regarding selling, general and administrative expenses for the periods indicated:

| | THREE MONTHS ENDED | |
|------------------------------------|--------------------|---------|
| | MARCH 31, | |
| | 2 0 0 3 | 2 0 0 2 |
| | ----- | ----- |
| Salaries and related expenses | \$ 78 | \$243 |
| Professional fees | 105 | 94 |
| Telephone and office maintenance | 53 | 51 |
| Travel vehicles and transportation | 10 | 46 |
| Depreciation | 33 | 21 |
| Sales and marketing | 48 | 60 |
| | ---- | ---- |
| | \$327 | \$515 |
| | ==== | ==== |

Selling, General and Administrative Expenses ("SG&A") have decreased \$0.19 million (or 36.5%) to \$0.33 million in 2003 from \$0.51 million in 2002. The decrease is primarily attributable to the termination of three senior employees at end of 2002.

INTEREST EXPENSE

Interest expense increased by \$134 to \$170 in 2003 from \$36 in 2002. The increase is primarily attributable to a higher level of outstanding debt in 2003 as compared to 2002.

OTHER INCOME (EXPENSE)

The decrease in other expense of \$(254) to \$(21) in 2003 as compared to an expense of \$(275) in 2002 is primarily the result of foreign currency translation adjustments. Substantially all of the Company's sales are made in U.S. dollars. In addition, a substantial portion of the Company's costs are incurred in U.S. dollars. Since the U.S. dollar is the primary currency in the economic environment in which the Company operates, the U.S. dollar is its functional currency.

During the three months ended March 31, 2003 and 2002, certain assets and liabilities were denominated in NIS while the payments to suppliers was linked to the U.S. dollar.

LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2003, the Company had cash and cash equivalents of \$15 as compared to \$23 at March 31, 2002.

Net cash used in operating activities was \$386 for the three months ended March 31, 2003 as compared to \$813 for the three months ended March 31, 2002. The use of net cash for operating activities is primarily attributable to increases in net accounts receivables and costs incurred in excess of billings. These cash

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outflows were partially offset by the increase in net income.

Net cash used in investing activities was \$41 and \$(427) for the three months ended March 31, 2003 and 2002, respectively. In 2002, the Company purchased real estate property (\$200) and an equity investment in an unconsolidated subsidiary (\$100) versus 2003 in which there were no such cash outlays.

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Net cash provided by financing activities was \$337 and \$1,156 for the three months ended March 31, 2003 and 2002, respectively. The decrease was primarily due to a lower level of new borrowings to support the Company's working capital position in 2003 versus 2002.

The following summarizes certain financing outstanding as of March 31, 2003:

[a] Bank Guarantees - Certain customers require the Company to obtain bank guarantees of a portion of the contract undertaken. The Company has an agreement with the bank under which such guarantees are available. In the event the Company is unable to perform all aspects of the contracts, the bank will make contractual payments to customers and then seek reimbursement from the Company. As of March 31, 2003, the bank had extended approximately \$333 in guarantees to five customers.

Subsequent to March 31, 2003, the Company issued an aggregate of \$200 convertible notes with terms substantially the same as described in Note 5 of the unaudited consolidated interim financial statements.

Assuming there is no significant change in the business, the Company believes that additional funding such as described above and cash flow from operations and will be sufficient to fund its needs for at least the next twelve months.

ITEM 3. CONTROLS AND PROCEDURES.

Our Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation within 90 days of the filing date of this report, that our disclosure controls and procedures are effective for gathering, analyzing and disclosing the information we are required to disclose in our reports filed under the Securities Exchange Act of 1934. There have been no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of the previously mentioned evaluation.

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PART II - OTHER INFORMATION

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ITEM 1. LEGAL PROCEEDINGS

Other than as previously disclosed in the Company's Form 10-KSB, the Company is not party to any other material legal proceedings.

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

(a) Exhibits.

99.1 - Certification of Chief Executive Officer pursuant to the Sarbanes-Oxley Act of 2002 99.2 - Certification of Chief Financial Officer pursuant to the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K.

There were no reports filed on Form 8-K during the quarter ended March 31, 2003.

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SIGNATURES

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

CLEAN SYSTEMS TECHNOLOGY GROUP, LTD.

Dated: June 2, 2003

By: /S/ JACOB LUSTGARTEN

Jacob Lustgarten
Chief Executive Officer and
Chairman of the Board

Dated: June 2, 2003

By: /S/ YONA LIEBOWITZ

Yona Liebowitz
Chief Financial Officer

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CERTIFICATIONS

CERTIFICATION BY JACOB LUSTGARTEN PURSUANT TO SECURITIES EXCHANGE ACT
RULE 13A-14

I, Jacob Lustgarten, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Clean Systems Technology Group, Ltd.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

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6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: June 2,, 2003

/S/ JACOB LUSTGARTEN

CHIEF EXECUTIVE OFFICER AND CHAIRMAN

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CERTIFICATION BY YONA LEIBOWITZ PURSUANT TO
SECURITIES EXCHANGE ACT RULE 13A-14

I, Yona Liebowitz, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Clean Systems Technology Group, Ltd.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

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c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: June 2, 2003

/S/ YONA LIEBOWITZ

CHIEF FINANCIAL OFFICER

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CERTIFICATION BY MEIR ELAZAR PURSUANT TO
SECURITIES EXCHANGE ACT RULE 13A-14

I, Meir Elazar, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Clean Systems Technology Group, Ltd.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the

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registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: June 2, 2003

/S/ MEIR ELAZAR

SECRETARY AND DIRECTOR