CYCLO3PSS CORP
Form 10QSB
January 14, 2002

CONFORMED

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB

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

FOR THE QUARTER ENDED NOVEMBER 30, 2001

OR

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

COMMISSION FILE NUMBER 0-22720

CYCLO3PSS CORPORATION

(Name of Small Business Issuer as specified in its charter)

Delaware	87-0455642
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)
7105 South Highland Dr. #102 Salt Lake City, Utah	84121
(Address of principal executive offices)	(Zip Code)

Issuer's telephone number, including area code: (801) 947-1101

Securities registered pursuant to Section 12(b) of the Exchange Act: None

Securities registered pursuant to Section 12(g) of the Exchange Act: $.001 Par Value Common Stock

Check whether the Issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 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 X No .

Common Stock outstanding at January 11, 2002 - 37,348,040 shares of $.001 par value Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE: NONE

FORM 10-QSB

Financial Statements and Schedules

Cyclo3pss Corporation

For Three and Nine Months Ended November 30, 2001

The following financial statements and schedules of the registrant and its consolidated subsidiaries are submitted herewith:

PART I - FINANCIAL INFORMATION

CYCLO3PSS CORPORATION
Condensed Consolidated Balance Sheets
(Unaudited)

	November 30 2001 (unaudited)	February 28 2001
Assets		
Current assets:		
Cash	$ 106,054	$ 62,022
Accounts receivable,net	24,123	28,850
Work in progress inventory	24,302	-
Notes receivable from OxiDyn	-	80,000
Prepaid expenses	67	3,462
Total current assets	154,546	174,334
Property and equipment, net	25,214	67,800
Other assets:		
Acquired patents, net	9,107	36,407

Developed patents and other, net	26,914	36,693
	$ 215,781	$ 315,234

CYCLO3PSS CORPORATION
Condensed Consolidated Balance Sheets
(continued)

	November 30 2001 (unaudited)	February 28 2001
Liabilities and stockholders' equity (deficit)		
Current liabilities:		
Accounts payable	$ 149,902	$ 124,937
Accrued liabilities	183,551	119,351
Notes payable	695,000	1,000,000
Note payable to officer	-	10,000
Deferred revenue	100,000	100,000
Total current liabilities	1,128,453	1,354,288
Commitments and contingencies		
Stockholders' deficit:		
Preferred stock:		
Preferred stock issuable in series: par value $.01, 4,500,000 shares authorized:		
Series "A" convertible preferred stock; 356,638 shares authorized; 356,638 shares issued and outstanding	356	356
Series "B" convertible preferred stock; 30,000 shares authorized; no and 614 shares issued and outstanding November 30, and February 28, 2001, respectively	-	6
Series "E"convertible preferred stock; 10,000 shares authorized; 500 shares and no shares issued and outstanding	5	-
Common stock, par value $.001; 55,000,000 shares authorized; 37,348,040 and 30,352,826 shares issued and outstanding at November 30, 2001 and February 28, 2001, respectively	37,348	30,353
Additional paid-in capital	20,441,090	19,504,245
Deferred stock-based compensation	-	(1,969)
Stock subscription received	-	190,000
Accumulated deficit	(20,889,926)	(20,260,500)
Less treasury stock, 264,000 common shares at cost	(501,545)	(501,545)
Total stockholders' equity (deficit)	(912,672)	(1,039,054)
	$ 215,781	$ 315,234

See accompanying notes to condensed consolidated financial statements

CYCLO3PSS CORPORATION
Condensed Consolidated Statements of Operations
(Unaudited)

	For the three months ended November 30, 2001	2000
Net revenues	$ 49,744	$ 74,729
Costs and expenses:		
Cost of revenues	54,194	56,270
Research and development	2,366	17,793
Selling and marketing	31,028	27,264
General and administrative	109,696	131,363
Depreciation and amortization	21,450	21,250
Total expenses	218,734	253,940
Loss from operations	(168,990)	(179,211)
Interest income	3,331	519
Interest expense	(5,560)	-
Net Loss from continuing operations	(171,219)	(178,692)
Discontinued operation:		
Gain on sale of discontinued operations	201,530	-
Loss from discontinued operations	-	(602)
Net gain (loss) from discontinued operations	201,530	(602)
Net Loss	$ 30,311	$ (179,294)
Basic and diluted net loss per common share:		
Continued operations	$ (.005)	$ (.006)
Discontinued operations	$ .006	$ -
Net loss per common shares- basic and diluted	$ .001	$ (.006)
Weighted average number of common shares issued and outstanding	36,372,343	28,610,961

See accompanying notes to condensed consolidated financial statements

-5-

CYCLO3PSS CORPORATION
Condensed Consolidated Statements of Operations
(Unaudited)

	For the nine months ended November 30, 2001	2000
Net revenues	$ 251,022	$ 157,136
Costs and expenses:		
Cost of revenues	190,093	182,240

Research and development	27,181	51,638
Selling and marketing	109,189	92,846
General and administrative	719,550	575,089
Depreciation and amortization	63,630	104,408
Total expenses	1,109,643	1,006,121
Loss from continuing operations	(858,621)	(849,085)
Interest income	5,140	2,697
Interest expense	(5,560)	(131)
Net loss from continuing operations	(859,041)	(846,519)
Discontinued operation:		
Gain on sale of discontinued operations	213,539	-
Income from discontinued operations	16,076	23,341
Net gain from discontinued operations	229,615	23,341
Net Loss	$ (629,426)	$ (823,178)
Basic and diluted net loss per common share:		
Continued operations	$ (.025)	$ (.031)
Discontinued operations	$ .007	$ .001
Net loss per common shares- basic and diluted	$ (.018)	$ (.030)
Weighted average number of common shares issued and outstanding	34,740,376	27,236,575

See accompanying notes to condensed consolidated financial statements

CYCLO3PSS CORPORATION

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	For the nine months ended November 30, 2001	2000
Cash flows from operating activities:		
Net loss	$ (629,426)	$ (823,178)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	63,630	120,195
Common Stock issued for services	-	177,060
Stock based compensation	1,969	-
Common stock issued for legal settlement	25,000	-
Gain on sale of discontinued operations	(213,539)	-
Write off of note receivable	200,386	-
Changes in assets and liabilities:		
Accounts receivable	4,727	(148,491)
Work in progress inventory	(24,302)	-
Prepaid expenses	3,395	349
Accounts payable and accrued liabilities	89,165	(429,099)

Net cash used in operating activities	(478,995)	(1,103,164)
Cash flows from investing activities:		
Disposals (purchases) of property and equipment, net	(3,357)	6,215
Proceeds from sale of discontinued operations	235,000	-
Increase to notes receivable from OxiDyn	(120,386)	-
Addition to developed patents and other	(2,069)	(46,803)
Net cash provided (used) in investing activities	109,188	(40,588)
Cash flows from financing activities:		
Proceeds from issuance of common stock	100,000	150,000
Proceeds from issuance of warrants	-	196,000
Proceeds from exercise of stock options	45,839	8,477
Proceeds from issuance of notes payable	278,000	750,000
Payment on note payable to officer	(10,000)	-
Principal payments under capital lease obligations	-	(3,084)
Net cash provided by financing activities	413,839	1,101,393
Net increase (decrease) in cash	44,032	(42,359)
Cash at beginning of period	62,022	107,565
Cash at end of period	$ 106,054	$ 65,206
Non-cash financing activities:		
Issuance of common stock for stock subscription	$ 190,000	$ -
Conversion of note payable to preferred stock	500,000	-
Conversion of note payable to common stock	83,000	-
Conversion of preferred stock to common stock	6	-

See accompanying notes to condensed consolidated financial statements.

CYCLO3PSS CORPORATION
Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Summary of Significant Accounting Policies

Organization

The Corporation was formed in Delaware in 1927. In 1990, the Corporation was reorganized as Cyclo3pss Medical Systems, Inc. In 1995, the Company changed its name to Cyclo3pss Corporation (The Company). The Company is engaged in the manufacture, sale and installation of ozone food processing products, ozone washing for commercial and institutional laundries, and research and development of technologies for the sterilization and/or disinfection of surgical and medical instruments, as well as ozone based consumer appliances.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary. All intercompany balances and transactions have been eliminated.

The accompanying unaudited condensed consolidated financial statements are stated in accordance with the instructions to Form 10-QSB and do not include all of the 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 for a fair presentation have been included.

Operating results for the nine months ended November 30, 2001 are not necessarily indicative of the results that may be expected for the full year ended February 28, 2002. The unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-KSB for the year ended February 28, 2001.

Comprehensive Income

Statement of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income", requires that all items that are recognized under accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. The items of other comprehensive income that are typically required to be displayed are foreign currency items, minimum pension liability adjustments, and unrealized gains and losses on certain investments in debt and equity securities. There have been no items of other comprehensive income to date.

Use of Estimates

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 and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain reclassifications have been made to previously reported amounts to conform to the current presentation.

Letter of Intent to Acquire OxiDyn, Incorporated

In October 2000, the Company entered into a letter of intent to acquire OxiDyn, Incorporated (OxiDyn), a North Carolina based manufacturer of ozone based clean-in-place and sanitizing rinsing systems for the beverage and bottling industry. A preliminary acquisition agreement was executed in February 2001, subject to final negotiation, which called for the Company to issue shares of common stock determined by dividing OxiDyn's net book value by the average closing price of the Company's common stock during the five-day trading period immediately prior to the closing date of the acquisition.

In November 2000, the Company loaned $80,000 to OxiDyn to meet its current operating requirements. In order to provide the above funding, the acquisition agreement called for the Company to complete a private placement offering of at least $300,000 at a price of $0.195 per share, which was to be purchased by OxiDyn's investors and shareholders. The Company received cash of $190,000 related to the offering prior to February 28, 2001, which was reported as a stock subscription received in the financial statements. Subsequent to February 28, 2001, the Company completed the private placement offering receiving an additional $100,000 for a total gross proceeds of $290,000, including the subscription received, and issued 1,487,179 shares of common stock. The Company advanced an additional $120,386 in cash to OxiDyn subsequent to February 2001 to meet additional operating requirements.

OxiDyn has been unable to meet various expected operational target milestones over the past twelve months, raising doubt that the proposed acquisition will close. Therefore, the Company wrote off the note receivable and other funds advanced totaling $200,386 during the second quarter of fiscal 2002.

Asset purchase and sale agreement with Paragon, LLC

On June 15, 2001, the Company entered into an asset purchase and sale agreement with Paragon, LLC to sell primarily all of the assets of Cyclopss Biochemical Corporation, a wholly owned subsidiary, for $285,000. The Principals of Paragon, LLC are the employees of Cyclopss Biochemical Corporation. The Company received $30,000 as a down payment and financed the balance of $255,000 over five years, at 8% interest, secured by Paragon's assets.

The terms of the sale agreement allow for a discount in the purchase price of $50,000 if all amounts due under the note receivable, less the purchase price discount, are paid prior to a specific date. The Company received a final payment of $205,000 from Paragon, LLC during the third quarter of fiscal 2002 in connection with this sale, and recorded a total gain of $213,539 on the sale of the biochemical products business.

The biochemical products business has been accounted for as a discontinued operation and accordingly, the results of operations are segregated from continuing operations in the accompanying 2001 statements of operations. Revenue, operating costs and expenses, other income and expenses of this business has been reclassified to discontinued operations for the three and nine months ended November 30, 2001 and 2000. No allocation of general corporate overhead has been made to discontinued operations relating to this business.

2. Basis of Presentation

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. The Company has sustained significant net losses which have resulted in an accumulated deficit at November 30, 2001 of $20,889,926 and $20,260,500 at February 28, 2001, has significant cash flow difficulties, and is in default on debt covenants related to the outstanding notes payable, all of which raise substantial doubt of the Company's ability to continue as a going concern.

The net loss for the year ended February 28, 2001 was $1,114,855 and the Company recorded a net loss of $629,426 for the nine months ended November 30, 2001. To date, the Company has funded its operations through the issuances of debt and common and preferred stock. The Company anticipates a net loss for the year ended February 28, 2002, and with a cash balance of $106,054 at November 30, 2001 and expected cash requirements for the year, there is doubt as to the Company's ability to continue operations.

The Company believes that these conditions have resulted from the inherent risks associated with small technology companies. Such risks include, but are not limited to, the ability to: a) generate sales of its product at levels sufficient to cover its costs and provide a return for investors, b) attract additional capital in order to finance growth, c) further develop and successfully market commercial products and d) successfully compete with other technology companies having financial, production and marketing resources significantly greater than those of the Company.

The Company is attempting to improve these conditions by way of financial assistance through collaborative partnering agreements, issuances of additional equity, debt arrangements, and product sales. Management believes that appropriate funding will be generated and future product sales will result from these opportunities and that the Company will continue operations through the next fiscal year; however, no assurance can be given that sales will be generated or that the additional necessary funding will be raised.

3. Contingencies

The Company is not a party to and presently is not aware of any pending claims or existing litigation. The Company issued 250,000 shares of common stock during the second quarter of fiscal 2002 as final adjustment of a previous legal settlement, for which the Company recorded a non-cash charge of $25,000. Previous settled matters are described in the Company's Form 10-KSB for the year ended February 28, 2001.

4. Segment Information

On March 7, 2000 the Company internally realigned its ozone businesses, collapsing these separate business units into a single entity. The Company operated in two principal industries; the manufacture, sale and installation of ozone products ("ozone products"); and the manufacture and sale of specialty chemicals ("biochemical products").

On June 15, 2001 the Company sold the assets and business related to its biochemical products subsidiary, Cyclopss Biochemcial Corporation, to Paragon, LLC(see Note 1). The Company now only operates in one segment.

5. Long term debt

In December 1999, the Company negotiated a letter of intent with a strategic partner that provided for two separate financings. The first, an unsecured promissory note for $250,000, was executed and funded in concert with the signing of the letter of intent. The second financing is a convertible secured loan for $750,000 that was funded in the second quarter of fiscal 2001. The loan agreement is collateralized by a first security interest in all of the Company's intellectual property and was due and payable in one year from its execution. The loan and accrued interest is convertible, in whole or in part, into the Company's common stock at anytime during the loan term.

In February 2001, the Company renegotiated the loan whereby the unpaid accrued interest on the notes of $97,397 was converted into 593,777 shares of common stock and $500,000 of the principal balance would be converted into 5 shares of Series "E" convertible preferred stock, which occurred in March 2001. Under the terms of the renegotiated loan agreement, the remaining $500,000 principal balance is due February 28, 2002.

Under the terms of the loan agreements, the Company is subject to various covenants, including maintaining minimum liquid assets in the form of cash or marketable securities of $100,000. At February 28, 2001 and subsequent to that date, the Company is in default with the minimum liquid assets covenant and, therefore, the loan may be called at any time.

During fiscal 2002, the Company issued notes payable totaling $278,000 related to a private placement offering. The notes bear interest at an annual interest rate of 10% and have a term of six months. In connection with the issuance of the notes payable the Company is required to issue common stock for an amount equal to 2% of the face value of the notes payable. During the second quarter of fiscal 2002, the Company issued 19,750 shares of common stock under this arrangement and recorded interest expense of $3,752, based on the fair value of the common stock issued in conjunction with the financing. The Company has accrued interest of $1,808 at November 30, 2001 related to its commitment under the note agreements to issue approximately 10,200 shares of common stock for the $120,000 in notes payable issued during the third quarter of fiscal 2002. During the third quarter of fiscal 2002, $83,000 of the above notes payable were converted into 544,688 shares of common stock.

PART I - ITEM 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

General

Cyclopss Corporation is primarily engaged in ozone application technologies and processes. The Company believes that its technologies and product lines offer cost effective, energy efficient, environmentally benign alternatives for cleaning and disinfection products and systems. We believe that the technologies are easily scalable from consumer appliances up through industrial systems. The products provide systems to address food safety, particularly microbial reductions on meat and poultry, fruits and vegetables. Additional products offered by the Company enable manufacturers to eliminate microbial build up in and on plant equipment. Other ozone-related products marketed by the Company to commercial and institutional laundry operators enable users to reduce costs associated with labor, water, energy, chemicals, and wastewater disposal. The Company has developed consumer product prototypes ranging from the sanitization of kitchen sponges and toothbrushes, to counter top drinking water processors and food sanitizers.

In October 2000, the Company entered into a letter of intent for the acquisition/merger of OxiDyn Incorporated (OxiDyn), a North Carolina based manufacturer of ozone based clean-in-place and sanitizing rinsing systems for the beverage and bottling industry. A preliminary acquisition agreement was executed in February 2001, subject to final negotiation, which calls for the Company to issue shares of common stock determined by dividing OxiDyn's net book value by the average closing price of the Company's common stock during the five-day trading period immediately prior to the closing date of the acquisition.The acquisition is pending, however, as of the date of this filing, and all indications are that the transaction will not close.

In November 2000, the Company loaned $80,000 to OxiDyn to meet its current operating requirements, which is to be repaid upon the closing of the acquisition. In order to provide the above funding, the acquisition agreement called for the Company to complete a private placement of its common stock with an offering of at least $300,000 at a price of $0.19 per common share. This offering was to be purchased by OxiDyn's investors and shareholders. The Company received cash of $190,000 related to the offering as of February 28, 2001. Subsequent to February 28, 2001 the Company received an additional $100,000, the offering was closed, and 1,487,179 shares of common stock were issued. The Company advanced an additional $120,386 in cash to OxiDyn subsequent to February 28, 2001 to OxiDyn to meet additional operating requirements. As the completion of the acquisition is questionable, the Company wrote off the note receivable and other advances totaling $200,386.

-13-

On June 15, 2001, the Company entered into an asset purchase and sale agreement with Paragon, LLC to sell primarily all of the assets of Cyclopss Biochemical Corporation, a wholly owned subsidiary. The principals of Paragon, LLC are the employees of Cyclopss Biochemical Corporation. During the nine months ended November 30, 2001, the Company received a total of $235,000 from Paragon, LLC in connection to this sale, and recorded a gain of $213,539 on the sale of the biochemical products business.

Consumers, food producers and processors, both large and small, are searching for new technologies to address food safety and sterilization concerns. Both consumers and food processors, who have relied heavily on chlorination and other chemicals to decontaminate foods and household items, are being forced to consider alternatives to chlorine and those other toxic chemicals. The Company believes that ozone products offer a lower cost and more environmentally-friendly and consumer accepted form of decontamination and sterilization than many other chemical treatments and irradiation. The FDA issued a final ruling allowing for the use of ozone in all food processing on June 28, 2001. The FDA also issued a ruling on retained water in raw meat and poultry products that will become effective January 9, 2002. The ruling will allow beef, pork and lamb producers to use water post-evisceration where it is an inevitable part of a process to meet food safety requirements. Until this ruling raw meat producers were not able to use water or water-based sanitizers. These two rulings will open up a wide range of applications of aqueous ozone to be used in raw meet and poultry processing.

These statements are forward-looking and involve matters which are subject to a number of risks and uncertainties that could cause actual results to differ materially from those expressed in or implied by such forward looking statements. These risks and uncertainties include product development or production difficulties or delays due to supply constraints, technical problems or other factors; technological changes; the effect of global, national and regional economic conditions; the impact of competitive products and pricing; changes in demand; increases in component prices or other costs; and a number of other risks including those identified by the Company throughout Form 10-KSB for February 28, 2001, and other risks identified from time to time in the Company's filings with the Securities and Exchange Commission, press releases and other communications. Information on the Procter & Gamble Agreements and the Acquisition of OxiDyn, Inc. can also be found in the Form 10-KSB for February 28, 2001. The Company assumes no obligation to update forward-looking statements.

Results of Operations

The Company's revenues were $49,744 for the three months ended November 30, 2001 compared to $74,729 for the three months ended November 30, 2000. The revenues were $251,022 for the nine months ended November 30, 2001 compared to $157,136 for the nine months ended November 30, 2000. While revenue for the third quarter of fiscal 2002 decreased from the same period in the prior year due to timing of the completion of, and composition of the Company's contracts, revenues increased for the nine months ended November 30, 2001 over the same period in the prior year due to the Company's effort to generate more

income and find institutions willing to pay for the Company's research efforts. The Company's gross margin for the three months ended November 30, 2001, was $(4,450) compared to $18,459 for the three months ended November 30, 2000. The Company's gross margin for the nine months ended November 30, 2001, was $60,929 compared to $(25,104) for the nine months ended November 30, 2000. The change in gross margin is based on the composition of the Company's contracts as research and development contracts generally have a lower gross margin than equipment sales contracts. The Company continues to closely monitor expenses to minimize all unnecessary operating costs. The Company expects to start receiving royalty payments from the sale of consumer products as described further in this section.

Research and development expenses decreased to $2,366 and $27,181 for the three and nine months ended November 30, 2001 respectively from $17,793 and $51,638 for the three and nine months ended November 30, 2000. This decrease is due the Company's reduced research and development activity.

Selling and marketing expenses increased to $31,028 and $109,189 for the three and nine months ended November 30, 2001 respectively from $27,264 and $92,845 for the three and nine months ended November 30, 2000. This increase is due to the management's efforts to produce an increase in sales and further market the Company's products and technology.

General and administrative expenses decreased to $109,696 for the three months ended November 30, 2001 from $131,363 for the three months ended November 30, 2000. General and administrative expenses increased to $719,550 for the nine months ended November 30, 2001 from $575,089 for the nine months ended November 30, 2000. The increase in general and administrative expenses for the nine month period ended November 30, 2001 is primarily due to the write off of the note receivable and other advances to OxiDyn totaling $200,386. The decrease in general and administrative expenses for the three months ended November 30, 2001 resulted from management more closely monitoring and controlling expenses due to significant cash flow constraints. However, legal and accounting expenses related to being a public company continue to escalate, and new accounting requirements and SEC regulations are being adopted with increasing regularity. These expenses while burdensome are crucial to providing and maintaining a market for the Company's securities. These expenses are expected to increase in fiscal 2002, with other potential increases due to management and human resource requirements for the Company should commercial activities increase, and more funds become available for this use.

Net income from discontinued operations related to the biochemical products business, which was sold in the second quarter and was paid in full in October of 2001, was $16,076 and $23,341 for the nine months ended November 30, 2001 and 2000, respectively. The decrease in net income is due to continuous declining sales of biochemical products, which could be recorded by the Company before the sale of this subsidiary. The Company recorded a gain on the sale of the biochemical products business of $201,530 and $213,539 for the three and nine months ended November 30, 2001, respectively.

The Company recorded net income for the three months ended November 30, 2001 of $30,311, which resulted primarily from the gain on sale of Cyclopss Biochemical Corporation. The loss recorded for the three months ended November 30, 2000 was $179,896. The Company recorded a net loss applicable to common stock for the nine months ended November 30, 2001 of $629,426. The loss recorded for the nine months ended November 30, 2000 was $823,781. The Company continues to incur losses from operations as revenue from product sales, royalties, and consulting are not sufficient to offset the continued cost of operations.

Liquidity and Capital Resources

Cash used in operating activities was $478,995 for the nine months ended November 30, 2001 compared to $1,103,164 for the nine months ended November 30, 2000. This decrease is primarily due to the cash received from the sale of Cyclopss Biochemical Corporation resulting in a gain on sale of $213,539, the $200,386 write-off of receivables from OxiDyn and no common stock issued for services in fiscal 2002 compared to $177,060 in stock issued for services in fiscal 2001. In addition, the Company extended payables in fiscal 2002 while in fiscal 2001 significant efforts were made to pay down outstanding payables.

Net cash provided by financing activities for the nine months ended November 30, 2001, was $413,839. An additional $100,000 was received on a private placement offering related to the proposed acquisition of OxiDyn. The Company also received $278,000 as of November 30, 2001 in connection with a private placement offering of convertible promissory notes at an annual interest rate of 10%. The note holders have the right to convert the principal amount into restricted common shares at the fair market value of the stock on the date of conversion. Approximately $288,000 has been received from this private placement offering as of the date of this filing.

The Company had entered into a convertible secured loan for $ 1,000,000 with Procter & Gamble that provided funds of $250,000 in the fourth quarter of fiscal 2000 and $750,000 in the second quarter of fiscal 2001. The loan accrued interest at 8% and is collateralized by a first security interest in all of the Company's Intellectual Properties and was due on or before February 28, 2001. The loan agreement granted a conversion right to Proctor & Gamble allowing for the conversion of all or any part of the outstanding loan, including all or any part of interest due into shares in the Company's common stock at anytime during the term of the loan, and at the sole discretion of Proctor & Gamble. The Company recognized its inability to repay the loan by the end of its third quarter, notified Proctor & Gamble, and negotiated a revised loan agreement. On February 4, 2001 the Company entered into a Conversion and Amendment Agreement with Proctor & Gamble that extended the due date for a portion of the loan amount equal to $500,000 to February 28, 2002 and a conversion of the remaining $500,000 loan principal into 500,000 shares of Series "E" convertible preferred stock, which occurred in March 2001.

Under the terms of the loan agreements, the Company is subject to various covenants, including maintaining minimum liquid assets in the form of cash or

-16-

marketable securities of $100,000. At February 28, 2001 and subsequent to that date, the Company is in default with the minimum liquid assets covenant and, therefore, the loan may be called at any time.

Total assets decreased to $215,781 for the nine months ended November 30, 2001 from $315,234 for the year ended February 28, 2001, mainly due to a decrease related to the write off of the notes receivable from OxiDyn and the utilization of assets in operating activities. Total current liabilities decreased to $1,128,453 at November 30, 2001 from $1,354,288 at February 28, 2001, mainly due to the conversion of $500,000 of notes payable to equity by Procter and Gamble, as described earlier in this section, offset by additional net borrowings of $185,000 and an increase of approximately $89,000 in accounts payable and accrued liabilities.

The Company is attempting to generate more cash by way of financial assistance through collaborative partnering agreements, issuances of additional equity, debt arrangements, and product sales. Management believes that appropriate funding will be generated and future product sales will result from these opportunities and that the Company will continue operations over the next fiscal year; however, no assurances can be given that sales will be generated or that additional necessary funding will be raised. The Company anticipates it will receive limited royalties from some of its licensed products within fiscal year 2002 and expects the bulk of its revenues to stem from development contracts and product sales. So far this fiscal year, as of November 30, 2001, the Company has negotiated and executed six separate development contracts with Kohler Co., Kaz, Inc., Nelson Laboratories, Pharmacia, Proctor & Gamble and ConAgra. Revenues recorded through November 30, 2001 under the above contracts totaled approximately $150,000. The Company expects future revenues of approximately $275,000 under these contracts. These contracts involve the development of disinfection applications of the Company's ozone technology for consumer and industrial products.

Should the Company be unsuccessful in achieving the increased level of revenues and gross profits required to pay its operating expenses or in acquiring additional equity financing to pay the shortfall, the Company will seek direction from the Board of Directors as to what action would need to be taken.

Plan of Operation

The Company historically has acted as both the developer of its technologies and as the manufacturer and marketer of those technologies. It has become apparent that the customers within the markets pursued by the Company are intrigued by the performance and potential of the products and technologies. However, the size and operating capabilities of the Company does not support the confidence required for the Company's targeted customers to purchase the Company's products. The Company's targeted industrial customer base is accustomed to doing business with vendors and suppliers of a size and stability that reasonably assures business continuity and internal product support. The single exception to this discrimination as to our limited size has been the United States Navy who is mandated to provide business opportunity for small business enterprises such as Cyclopss.

Under the Company's current plan of operations it will act as a limited manufacturer and marketer of its products and also will market its intellectual properties and development capabilities as a technology provider. Our efforts will be directed toward the creation of technology bridges and partnership and licensing arrangements with companies that provide products and services. The Company will utilize its technology to produce new complete ozone related processes and products. These anticipated ventures, partnerships and licensing arrangements are expected to include suppliers of equipment and appliances and suppliers of disposable or consumable products modified to utilize the Company's proprietary technologies under licensing and royalty agreements. The end result will create interlocking process systems that we believe will be both effective and economic. Additionally the process systems will be sold and serviced by vendors and suppliers already accepted by the target markets.

This model provides the manufacturers with technology and new product offerings and provides the Company with royalty revenue and commercialization of its technologies through already existing manufacturing, sales and service infrastructures.

The Company will continue to provide low volume production of ozone systems to customers like the United States Navy, and the Company also anticipates it will be compensated by one or more of the industry partners for design and development work required in modifying their existing products to accommodate the incorporation of the Company's proprietary technologies. This model allows the Company to keep the number of employees limited to specific requirements of the technology application, and converts the Company into a technology purveyor.

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The Company's initial execution of a variation of this business model was illustrated by the relationship between the Company, Procter & Gamble and Otres, Inc. Cyclopss established a working relationship with Procter & Gamble early in 1999. In May of 1999, the Company was approached by the principals of Otres to assist in the development and validation of a toothbrush sanitizer and a kitchen sponge sanitizer utilizing ozone. The management of the Company determined the products could be of great interest to Procter & Gamble and, after having appropriate confidentiality documents executed, Otres agreed to allow the Company to introduce the product concepts to Procter & Gamble. Procter & Gamble determined they had products that would lend themselves to a co-marketing relationship with the Otres appliances as long as the product development was responsibly executed and the technology application proved safe and effective. Both Otres and Procter & Gamble engaged the Company for these activities. This resulted in the Company receiving revenues of approximately $98,000 from both venture partners for the development and testing of the appliances. The Company continues to manage the relationship with Procter & Gamble for Otres under contract, and contributed to the execution of co-marketing agreements between Otres and CREST for the toothbrush sanitizer, and Otres and DAWN for dish washing soap that were announced at the International Home Appliance Show in Chicago on January 16, 2000. The Company negotiated to receive an ongoing royalty of approximately 3% from the sale of these appliances, which is expected to provide future

revenues with minimal related costs incurred by the Company. Due to internal problems at Otres the products have yet to become fully commercialized. The revenue produced by the expected royalty stream has been minimal as of the filing date. The Company continues to assist Otres in solving its internal problems and positioning the products for success. In June, 2001 the FDA granted its approval of the Otres Toothbrush Sanitizer.

A License and Royalty Agreement executed at year end 2001 with Consolidated Sills and Sterilizers of Boston, Mass. is also an illustration of the Company's new business plan. The agreement called for an up-front license fee and ongoing royalty, and includes revenues from the production of a prototype for Consolidated Stills and Sterilizers and for consulting fees for future work performed on the project. The FDA approval process facing Consolidated is formidable and the Company can make no prediction as to when the ozone sterilizer may be available to the Health-Care industry, but the financial burden is Consolidated's and the Company will receive a 3% royalty on any future gross sales of products utilizing our technology.

The plan provides for ongoing operating revenues derived from limited manufacturing and direct sales of the companies' industrial products, ongoing contract product development, with the future revenues derived primarily through license and royalty streams generated by the success of its selected strategic partners in commercializing the products.

The Company anticipates its revenues as well as the source of those revenues to change significantly through establishment of these types of relationships. However, there can be no assurance that the current loan to Procter & Gamble can be serviced upon its due date nor can there be any assurance that any of the Company's products will be accepted in such numbers that will generate adequate revenues and cash flow sufficient to cover the ongoing costs of operation.

On March 13, 2001 the Company was granted a very broad patent by the United States Patent office relating to the use of water, ozone and food grade surfactants for use in all food processing activities. The patent is extremely important to the Company's ability to defend a position of proprietary processes for development and subsequent licensing since an FDA ruling was granted on June 28, 2001, that allows the use of ozone in the processing of certain food items. The Company is in a enviable position and expects a resurgence of the interest previously expressed by potential strategic partners in the food processing sector.

The Company continues to seek customers and strategic partners such as, Kohler Co., Kaz, Inc., and Nelson Laboratories, who are sufficiently convinced of the potential to collaboratively participate in necessary research and development costs. These customers and strategic partners not only may provide revenues from research and development contracts but also follow-on royalty revenues from the purchase of systems and processes.

The Company has provided major agricultural producers with prototype ECO-PURE test systems that have been installed in wet produce processing plants, long-term produce storage facilities, short term banana and tomato ripening rooms, and for use in treatment of herbal remedies and dietary supplements. The Company will seek to commercialize these successful test processes based on the new FDA ruling discussed above.

-19-

Even with sufficient funds available, the ongoing challenge facing the Company is that of educating potential partners, government, industry and the end consumer about the benefits of ozone. Ozone is a naturally occurring phenomenon that is usually associated with photochemical smog or an eroding level of protection in our atmosphere. It is the Company's intent to provide this education and show the beneficial side of ozone decontamination. For industry, ozone is a cost competitive and environmentally friendly answer to microbial contaminates. For the consumer, ozone kills harmful microorganisms quickly and leaves behind no chemical residue.

The information set forth herein as to anticipated research and development costs, equipment purchases and increase in employees are management's best estimates based upon current plans. Actual expenditures may be greater or less than such estimates depending on many factors including, but not limited to, the availability of new technologies, the completion or lack of completion of certain strategic alliances, and the timing and successful completion of the Company's stated requirement to acquire additional operating and growth capital, industry initiatives, success of the Company's research and development efforts, and other factors.

From time to time, the Company may publish forward-looking statements relating to such matters as anticipated financial performance, business prospects, technological developments, new products, research and development activities and similar matters. The private Securities litigation Reform Act of 1995 provides a safe harbor for forward looking statements. In order to comply with the terms of the safe harbor, the Company notes that a variety of factors could cause the Company's actual results and experience to differ materially from the anticipated results or other expectations expressed in the Company's forward looking statements. The risks and uncertainties that may affect the operations, performance, development and results of the Company's business include, but are not limited to, the following:

1. Successful commercialization of the Company's proprietary technologies and intellectual property;
2. Market acceptance of the Company's products;
3. Obtaining sufficient additional operating capital in the form of debt or

equity;
4. The existence of an orderly market in the Company's securities;
5. Increased sales of the various products of the Company;
6. Continued success in the Company's research and development activities;
7. Successful completion of strategic alliances;
8. Ability to attract and maintain qualified management, operations and engineering personnel; and
9. Successful transformation to the Company's new business model.

-20-

Subsequent Events

Extension of Convertible Promissory Note

Subsequent to the end of the reporting period the Company began discussions with Procter & Gamble regarding the extension of the February 2002 due date of a Convertible Promissory note in the amount of $500,000 of which Procter & Gamble is the holder. The terms being discussed as of the filing date would call for the Company to pay the interest earned as of the maturity date, and Procter & Gamble extending the due date of the note for up to 18 months. The re-negotiation is being aided in part by Procter & Gamble's interest in commercializing one of the Companies more mature technologies and the anticipation of a resulting Licensing and Royalty Agreement being entered into between the parties. There can be no assurances however that the parties will successfully re-negotiate the terms of the note, nor can there be any assurances that the parties will enter into an acceptable Licensing and Royalty agreement.

Underwriting Letter of Intent

On December 20th, 2001, the Company executed a Letter of Intent for the underwriting of up to $3,000,000 worth of shares of the Company's common stock by Delano Group Securities, LLC., a registered securities broker dealer with primary offices in Chicago, Illinois. The proceeds of the underwriting would potentially be used to fund ongoing operations if needed, and to finance some small acquisitions being entertained by the Company. The underwriting would be subject to the terms and conditions of an Investment Agreement, which as of the time of this filing, has not been constructed nor has it been agreed to by the parties. There can be no assurances that Delano and the Company will successfully negotiate an Investment Agreement acceptable to both parties, nor can there be any assurances a registration of the Company's shares would be allowed effective by the Securities Exchange Commission

21

PART II - OTHER INFORMATION

Item 1. Legal Proceedings. None.

Item 2. Changes in Securities and Use of Proceeds None.

Item 3. Defaults Upon Senior Securities. See discussion on page 12, Note 5 to the Condensed Consolidated Financial Statements included herein and page 16 "Liquidity and Capital Resources," with respect to the discussion concerning the default on the loan convents of the Proctor and Gamble Senior Secured note.

Item 4. Submission of Matters to a Vote of Security Holders. None.

Item 5. Other Information. None

Item 6 Exhibits and Reports on Form 8-K and S-8. None

SIGNATURES

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

CYCLO3PSS CORPORATION

Date: January 14, 2002

By/s/ William R. Stoddard
William R. Stoddard
Chief Executive Officer
Principal Executive Officer

Date: January 14, 2002

By/s/ Mondis Nkoy
Mondis Nkoy
Controller, Corporate Secretary
Principal Financial Officer