PROFILE TECHNOLOGIES INC
Form 10QSB
May 09, 2006

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

FORM 10-QSB

(Mark One)

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

For the quarterly period ended:
March 31, 2006

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

For the transition period from __________________ to ________________

Commission file number
0-21151

PROFILE TECHNOLOGIES, INC.

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

DELAWARE	91-1418002
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
2 Park Avenue, Suite 201 Manhasset, New York	11030
(Address of Principal Executive Office)	(Zip Code)

516-365-1909

(Issuer's telephone number)

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 [X] No [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X]

As of May 1, 2006, the number of shares outstanding of the issuer's common stock, the only class of common equity was 12,346,445.

Transitional Small Business Disclosure Format (Check one): Yes [ ] No [X]

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PART I -- FINANCIAL INFORMATION

Item 1. Financial Statements.

PROFILE TECHNOLOGIES, INC.
Balance Sheet
(unaudited)

	March 31, 2006
Assets	

Current assets:	
Cash	$ 499,075
Prepaid expenses and other current assets	14,023
Total current assets	513,098
Equipment, net of accumulated depreciation of $542,637	3,929
Deferred financing fees	910
Other assets	1,550
Total assets	$ 519,487

Liabilities and Stockholders' Deficit

Current Liabilities:	
Accounts payable	$ 169,460
Notes payable to stockholders	57,500
Current portion of convertible debt	107,500
Deferred wages	707,636
Accrued professional fees	186,150
Accrued interest	2,232
Other accrued expenses	23,644
Total current liabilities	1,254,122
Long-term convertible debt, net of unamortized discount of $67,388	112
Stockholders' deficit:	
Common stock, $0.001 par value. Authorized 25,000,000 shares; issued and outstanding 10,584,445 shares	10,584
Common stock issuable; 694,000 shares	694
Additional paid-in capital	11,894,799
Accumulated deficit	(12,640,824)
Total stockholders' deficit	(734,747)
Commitments, contingencies and subsequent events	
Total liabilities and stockholders' deficit	$ 519,487

See accompanying notes to financial statements.

PROFILE TECHNOLOGIES, INC.
Statements of Operations
(unaudited)

For the three months ended March 31,	For the n

	2006	2005	2006
Revenue	$ --	$ --	$ --
Cost of revenues	--	--	--
Gross profit	--	--	--
Operating expenses:			
Research and development	56,852	207,926	303,7
General and administrative	158,891	169,633	494,3
Total operating expenses	215,743	377,559	798,0
Loss from operations	(215,743)	(377,559)	(798,0
Interest expense	12,300	19,113	237,6
Net loss	$ (228,043)	$ (396,672)	$ (1,035,6
Basic and diluted net loss per share	$ (0.02)	$ (0.07)	$ (0.
Weighted average shares outstanding used to calculate basic and diluted net loss per share	10,544,723	5,795,705	8,811,9

See accompanying notes to financial statements.

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PROFILE TECHNOLOGIES, INC.
Statements of Cash Flows
(unaudited)

Cash flows from operating activities:
Net loss
Adjustments to reconcile net loss to net cash used in operating activities:
Depreciation and amortization
Accreted discount on convertible debt
Amortization of convertible debt discount included in interest expense
Accrued interest on convertible debt converted to equity

Accrued interest on notes payable to stockholders converted to equity
Amortization of debt issuance costs
Equity issued for services
Changes in operating assets and liabilities:
Prepaid expenses and other current assets
Other assets
Accounts payable
Deferred wages
Accrued professional fees
Accrued interest
Other accrued expenses

Net cash used in operating activities

Cash flows from financing activies:
Allocated proceeds from issuance of convertible debt
Allocated proceeds from issuance of warrants attached to convertible debt
Common stock issuance costs
Allocated proceeds from issuance of common stock
Allocated proceeds from issuance of warrants attached to issuance of common stock
Proceeds from issuance of notes payable to stockholders
Repayments of note payable to stockholders

Net cash provided by financing activities

Increase (decrease) in cash

Cash at beginning of period

Cash at end of period

Supplemental disclosure of cash flow information:
Debt discount recorded for beneficial conversion feature
Cash paid for interest
Convertible debt and related accrued interest converted into 456,740 and 201,044 shares o
common stock during the nine months ended March 31, 2006 and 2005, respectively
Notes payable to stockholder converted into 2,322,446 shares of common stock
during the nine months ended March 31, 2006
Accrued interest on notes payable to stockholder converted into 229,554 shares of common
during the nine months ended March 31, 2006

See accompanying notes to financial statements.

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PROFILE TECHNOLOGIES, INC.
Statements of Stockholders' Deficit
For the Nine Months Ended March 31, 2006
(unaudited)

Common Stock		Common
Shares	Amount	Shares

Balance at June 30, 2005	5,925,705	$ 5,926	45,
Common stock issued related to the 2005 Offering	45,000	45	(45,
Issuance of common stock warrants and options for services	--	--	-
Issuance of common stock upon conversion of stockholder loan and accrued interest to equity	2,552,000	2,552	-
Issuance of common stock upon conversion of convertible debt to equity	456,740	456	-
Issuance of common stock warrants related to the 2005 Offering	--	--	-
Issuance of common stock related to the 2005 Offering	1,605,000	1,605	-
Common stock issuance costs	--	--	-
Common stock issuable related to the 2005 Offering	--	--	694,
Net loss	--	--	-
Balance at March 31, 2006	10,584,445	$ 10,584	694,

Table continues below.

	Additional Paid-in Capital	Accumulated Deficit	Tota Stockho Equi (Defi
Balance at June 30, 2005	$ 9,271,137	$(11,605,139)	$ (2,32
Common stock issued related to the 2005 Offering	--	--	
Issuance of common stock warrants and options for services	85,850	--	8
Issuance of common stock upon conversion of stockholder loan and accrued interest to equity	1,273,448	--	1,27
Issuance of common stock upon conversion of convertible debt to equity	227,913	--	22
Issuance of common stock warrants related to the 2005 Offering	771,694	--	77
Issuance of common stock related to the 2005 Offering	376,201	--	37
Common stock issuance costs	(110,750)		(11
Common stock issuable related to the 2005 Offering	(694)	--	
Net loss	--	(1,035,685)	(1,03
Balance at March 31, 2006	$ 11,894,799	$(12,640,824)	$ (73

See accompanying notes to financial statements.

PROFILE TECHNOLOGIES, INC
March 31, 2006
Notes to Financial Statements (Unaudited)

1. Description of Business

Profile Technologies, Inc. (the "Company"), was incorporated in 1986 and commenced operations in fiscal year 1988. The Company is in the business of inspecting pipelines for corrosion and is in the final stages of researching and developing a patented, non-destructive and non-invasive, high speed scanning process, using electro magnetic waves to remotely inspect buried, encased and insulated pipelines for corrosion.

2. Basis of Presentation

The unaudited interim financial statements and related notes of the Company have been prepared pursuant to the instructions to Form 10-QSB. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted pursuant to such instructions. The preparation of financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses. On an on-going basis, the Company evaluates its estimates, including contract revenue recognition and impairment of long-lived assets. Actual results and outcomes may differ materially from these estimates and assumptions.

The financial statements and related notes should be read in conjunction with the audited financial statements and notes thereto included in the Company's annual report on Form 10-KSB for the year ended June 30, 2005. The information furnished reflects, in the opinion of management, all adjustments, consisting of only normal recurring items, necessary for fair presentation of the results of the interim periods presented. Interim results are not necessarily indicative of results for a full year.

3. Liquidity

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. The Company incurred cumulative losses of $12,640,824 through March 31, 2006 and had negative working capital of $741,024 as of March 31, 2006. Additionally, the Company has expended a significant amount of cash in developing its technology and patented processes. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management recognizes that in order to meet the Company's capital requirements, and continue to operate, additional financing, including seeking industry-partner investment through joint ventures or other possible arrangements, will be necessary. The Company is evaluating alternative sources of financing to improve its cash position and is undertaking efforts to raise capital. If the Company is unable to raise additional capital or secure additional revenue contracts and generate positive cash flow, it is unlikely that the Company will be able to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

4. Summary of Significant Accounting Policies

Cash

Cash includes highly liquid investments with original maturities of three months or less.

Fair Value of Financial Instruments

The Company has the following financial instruments: cash, accounts payable, notes payable to stockholders, and convertible debt. The carrying value of these instruments, other than the convertible debt, approximates fair value based on their liquidity. The fair value of the convertible debt was determined as the excess of the proceeds over the fair value of the warrants.

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Deferred Financing Fees

The Company records costs incurred related to debt financings as deferred financing fees and amortizes, on a straight-line basis, the costs incurred over the life of the related debt. The amortization is recognized as interest in the financial statements. Upon conversion into equity or extinguishment of the related debt, the Company recognizes any unamortized portion of the deferred financing fees as interest expense.

Contract Revenue Recognition

The Company recognizes revenue from service contracts using the percentage of completion method of accounting. Contract revenues earned are measured using either the percentage of contract costs incurred to date to total estimated contract costs or, when the contract is based on measurable units of completion, revenue is based on the completion of such units. This method is used because management considers total cost or measurable units of completion to be the best available measure of progress on contracts. Because of the inherent uncertainties in estimating costs, it is at least reasonably possible that the estimates used may change in the near term.

Anticipated losses on contracts, if any, are charged to earnings as soon as such losses can be estimated. Changes in estimated profits on contracts are recognized during the period in which the change in estimate is known.

Cost of revenues include contract costs incurred to date as well as any idle time incurred by personnel scheduled to work on customer contracts.

The Company records claims for additional compensation on contracts upon revision of the contract to include the amount to be received for the additional work performed. Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools and repairs, and depreciation costs. Selling, general, and administrative costs are charged to expense as incurred. Service contracts generally extend no more than six months.

Research and Development

Research and development costs are expensed when incurred. During the three and nine months ended March 31, 2006 the Company incurred $56,852 and $303,718, respectively, on research and development activities. During the three and nine months ended March 31, 2005 the Company incurred $207,926 and $245,455, respectively, on research and development activities.

Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of

The Company reviews long-lived assets, such as equipment and intangibles, for impairment at least annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected

to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset.

Valuation of Warrants and Options

The Company estimates the value of warrants and option grants using a Black-Scholes pricing model based on management assumptions regarding the warrant and option lives, expected volatility, and risk free interest rates.

5. Stock Based Compensation

Prior to January 1, 2006, the Company accounted for stock-based awards under the intrinsic value method, which followed the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations. The intrinsic value method of accounting resulted in compensation expense for stock options to the extent that the exercise prices were set below the fair market price of the Company's stock at the date of grant.

As of January 1, 2006, the Company adopted SFAS No. 123(R) using the modified prospective method, which requires measurement of compensation cost for all stock-based awards at fair value on date of grant and recognition of

compensation over the service period for awards expected to vest. The fair value of stock options is determined using the Black-Scholes valuation model, which is consistent with the Company's valuation techniques previously utilized for options in footnote disclosures required under SFAS No. 123, Accounting for Stock Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation--Transition and Disclosure. Such value is recognized as expense over the service period. To date, all stock option grants have been fully vested upon grant.

The application of SFAS 123(R) had the following effect on net loss as reported:

	Three Months Ended March 31,		Nine Months March 3	
	2006	2005	2006	
Net loss:				
As reported	$ (228,043)	$ (396,672)	$(1,035,685)	$
Plus: stock-based employee compensation expense included in reported net loss	--	--	--	
Less: stock based compensation expense determined under fair value based method for all employee awards	--	(1,255,965)	(352,000)	
Net loss	$ (228,043)	$(1,652,637)	$(1,387,685)	$
Net loss per share				
Basic and diluted - as reported	$ (0.02)	$ (0.07)	$ (0.12)	$
Basic and diluted - pro forma	$ (0.02)	$ (0.29)	$ (0.16)	$

6. Net Loss Per Share

Basic net loss per share is computed by dividing the net loss by the weighted average number of common shares outstanding during the period. Diluted net loss per share is computed by dividing the net loss by the weighted average number of common and dilutive common equivalent shares outstanding during the period. As the Company had a net loss attributable to common shareholders in each of the periods presented, basic and diluted net loss per share are the same.

Excluded from the computation of diluted net loss per share for the three and nine months ended March 31, 2006, because their effect would be antidilutive, are options and warrants to acquire 10,204,818 shares of common stock with a weighted-average exercise price of $1.12 per share. Also excluded from the computation of diluted net loss per share for the three and nine months ended March 31, 2006 are 350,000 shares of common stock that may be issued if investors exercise their conversion right under the Debentures related to the 2003 Offering as discussed in Note 8 because their effect would be antidilutive.

Excluded from the computation of diluted net loss per share for the three and nine months ended March 31, 2005, because their effect would be antidilutive, are options and warrants to acquire 5,664,818 shares of common stock with a weighted-average exercise price of $1.44 per share. Also excluded from the computation of diluted net loss per share for the three and nine months ended March 31, 2005 are 806,000 shares of common stock that may be issued if investors exercise their conversion right under the Debentures related to the 2003 Offering as discussed in Note 8 because their effect would be antidilutive.

For the three and nine months ended March 31, 2006 and 2005, additional potential dilutive securities that were excluded from the diluted net loss per share computation are the exchange rights discussed in Note 9 that could result in options to acquire up to 223,000 shares of common stock with an exercise price of $1.00 per share at March 31, 2006 and 2005.

For purposes of earnings per share computations, shares of common stock that are issuable at the end of a reporting period are included as outstanding.

7. Notes Payable - Stockholders

In April 2002, the Company issued a non-interest bearing bridge note payable to an officer of the Company in the amount of $7,500. The note is payable in full when the Company determines it has sufficient working capital to do so. On September 29, 2002, the officer who was owed the $7,500 died.

The Company has entered into various loan agreements with Murphy Evans, President, a director and stockholder of the Company. On March 6, 2003, the Company's Board of Directors approved the Loan Amendment and Promissory Note (the "Amended Evans Loan") between the Company and Murphy Evans. The Amended Evans Loan aggregates all previous debt and supersedes and replaces all of the terms of the previous loans with Mr. Evans, including any conversion features. The Amended Evans Loan bears interest on the aggregate principal balance at a rate of 5% per annum, payable on June 30 and December 31 of each year, with the principal balance due and payable in full on December 31, 2003. The Amended Evans Loan is exempt from registration under Section 4(2) of the Securities Act.

During the nine months ended March 31, 2006, Mr. Evans loaned the Company

an additional $89,733 pursuant to the terms of the Amended Evans Loan. During the nine months ended March 31, 2006, Mr. Evans converted the entire then outstanding $1,161,223 of principal and $114,777 of accrued interest of the Amended Evans Loan pursuant to the terms of the 2005 Offering as defined below. Accordingly, Mr. Evans received 2,552,000 shares of common stock and warrants to purchase 2,552,000 shares of common stock at an exercise price of $0.75 per share. The warrants are exercisable any time prior to the fifth anniversary from the date of grant.

Interest expense related to the Amended Evans Loan was $579 and $16,449 for the three and nine months ended March 31, 2006, respectively. Interest expense related to the Amended Evans Loan was $12,059 and $33,955 for the three and nine months ended March 31, 2005, respectively.

In September 2002, the Company entered into two non-interest bearing bridge loans in the respective principal amounts of $40,000 and $10,000 (the "Stockholder Loans") payable to two stockholders of the Company. The terms of the Stockholder Loans provide for payment at such time as the Company determines it has sufficient working capital to repay the principal balances of the Stockholder Loans. The Stockholder Loans are convertible into 57,142 and 14,286 equity units, respectively, at any time prior to re-payment. Each equity unit is comprised of one share of the Company's common stock, with a detachable 5-year warrant to purchase one additional share at an exercise price of $1.05 per share. Neither stockholder has converted either Stockholder Loan into equity units.

On June 19, 2003, the Board of Directors approved a promissory note (the "2003 Gemino Note") in the principal amount of $34,047 payable to Henry E. Gemino, the Chief Executive Officer, Chief Financial Officer and a director and stockholder of the Company. From time to time, Mr. Gemino loaned the Company additional money and the Company repaid various amounts under the terms of the 2003 Gemino Note. The 2003 Gemino Note bears interest at the rate of 5% per annum, payable on June 30 and December 31 of each year. During the year ended June 30, 2005, the Company repaid the then outstanding principal balance of $48,270 and accrued interest to Mr. Gemino. Interest expense related to the 2003 Gemino Note was $0 for the three and nine months ended March 31, 2006. Interest expense related to the 2003 Gemino Note was $32 and $892 for the three and nine months ended March 31, 2005, respectively.

The following is a summary of notes payable to stockholders as of March 31, 2006:

Deceased Officer Note	7,500
Stockholder Loans	50,000
Total	$57,500

8. Convertible Debt

On June 19, 2003, the Board of Directors approved the offering (the "2003 Offering") of $1,000,000 in convertible debentures (the "Debentures"). The Debentures are convertible into that number of shares of the Company's common stock equal to the amount of the converted indebtedness divided by $0.50 per share. The Debentures bear interest at a rate of 5% per annum, payable quarterly. Delinquent interest payments bear interest at a rate of 12% per

annum. The Company is required to redeem each Debenture on the 5th anniversary of the date of the Debenture. The Company may, in its discretion, redeem any Debenture at any time prior to the mandatory redemption date of the Debenture by providing no less than 60 days' prior written notice to the holder of the Debenture. Certain events of default will result in the Debentures being redeemable by the Company upon demand of the holder.

Upon the purchase of, and for each $0.50 of the Debenture's principal amount, the Company issued to each investor a warrant (the "Warrant") to purchase one (1) share of the Company's common stock at an exercise price of $0.75 per share. The Warrants are exercisable at any time prior to the 5th anniversary date of the redemption of the Debenture.

Warrants issued in connection with the 2003 Offering were recorded based on their relative fair value as compared to the fair value of the debt at issuance. The relative fair value of the warrants was recorded as paid-in capital, estimated at $0 and $101,977 for the three and nine months ended March 31, 2005, respectively. The fair value of the warrants issued during the three and nine months ended March 31, 2005, was determined based on an option pricing model with the following assumptions: warrant lives of 10 years, risk free interest rates ranging from 4.14% to 4.30%, volatility of 120%, and a zero dividend yield. The intrinsic value of the Debentures results in a beneficial conversion feature that reduces the book value of the convertible debt to not less than zero. Accordingly, the Company recorded a discount of $0 and $56,023 during the three and nine months ended March 31, 2005, respectively, on the convertible debt issued under the 2003 Offering. The Company amortizes the discount using the effective interest method over the five-year life of the Debentures.

During the quarter ended March 31, 2005, the Board of Directors terminated the 2003 Offering. As of the closing date of the 2003 Offering, the Company had raised $503,000 from the 2003 Offering.

During the three and nine months ended March 31, 2006, one and six investors, respectively, exercised their conversion right under the terms of the Debentures. Accordingly, the carrying value of the convertible debt was reclassified as equity upon conversion. Since the convertible debt instruments include a beneficial conversion feature, the remaining unamortized discount of $7,991 and $197,945 at the conversion date was recognized as interest expense during the three and nine months ended March 31, 2006, respectively.

During the three and nine months ended March 31, 2005, none and five investors, respectively, exercised their conversion right under the terms of the Debentures. Accordingly, the carrying value of the convertible debt was reclassified as equity upon conversion. Since the convertible debt instruments include a beneficial conversion feature, the remaining unamortized discount of approximately $0 and $100,000 at the conversion date was recognized as interest expense during the three and nine months ended March 31, 2005, respectively.

As of March 31, 2006, accrued interest on the Debentures was $2,232. The Company recorded interest expense related to the accretion of the discount on the Debentures and amortization of the convertible debt discount as a result of the conversions discussed above of $8,039 and $198,051 for the three and nine months ended March 31, 2006, respectively. The Company recorded interest expense related to the accretion of the discount on the Debentures and amortization of the convertible debt discount as a result of the conversions discussed above of $17 and $100,031 for the three and nine months ended March 31, 2005, respectively. As of March 31, 2006 the carrying value of the long-term portion of the Debentures was $112, net of unamortized debt discount of $67,388.

9. Deferred Wages and Accrued Professional Fees

To reduce cash outflows, certain of the Company's employees, officers,

consultants, and directors have agreed to defer a portion of their salaries and professional fees until the Company has sufficient resources to pay the amounts owed or to exchange such amounts into options as described below. At March 31, 2006, the Company has accrued $893,786 related to the deferred payment of salaries and professional fees of which $707,636 is included under deferred wages and $186,150 in accrued professional fees. On March 18, 2002, the Board

approved a conversion right on all deferred wages and accrued professional fees deferred as of March 18, 2002. Pursuant to this conversion right, employees, officers, consultants, and directors may elect to convert $1.00 of fees owed to them as of March 18, 2002 for an option to purchase two shares of the Company's common stock, at an exercise price of $1.00 per share for a term of five years. Deferred salaries and fees as of March 18, 2002 were $111,500, resulting in the potential issuance of 223,000 options under the terms mentioned above. No conversions have occurred to date. At March 18, 2002, there was no intrinsic value associated with these exchange rights. As such, no additional compensation cost was recorded.

10. Common Stock

On January 19, 2005, the Board of Directors approved the offering (the "2005 Offering") of 2,000,000 units (the "Units") for a total offering price of $1,000,000, consisting of shares of common stock and attached warrants. On November 21, 2005, the Board of Directors approved an increase in the number of Units to 6,000,000 Units for a total offering price of $3,000,000. The purchase price of one Unit is $0.50. Each Unit consists of one share of common stock and a warrant to purchase one share of common stock at an exercise price of $0.75 per share. The warrants are exercisable at any time prior to the fifth anniversary from the date of grant.

During the nine months ended March 31, 2006, the Company raised $1,149,500 under the terms of the 2005 Offering. Accordingly, the Company issued 2,299,000 shares of common stock and warrants to purchase up to 2,299,000 shares of common stock at an exercise price of $0.75 per share.

The Company engaged a brokerage firm to help in the fund raising efforts of the 2005 Offering. Pursuant to the terms of the agreement with the brokerage firm, the Company will pay the brokerage firm a ten percent cash commission on all funds that the brokerage firm helps raise. Additionally, the Company will issue warrants to purchase shares of common stock at $0.75 per share equal to ten percent of the total warrants issued in connection with the 2005 Offering. The warrants may be exercised up to five years from the date of issuance, which is the date the proceeds are received under the 2005 Offering. During the three and nine months ended March 31, 2006, the Company incurred $39,400 and $110,750, respectively, of fees to be paid in cash to the brokerage firm and issued warrants to purchase 78,800 and 221,500, respectively, shares of common stock. During the three and nine months ended March 31, 2006, the Company recorded $100,076 and $207,260, respectively, as a reduction to paid-in capital for the fair value of the warrant grants. The fair value of the warrants issued to the brokerage firm during the three months ended March 31, 2006 were estimated using the Black-Scholes option pricing model with the following weighted average assumptions: expected volatility of 151.04%, risk-free interest rate of 4.82%, expected lives of five years, and a 0% dividend yield. The fair value of the warrants issued to the brokerage firm during the nine months ended March 31, 2006 were estimated using the Black-Scholes option pricing model with the following weighted average assumptions: expected volatility ranging from 151.04% to 376.15%, risk-free interest rates ranging from 4.14% to 4.82%, expected lives of five years, and a 0% dividend yield.

11. Subsequent Events

Subsequent to March 31, 2006, and as of May 1, 2006, the Company has raised $534,000 and issued 1,068,000 shares of common stock and warrants to purchase up to 1,068,000 shares of common stock in accordance with the terms of the 2005 Offering. Additionally, pursuant to an agreement with a brokerage firm, the Company has incurred $29,800 of commission related fees and issued warrants to purchase 59,600 shares of common stock at $0.75 per share.

On May 1, 2006, The Board approved the extension of the expiration date of all outstanding warrants held by officers and directors as of May 1, 2006 that originally expired on or before May 1, 2011. In consideration of ongoing efforts to achieve business objectives of the Company, the Board extended the expiration date of these warrants until May 1, 2011. The Company will account for the modification of these terms in accordance with FASB Statement No. 123(R), Share-Based Payment and EITF Issue No. 96-18 Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services in which the modification results in a new measurement date and therefore, a new measurement of compensation cost at the date of modification. The Company is still evaluating the impact of this modification on the Company's financial statements.

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

Business Overview

Profile Technologies, Inc. (the "Company"), a Delaware corporation, was incorporated in 1986 and commenced operations in fiscal year 1988. The Company is in the business of inspecting pipelines for corrosion and is in the final stages of researching and developing a patented, non-destructive and non-invasive, high speed scanning process using electro magnetic waves to remotely inspect buried, encased and insulated pipelines for corrosion (the "EMW Inspection Process").

During the summer of 1998, the Company completed work on its first commercial contract with ASCG Inspection, Inc. testing British Petroleum pipelines at approximately 100 road and caribou crossings located on the North Slope of Alaska. During the summer of 1999, the Company continued work testing pipelines under a contract with another large multi-national oil company related to the inspection of approximately 250 below-grade pipelines. During the summer of 2000, the Company expanded its Alaska efforts by testing a total of 372 below-grade pipelines. In 2001, the Company completed the testing of approximately 441 pipelines in Alaska. In 2002 and 2003, the Company inspected 364 and 250 below-grade pipelines, respectively.

As a result of the Company's experience in Alaska and in response to regulatory changes that occurred in 2003, the Company decided to improve its buried pipe inspection capabilities to meet the needs of a more significant portion of the buried-pipe market. The Company refocused its efforts on improving its current technology to take advantage of this opportunity. These efforts, which to some degree are still ongoing, refined our technology to specifically address the buried pipeline market by developing a new pulse (wave form) that is distorted by electrolysis i.e., active corrosion, in a specific way. The Company also refined the hardware underlying its inspection process by making its test system more powerful, portableand useful. Among other things, it eliminated the need for a cumbersome, external power source.

Industry Overview

Refineries, chemical plants, utilities, natural gas transmission companies and the petroleum industry have millions of miles of pipeline much of which may be exposed to harsh and severe environments subjecting such pipeline to higher incidence of corrosion. As a result of such environments these industries are continually challenged to ensure that the quality of its pipeline meets applicable standards established by relevant regulatory bodies to protect operating personnel and the environment.

When pipeline is not insulated and above ground, external corrosion can be identified visually. The petroleum and other related industries, however, insulate much of their piping to conserve energy and to prevent injury to personnel from high temperature levels on the pipelines. When pipeline is insulated, corrosion can occur underneath the insulation due to moisture or corrosive products that find their way through broken or poorly sealed insulation. Corrosion underneath the insulation of insulated pipelines is very difficult and costly to locate. In the past, corrosion testing on insulated pipelines has been conducted on a limited sample basis and relied upon inspection processes that were both cumbersome and costly.

The two prevalent testing methods used to detect corrosion on insulated pipelines, X-ray and eddy current, detect defects by analyzing visual image and decay. These methods require the physical stripping away of the pipeline insulation to conduct visual inspection, depth gauges, ultrasonics and X-ray are then used to determine the severity of the visually located corrosion. The physical removal of insulation required by these methods is costly for various reasons including the assembly of scaffolding for testing otherwise inaccessible above ground pipe (particularly in refineries and petrochemical plants) or the actual dig-up on below ground pipe. The Company's technology enables it to test pipe segments in a refinery setting for a distance up to three hundred feet and to use "cherry pickers" instead of costly scaffolding.

Corrosion under the insulation of insulated pipelines presents a very complicated testing problem because corrosion cannot be easily identified by statistical sampling. If, for example, a small section of the insulation on a segment of insulated pipe is removed every ten feet for visual inspection using eddy current or x-ray techniques, there is no statistical basis to assume that the external condition of the piping between the removed sections of insulation is corrosion free.

The Company's EMW Inspection Process

The EMW Inspection Process provides a corrosion inspection method which does not require the inspector to physically remove the pipeline's insulation or otherwise dig up the pipeline to visually inspect for corrosion. In certain instances, limited access points to buried pipelines exist for reasons unrelated to corrosion inspection. As a result, corrosion inspection may be conducted at these access points. Where such access points are not already available, the EMW Inspection Process permits the inspection of pipelines with a minimal amount of disturbance to the coating or insulation on the pipeline. In addition, the EMW Inspection Process permits corrosion inspection over the entire pipeline, as opposed to other inspection methods, which only provide for spot point inspections. Such "spot inspections" are not necessarily accurate in indicating the overall condition of a pipeline.

The Company has developed two basic EMW Inspection Process techniques, namely, Dual Pulse or Pulse Propagation Analyzer and Single-Pulse or Calibration Mark Z. For above-grade piping, the Company has used both the Dual-Pulse and Single-Pulse techniques to determine the condition of a pipeline segment in the

open field as well as in refineries, chemical plants and power plants. For below-grade piping under streets and road crossings, the Company has historically used only the Dual Pulse technique. However, for more than a year, the Company has been developing new hardware and software to permit the testing of direct buried pipe from a single location while, at the same time, capturing data from the pipe traveling in both directions. This new equipment has been tested at the Company's pipe test facility in Ferndale, Washington, and is now being field tested on natural gas pipelines in Pennsylvania with the cooperation and assistance of a host company engaged in the natural gas distribution business.

Correlating pipeline corrosion information using the Company's technology requires a combination of state-of-the-art instrumentation plus an understanding of the physical phenomena that are being measured. Management believes that the EMW measurement and analysis are on the leading edge of inspection technology.

The Company believes that its technology has at least two significant competitive advantages. First, it can inspect certain pipelines that are inaccessible to other testing methods. Second, with respect to facilities that are accessible to other inspection methods, the Company's technology does not require the removal of much, if any, insulation, coatings or encasements or pipeline excavation as a prerequisite to testing. Accordingly the Company's technology will typically have a lower cost of site preparation that results in a significant cost advantage. The Company's ongoing research and development efforts are designed to produce new applications for the Company's technology in the oil, natural gas and other industries.

The New Test Set

To position the Company to address the buried pipeline market, the Company redesigned and improved the hardware underlying the EMW Inspection Process. The new hardware (the "New Test Set") provides a different pulse waveform specifically tailored to the buried pipe environment. This waveform has increased low frequency energy content, which enables efficient wave propagation through sand, soil, and moist earth.

The New Test Set is smaller than the previous more cumbersome generation hardware used in Alaska. The New Test Set weighs less than 12 pounds, including the data acquisition digitizer and battery power supply. The New Test Set can be hand-carried and operated by a single person and no longer requires an oscilloscope or a gasoline powered AC generator which were necessary with the previous generation hardware. This portable system is designed to allow testing of both underground and above-grade pipelines with one test set.

As noted above, initial testing of the new buried-pipe inspection hardware has been completed at the Company's Ferndale, Washington pipe test facility, and is now being tested on natural gas pipelines in Pennsylvania. In addition, the Company plans to do additional field testing in Washington state in May on the facilities of two companies that have agreed to verify test results by digging up sections of line.

The results of all these tests should provide the Company with critical information as to the detection capabilities of its new hardware in different "real world" conditions and accelerate the commercial deployment of the Company's new hardware and software.

Although several important milestones have been achieved in the testing of the Company's new hardware and software, there can be no assurance that the field testing portion of this testing program can be funded or that the new

hardware and software can be successfully tested and deployed on a commercial basis. Failure to do so could have a serious and material effect on the business and financial condition of the Company.

Regulatory Environment

A combination of federal, state, and industry rules combine to regulate corrosion protection. The U.S. Department of Labor, operating through the Occupational Safety and Health Administration has jurisdiction over numerous plants and facilities containing corrosion protected pipeline that, if breached, could cause serious bodily injury or death to on-site workers. The U.S. Department of Transportation has jurisdiction over interstate natural gas and hazardous liquids pipelines. Counterpart state agencies have jurisdiction over intrastate natural gas and hazardous liquids pipelines. In addition, the American Petroleum Institute has promulgated a comprehensive Piping Inspection Code which requires that extensive corrosion testing be done by all members (which includes the vast majority of the petroleum and petrochemical industries). As a result of extensive regulation and testing requirements, the industry is faced with the requirement to engage in extensive testing for corrosion. In 1993, the American Petroleum Institute imposed stricter test standards for corrosion under the insulation on pipelines.

The American Petroleum Institute testing standard adopted in 1993, in essence, mandates either the stripping of larger amounts of coating or using an alternate system that will identify corrosion under the insulation without stripping the coating on suspected and unsuspected pipe. Because of the enormous cost involved in using the stripping and visual testing process, the Company believes that the industry will be receptive to an alternate testing system that is reliable and less costly. The Company believes that its EMW Inspection Process provides an alternate testing system that could be widely accepted by the industry. However, while the Company has obtained some commercial contracts and prospects for expanded commercial contracts in the future appear strong, there can be no assurance that such acceptance will continue to grow or that competitors will not develop newer and better technologies.

On December 15, 2003, the U.S Department of Transportation ("DOT") issued regulations under the Pipeline Safety Improvement Act of 2002 requiring regulated companies to gather baseline integrity data on pipelines in so-called "high consequence areas" ("HCA's") (e.g., populated areas) initially over a ten-year period and then every seven years thereafter. Based on consultations with industry representatives, the Company believes that its new buried pipe inspection hardware will provide such regulated companies with a superior tool for gathering the baseline integrity data required under the DOT regulations.

Employees

Pending the commercial deployment of its new hardware and the receipt of new contracts, and in an effort to reduce its out-of-pocket expenses to the lowest practicable level, the Company furloughed all of its field crews. If and when commercial contracts are obtained, the Company may re-hire former crew personnel or may hire and train new crews.

Intellectual Property

Throughout its development stage, the Company has filed and continues to file patents in order to protect the proprietary nature of its technology. The Company's latest patent application, filed on November 25, 2005, incorporates the advances made in the design, fabrication and testing of the new buried-pipe inspection hardware and software.

Revenues

The Company derives revenue solely from the sale of the EMW inspection technology service. The Company relies solely upon several employees, including the Chief Executive Officer and the Chief Operating Officer to conduct the Company's sales activities.

The Company did not have revenues during the three and nine months ended March 31, 2006 and 2005, respectively.

Sales and Marketing

The Company's sales and marketing strategy has been to position the Company's EMW inspection process as the method of choice to detect pipeline corrosion where the pipelines are either inaccessible to other inspection tools or much more costly to inspect with tools other than the Company's EMW technology. Pipelines are commonly found in refinery and chemical plants (such as insulated, overhead pipes), natural gas distribution systems (such as pipes buried in city streets), and natural gas transmission systems (such as road, bridge and stream crossings and concrete-encased pipes).

As described above, the Company has fabricated new buried pipe inspection hardware and is actively seeking industry and other financing sources in order to rigorously field test that hardware (initial testing having been completed in Ferndale, WA). In order to obtain additional revenue generating contracts, the Company intends to emphasize the reliability of its buried pipeline testing method, the flexibility of the method's application, and its cost effectiveness as compared to other methods. The Company intends to concentrate its fiscal year 2006 marketing efforts on the pipeline and utility buried pipe inspection markets in the lower-48 states, particularly in "high consequence areas" as defined in the federal Department of Transportation's regulations ("HCAs"). However, there can be no assurance that the Company will be successful in concentrating its marketing efforts for the EMW technology on natural gas utility and pipeline markets.

Results of Operations

The Company's operating results depend exclusively on its ability to market its EMW inspection technology services. If the Company is not able to automate completely the EMW inspection process and fully implement its new technology, the Company may not be able to obtain future contracts to sell or license its EMW technology. Since the Company's revenues are derived solely from sales of its EMW technology, any failure to obtain future contracts will have a material adverse effect on the business and financial condition of the Company.

The Company did not generate any revenues during the three and nine months ended March 31, 2006 and 2005, respectively, as the Company was engaged solely in the redevelopment and improvement of its testing hardware and software.

The Company did not have any cost of revenues for the three and nine months ended March 31, 2006 and 2005, respectively. The Company did not have any employees working in the field because the Company did not have any revenue generating contracts during these periods.

Research and development expenses for the three months ended March 31, 2006 were $56,852 as compared to $207,926 for the three months ended March 31, 2005. The decrease of $151,074 is substantially due to the Company recording $174,000 for the fair value of 200,000 stock options granted to a consultant during the three months ended March 31, 2005. Offsetting this decrease in equity related compensation is an increase of approximately $25,000 during the three months ended March 31, 2006 for compensation paid to two consultants and a scientist to

continue focusing increased efforts on the design, fabrication, and testing of the Company's new hardware.

Research and development expenses for the nine months ended March 31, 2006 were $303,718 as compared to $245,455 for the nine months ended March 31, 2005. The increase of $58,263 is substantially the result of the Company retaining the services of two consultants and a scientist during the nine months ended March 31, 2006, to focus increased efforts on the design, fabrication, and testing of

the Company's new hardware. Research and development related consulting fees were approximately $150,129 for the nine months ended March 31, 2006 as compared to approximately $13,500 for the nine months ended March 31, 2006. Offsetting the increase in the cash related consulting fees are the value of the stock options granted to one of the consultants and the scientist. Included in research and development for the nine months ended March 31, 2006, is $75,750 for the fair value of 75,000 options granted to one of the consultants and the scientist as partial compensation for their past services rendered. Included in research and development during the nine months ended March 31, 2005 is $174,000 for the fair value of 200,000 stock options granted to the scientist as partial compensation for past services rendered.

General and administrative expenses for the three and nine months ended March 31, 2006 were $158,891 and $494,335, respectively, as compared to $169,633 and $540,310, respectively, for the three and nine months ended March 31, 2005. The decrease of $10,742 for the three months ended March 31, 2006 as compared to the three months ended March 31, 2005 is the result of a general reduction of operating expenditures as the Company continues to focus on controlling its overall burn rate.

The decrease in general and administrative expenses of $45,975 for the nine months ended March 31, 2006 as compared to the nine months ended March 31, 2005 is the result of a general reduction of operating expenditures as the Company continues to focus on controlling its overall burn rate. Contributing to the decrease in general and administrative expenses was a decrease in professional fees of approximately $7,400 and a decrease in insurance premiums of approximately $4,400 for the nine months ended March 31, 2006 as compared to the nine months ended March 31, 2005.

Loss from operations for the three and nine months ended March 31, 2006 was $215,743 and $798,053, respectively, as compared to $377,559 and $785,765, respectively, for the three and nine months ended March 31, 2005. In general, loss from operations decreased for the three months ended March 31, 2006 as compared to the three months ended March 31, 2005 primarily as a result of the decrease in equity compensation recorded for the stock options granted to the scientist during the three months ended March 31, 2005 as compared to the three months ended March 31, 2006. In general, loss from operations remained relatively flat for the nine months ended March 31, 2006 as compared to the nine months ended March 31, 2005 as a result of an increase in research and development activities, offset by reductions in professional fees and other operating expenses as discussed above.

Interest expense for the three and nine months ended March 31, 2006 was $12,300 and $237,632, respectively, as compared to $19,113 and $158,062, respectively, for the three and nine months ended March 31, 2005. The decrease of $6,816 for the three months ended March 31, 2006 as compared to the three months ended March 31, 2005 is substantially the result of Mr. Evans converting the remaining outstanding principal balance of his 5% interest bearing Amended Evans Loan on January 10, 2006, thereby reducing the outstanding principal balance on the Amended Evans Loan and the corresponding interest expense

incurred by the Company of approximately $11,480. Additionally, interest expense related to the 5% interest bearing Debentures decreased by approximately $2,700 for the nine months ended March 31, 2006 as compared to the three months ended March 31, 2005 as a result of investors who previously exercised their conversion right, converting their Debentures to equity, thereby reducing the outstanding principal balance on the Debentures. These decreases in interest expense are offset by an increase in interest expense related to investors who exercised their conversion right in accordance with the terms of the 2003 Offering. During the three months ended March 31, 2006, approximately $8,000 of unamortized discount was recognized as interest expense upon conversion by one investor. During the three months ended March 31, 2005, none of the investors exercised their conversion right in accordance with the terms of the 2003 Offering. Hence, there was no unamortized discount recorded as interest expense during the three months ended March 31, 2005.

The increase of $79,570 for the nine months ended March 31, 2006 as compared to the nine months ended March 31, 2005 is substantially the impact of investors exercising their conversion right in accordance with the terms of the 2003 Offering. Six investors exercised their conversion right during the nine months ended March 31, 2006 as compared to five investors during the nine months ended March 31, 2005. The unamortized discount recognized as interest expense upon conversion was approximately $198,000 during the nine months ended March 31, 2006 as compared to approximately $100,000 during the nine months ended March 31, 2005. This increase is offset by a decrease in interest expense on the Amended Evans Loan of approximately $17,500 for the nine months ended March 31, 2006 as compared to the nine months ended March 31, 2005 as a result of Mr. Evans converting the remaining outstanding principal balance of his loan during the nine months ended March 31, 2006.

Liquidity and Capital Resources

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. The Company incurred cumulative losses of $12,640,824 through March 31, 2006 and had negative working capital of $741,024 as of March 31, 2006. Additionally, the Company has expended a significant amount of cash in developing its technology and patented processes. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management recognizes that in order to meet the Company's capital requirements, and continue to operate, additional financing, including seeking industry-partner investment through joint ventures or other possible arrangements, will be necessary. The Company is evaluating alternative sources of financing to improve its cash position and is undertaking efforts to raise capital. If the Company is unable to raise additional capital or secure additional revenue contracts and generate positive cash flow, it is unlikely that the Company will be able to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Deferred Wages and Accrued Professional Fees

To reduce cash outflows, certain of the Company's employees, officers, consultants, and directors have agreed to defer a portion of their salaries and professional fees until the Company has sufficient resources to pay the amounts owed or to exchange such amounts into options as described below. At March 31, 2006, the Company has accrued $893,786 related to the deferred payment of salaries and professional fees of which $707,636 is included under deferred wages and $186,150 in accrued professional fees. On March 18, 2002, the Board approved a conversion right on all deferred wages and accrued professional fees deferred as of March 18, 2002. Pursuant to this conversion right, employees,

officers, consultants, and directors may elect to convert $1.00 of fees owed to them as of March 18, 2002 for an option to purchase two shares of the Company's common stock, at an exercise price of $1.00 per share for a term of five years. Deferred salaries and fees as of March 18, 2002 were $111,500, resulting in the potential issuance of 223,000 options under the terms mentioned above. No conversions have occurred to date. At March 18, 2002, there was no intrinsic value associated with these exchange rights. As such, no additional compensation cost was recorded.

Convertible Debt

On June 19, 2003, the Board of Directors approved the offering (the "2003 Offering") of $1,000,000 in convertible debentures (the "Debentures"). The Debentures are convertible into that number of shares of the Company's common stock equal to the amount of the converted indebtedness divided by $0.50 per share. The Debentures bear interest at a rate of 5% per annum, payable quarterly. Delinquent interest payments bear interest at a rate of 12% per annum. The Company is required to redeem each Debenture on the 5th anniversary of the date of the Debenture. The Company may, in its discretion, redeem any Debenture at any time prior to the mandatory redemption date of the Debenture by providing no less than 60 days' prior written notice to the holder of the Debenture. Certain events of default will result in the Debentures being redeemable by the Company upon demand of the holder.

Upon the purchase of, and for each $0.50 of the Debenture's principal amount, the Company issued to each investor a warrant (the "Warrant") to purchase one (1) share of the Company's common stock at an exercise price of $0.75 per share. The Warrants are exercisable at any time prior to the 5th anniversary date of the redemption of the Debenture.

Warrants issued in connection with the 2003 Offering were recorded based on their relative fair value as compared to the fair value of the debt at issuance. The relative fair value of the warrants was recorded as paid-in capital, estimated at $0 and $101,977 for the three and nine months ended March 31, 2005, respectively. The fair value of the warrants issued during the three and nine months ended March 31, 2005, was determined based on an option pricing model with the following assumptions: warrant lives of 10 years, risk free interest rates ranging from 4.14% to 4.30%, volatility of 120%, and a zero dividend yield. The intrinsic value of the Debentures results in a beneficial conversion feature that reduces the book value of the convertible debt to not less than zero. Accordingly, the Company recorded a discount of $0 and $56,023 during the three and nine months ended March 31, 2005, respectively, on the convertible debt issued under the 2003 Offering. The Company amortizes the discount using the effective interest method over the five-year life of the Debentures.

During the quarter ended March 31, 2005, the Board of Directors terminated the 2003 Offering. As of the closing date of the 2003 Offering, the Company had raised $503,000 from the 2003 Offering.

During the three and nine months ended March 31, 2006, one and six investors, respectively, exercised their conversion right under the terms of the Debentures. Accordingly, the carrying value of the convertible debt was reclassified as equity upon conversion. Since the convertible debt instruments include a beneficial conversion feature, the remaining unamortized discount of $7,991 and $197,945 at the conversion date was recognized as interest expense during the three and nine months ended March 31, 2006, respectively.

During the three and nine months ended March 31, 2005, none and five investors, respectively, exercised their conversion right under the terms of the

Debentures. Accordingly, the carrying value of the convertible debt was reclassified as equity upon conversion. Since the convertible debt instruments include a beneficial conversion feature, the remaining unamortized discount of approximately $0 and $100,000 at the conversion date was recognized as interest expense during the three and nine months ended March 31, 2005, respectively.

As of March 31, 2006, accrued interest on the Debentures was $2,232. The Company recorded interest expense related to the accretion of the discount on the Debentures and amortization of the convertible debt discount as a result of the conversions discussed above of $8,039 and $198,051 for the three and nine months ended March 31, 2006, respectively. The Company recorded interest expense related to the accretion of the discount on the Debentures and amortization of the convertible debt discount as a result of the conversions discussed above of $17 and $100,031 for the three and nine months ended March 31, 2005, respectively. As of March 31, 2006 the carrying value of the long-term portion of the Debentures was $112, net of unamortized debt discount of $67,388.

Common Stock

On January 19, 2005, the Board of Directors approved the offering (the "2005 Offering") of 2,000,000 units (the "Units") for a total offering price of $1,000,000, consisting of shares of common stock and attached warrants. On November 21, 2005, the Board of Directors approved an increase in the number of units to 6,000,000 units for a total offering price of $3,000,000. The purchase price of one Unit is $0.50. Each Unit consists of one share of common stock and a warrant to purchase one share of common stock at an exercise price of $0.75 per share. The warrants are exercisable at any time prior to the fifth anniversary from the date of grant.

During the nine months ended March 31, 2006, the Company raised $1,149,500 under the terms of the 2005 Offering. Accordingly, the Company issued 2,299,000 shares of common stock and warrants to purchase up to 2,299,000 shares of common stock at an exercise price of $0.75 per share.

The Company engaged a brokerage firm to help in the fund raising efforts of the 2005 Offering. Pursuant to the terms of the agreement with the brokerage firm, the Company will pay the brokerage firm a ten percent cash commission on all funds that the brokerage firm helps raise. Additionally, the Company will issue warrants to purchase shares of common stock at $0.75 per share equal to ten percent of the total warrants issued in connection with the 2005 Offering. The warrants may be exercised up to five years from the date of issuance, which is the date the proceeds are received under the 2005 Offering. During the three and nine months ended March 31, 2006, the Company incurred $39,400 and $110,750, respectively, of fees to be paid in cash to the brokerage firm and issued warrants to purchase 78,800 and 221,500, respectively, shares of common stock. During the three and nine months ended March 31, 2006, the Company recorded $100,076 and $207,260, respectively, as a reduction to paid-in capital for the fair value of the warrant grants. The fair value of the warrants issued to the brokerage firm during the three months ended March 31, 2006 were estimated using the Black-Scholes option pricing model with the following weighted average assumptions: expected volatility of 151.04%, risk-free interest rate of 4.82%, expected lives of five years, and a 0% dividend yield. The fair value of the warrants issued to the brokerage firm during the nine months ended March 31, 2006 were estimated using the Black-Scholes option pricing model with the following weighted average assumptions: expected volatility ranging from 151.04% to 376.15%, risk-free interest rates ranging from 4.14% to 4.82%, expected lives of five years, and a 0% dividend yield.

Other Commitments

The Company's other contractual obligations consist of commitments under an operating lease and repayment of loans payable to certain officers, directors and stockholders.

As of March 31, 2006, the Company had outstanding loans payable to certain officers, directors and stockholders with principal amounts, in the aggregate, equal to $57,500. The terms of the various notes are described above under "Note 7: Notes Payable - Stockholders."

As of March 31, 2006, the Company has future minimum lease payments of approximately $19,900 under its operating lease.

Capital will be expended to support operations until the Company can generate sufficient cash flows from operations. In order for the Company to generate cash flows from operations, the Company must obtain additional revenue generating contracts. Management is currently directing the Company's activities towards obtaining additional service contracts, which, if obtained, will necessitate the Company attracting, hiring, training and outfitting qualified technicians. If additional service contracts are obtained, it will also necessitate additional field test equipment purchases in order to provide the services. The Company's intention is to purchase such equipment for its field crews for the foreseeable future, until such time as the scope of operations may require alternate sources of financing equipment. The Company expects that if additional contracts are secured, and revenues increase, working capital requirements will increase. There can be no assurance that the Company's process will gain widespread commercial acceptance within any particular time frame, or at all. The Company will incur additional expenses as it hires and trains field crews and support personnel related to the successful receipt of commercial contracts. Additionally, the Company anticipates that cash will be used to meet capital expenditure requirements necessary to develop infrastructure to support future growth. There can be no assurance that the Company will be able to secure additional revenue generating contracts to provide sufficient cash.

Pending the deployment of the Company's new hardware and software and the receipt of new contracts, and in an effort to reduce its out-of-pocket expenses to the lowest practicable level, the Company has furloughed all of its field crews. If and when revenue-generating contracts are obtained, the Company will re-hire former crew personnel or may hire and train new crews. The Company was not obligated to make any severance payments for salaries, health benefits or accrued vacation and sick time related to the termination of any of its employees.

Off Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-QSB contains "forward-looking statements." These forward-looking statements can generally be identified as such because the context of the statement will include words such as the Company "believes," "anticipates," "expects" or words of similar import. Similarly, statements that describe the Company's projected future results, future plans, objectives or goals or future conditions or events are also forward looking statements. Actual results are inherently difficult to predict. Any such forward-looking statements are subject to the risks and uncertainties that could cause actual results of operations, financial condition, acquisitions, financing transactions, operations, expenditures, expansion and other events to differ materially from those expressed or implied in such forward-looking statements. Any such forward-looking statements would be subject to a number of assumptions regarding, among other things, future economic, competitive and market

conditions generally. Such assumptions would be based on facts and conditions as they exist at the time such statements are made as well as predictions as to future facts and conditions, the accurate prediction of which may be difficult and involve the assessment of events beyond the Company's control.

The forward-looking statements contained in this report are based on current expectations that involve a number of risks and uncertainties. Such forward-looking statements are based on assumptions that the Company will obtain or have access to adequate financing to continue its operations, that the Company will market and provide products and services on a timely basis, that there will be no material adverse competitive or technological change with respect to the Company's business, demand for the Company's products and services will significantly increase, that the Company will be able to secure additional fee-for-services or licensing contracts, that the Company's executive officers will remain employed as such by the Company, that the Company's forecast accurately anticipate market demand, and that there will be no material adverse change in the Company's operations, business or governmental regulation affecting the Company or its customers. The foregoing assumptions are based on judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond the Company's control. Although the Company believes the expectations reflected in the forward-looking statements are reasonable, the Company cannot guarantee future results, levels of activity, performance or achievements.

Item 3. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

The term "disclosure controls and procedures" is defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). This term refers to the controls and procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized, and reported within the required time periods. Our Chief Executive Officer and our Chief Financial Officer have evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. They have concluded that, as of that date, our disclosure controls and procedures were effective at ensuring that required information will be disclosed on a timely basis in our reports filed under the Exchange Act.

(b) Changes in Internal Control over Financial Reporting

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II -- OTHER INFORMATION

Item 1. Legal Proceedings.

The Company is not aware of any legal proceedings contemplated by any governmental authority or any other party involving the Company or its

properties. As of the date of this report, no director, officer or affiliate is a party adverse to the Company in any legal proceeding or has an adverse interest to the Company in any legal proceedings. The Company is not aware of any other legal proceedings pending or that have been threatened against the Company or its properties.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Convertible Debt

On June 19, 2003, the Board of Directors approved the offering (the "2003 Offering") of $1,000,000 in convertible debentures (the "Debentures"). The Debentures are convertible into that number of shares of the Company's common stock equal to the amount of the converted indebtedness divided by $0.50 per share. Upon the purchase of, and for each $0.50 of the Debenture's principal amount, the Company issued to each investor a warrant (the "Warrant") to purchase one (1) share of the Company's common stock at an exercise price of $0.75 per share. The Warrants are exercisable at any time prior to the 5th anniversary date of the redemption of the Debenture. The 2003 Offering is exempt from registration under Section 4(2) of the Securities Act.

During the three months ended March 31, 2006, an investor exercised their conversion right, pursuant to the terms of the 2003 Offering, and converted $8,000 of principal pursuant to the terms of the 2003 Offering. Accordingly, the Company issued 16,000 shares of common stock and warrants to purchase up to 16,000 shares of common stock in accordance with the terms of the 2003 Offering.

Common Stock

On January 19, 2005, the Board of Directors approved the offering (the "2005 Offering") of 2,000,000 units (the "Units") for a total offering price of $1,000,000 to accredited investors, as that term is defined by Rule 501 of Regulation D, consisting of shares of common stock and attached warrants. On November 21, 2005, the Board of Directors approved an increase in the number of Units to 6,000,000 Units for a total offering price of $3,000,000. The purchase price of one Unit is $0.50. Each Unit consists of one share of common stock and a warrant to purchase one share of common stock at an exercise price of $0.75. The warrants are exercisable at any time prior to the fifth anniversary from the date of grant. The 2005 Offering is exempt from registration under Section 4(2) of the Securities Act.

During the three months ended March 31, 2006, the Company raised $394,000 and issued 788,000 shares of common stock and warrants to purchase up to 788,000 shares of stock in accordance with the terms of the 2005 Offering.

During the three months ended March 31, 2006, Mr. Evans exercised his conversion right, pursuant to the terms of the Amended Evans Loan, and converted $512,500 of principal and accrued interest pursuant to the terms of the 2005 Offering. Accordingly, the Company issued 1,025,000 shares of common stock and warrants to purchase up to 1,025,000 shares of common stock in accordance with the terms of the 2005 Offering.

Warrants

During the three months ended March 31, 2006, the Company issued a warrant to a brokerage firm to purchase 78,800 shares of common stock at an exercise price of $0.75 per share. The warrant may be exercised up to five years from the date of issuance. These securities were issued in reliance on exemptions from

registration provided by Section 4(2) of the Securities Act.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Submission of Matters to a Vote of Shareholders.

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

The following exhibits are filed with or incorporated by reference into this report as required by Item 601 of Regulation S-B:

Exhibit No.	Description of Exhibit
Exhibit 3.1	Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Registration Statement on Form SB-2 filed with the Commission on May 10, 1996).
Exhibit 3.2	Bylaws of the Company (incorporated by reference to Exhibit 3.3 to the Company's Registration Statement on Form SB-2 filed with the Commission on May 10, 1996).
Exhibit 3.3	Amendment to Certificate of Incorporation (incorporated by reference to Exhibit A to the Company's Definitive Proxy Statement filed with the Commission on October 28, 2002).
Exhibit 10.1	Loan Agreement dated May 9, 2002, by and between the Company and Murphy Evans (incorporated by reference to Exhibit 4.1 to the Company's Quarterly Report on Form 10-QSB filed with the Commission on May 15, 2002).
Exhibit 10.2	Loan Amendment and Promissory Note dated March 6, 2003, by and between the Company and Murphy Evans (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-QSB filed with the Commission on May 20, 2003).
Exhibit 10.3	Lease Agreement dated January 26, 2001 by and between the Company and Fatum LLC (incorporated by reference to Exhibit 10.4 to the Company's Annual Report on Form 10-KSB filed with the Commission on October 12, 2004).
Exhibit 10.4	Lease Extension dated February 26, 2003 by and between the Company and Fatum LLC (incorporated by reference to Exhibit 10.5 to the Company's Annual Report on Form 10-KSB filed with the Commission on October 12, 2004).
Exhibit 10.5	Royalty Agreement (incorporated by reference to Exhibit 10.1 to the Company's Registration Statement on Form SB-2 filed with the Commission on May 10, 1996).
Exhibit 10.6	Assignment of Patent Rights (incorporated by reference to

	Exhibit 10.2 to the Company's Registration Statement on Form SB-2 filed with the Commission on May 10, 1996).
Exhibit 10.7	1999 Stock Option Plan (incorporated by reference to Exhibit 10.9 to the Company's Annual Report on Form 10-KSB filed with the Commission on October 12, 2004).
Exhibit 14.1	Code of Ethics (incorporated by reference to Exhibit 14 to the Company's Annual Report on Form 10-KSB filed with the Commission on October 12, 2004).
Exhibit 31.1	Rule 13a-14(a)/15d-14(a) Certification of Henry E. Gemino, as Chief Executive Officer and Chief Financial Officer of the Company.
Exhibit 31.2	Rule 13a-14(a)/15d-14(a) Certification of Philip L. Jones, as Chief Operating Officer and Executive Vice President of the Company.
Exhibit 32.1	Certification under Section 906 of the Sarbanes-Oxley Act of 2002 by Henry E. Gemino, as Chief Executive Officer and Chief Financial Officer of the Company.
Exhibit 32.2	Certification under Section 906 of the Sarbanes-Oxley Act of 2002 by Philip L. Jones, as Chief Operating Officer and Executive Vice President of the Company.

SIGNATURES

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

PROFILE TECHNOLOGIES, INC.
(Registrant)

Date: May 9, 2006

/s/ Henry E. Gemino

Henry E. Gemino
Chief Executive Officer and
Chief Financial Officer