AMERICAN TECHNOLOGY CORP /DE/
Form 10-Q/A
August 18, 2003

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

FORM 10-Q/A
(AMENDMENT NO.1)

(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, 2003

or

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

For the transition period from ____________ to ____________.

Commission File Number: 0-24248

AMERICAN TECHNOLOGY CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	87-03261799
(State or other jurisdiction of incorporation or organization)	(I.R.S. Empl. Ident. No.)

13114 Evening Creek Drive South, San Diego, California	92128
(Address of principal executive offices)	(Zip Code)

(858) 679-2114
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the 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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ____ No X

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of May 1, 2003.

Common Stock, $0.00001 par value 15,192,294

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(Class)	(Number of Shares)

This quarterly report on Form 10-Q/A is being filed to reflect the restatement of the Registrant's financial results for the three and six month periods ended March 31, 2003 (the "Restatement"). The Restatement primarily reflects increased imputed deemed dividends on the Series D Preferred Stock attributable to the discount on issuance. The increase results from the voluntary conversion of 170,400 shares of Series D Preferred Stock during the quarter ended March 31, 2003, which conversions were previously disclosed in the Notes to the Financial Statements, but for which accelerated accretion of deemed dividends was not recorded in the Financial Statements previously filed. The accretion of deemed dividends is a non-cash item and does not change the reported net loss, stockholders' equity or the balance sheet. As a result of the Restatement, the net loss available to common stockholders increased from $2,107,991 and $3,998,434 for the three and six months ended March 31, 2003, respectively, to $2,664,718 and $4,551,242, respectively. The loss per share of common stock increased from $0.14 and $0.27 for the three months and six months ended March 31, 2003, respectively, to $0.18 and $0.31. The balance sheets are March 31, 2003 was not affected by this restatement. Further information concerning accelerated accretion of the deemed dividend on the Series D Preferred Stock as a result of voluntary conversion is provided in Note 3 and 9 to the Financial Statements included herewith.

Except for the Restatement, this report does not attempt to update the information included herein beyond the original filing date.

AMERICAN TECHNOLOGY CORPORATION
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AMERICAN TECHNOLOGY CORPORATION

BALANCE SHEETS
(Unaudited)

	March 31, 2003	Septemb 200
ASSETS		
CURRENT ASSETS:		
Cash	$ 1,866,335	$ 1,8
Trade accounts receivable, less allowance of $8,091 and $20,191 for doubtful accounts	36,904	1
Subscription receivable	25,000	
Inventories	431,756	1
Prepaid expenses and other	73,000	
TOTAL CURRENT ASSETS	2,432,995	2,0
EQUIPMENT, net	165,247	3
PATENTS, net of accumulated amortization of $179,290 and $141,314	988,785	1,0
PURCHASED TECHNOLOGY, net of accumulated amortization of $1,157,278 and $946,864	105,222	3
TOTAL ASSETS	$ 3,692,249	$ 3,7
LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES:		
Accounts payable	$ 360,640	$ 7
Accrued liabilities:		
Payroll and related	188,276	2
Deferred revenue	388,168	2
Other	60,264	
Interest on notes	381,534	2
Capital lease short-term portion	9,110	
12% Convertible Promissory Notes	1,725,000	
Related party 12% Convertible Promissory Notes	300,000	
TOTAL CURRENT LIABILITIES	3,412,992	1,5
LONG-TERM LIABILITIES:		
12% Convertible Promissory Notes net of $0 and $345,000 debt discount	-	1,3
Related party 12% Convertible Promissory Notes, net of $0 and $60,000 debt discount	-	2
8% Senior Secured Promissory Notes	1,000,000	1,5
Capital lease long-term portion	28,497	
TOTAL LIABILITIES	4,441,489	4,6

COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' DEFICIT		
Series C Preferred stock 300,000 shares designated: 0 and 10,000 issued and outstanding respecitively. Liquidation preference of $0 and $230,510, respectively.	-	
Series D Preferred stock 235,400 shares designated: 65,000 and 235,400 issued and outstanding, respectively. Liquidation preference of $685,474 and $2,412,046, respectively.	1	
Series E Preferred stock 350,000 shares designated: 343,250 and 0 issued and outstanding, respectively. Liquidation preference of $3,449,126 and $0, respectively.	3	
Common stock, $0.00001 par value; 50,000,000 shares authorized 15,156,670 and 14,351,476 shares issued and outstanding	151	
Additional paid-in capital	30,976,600	27,2
Accumulated deficit	(31,725,995)	(28,1
TOTAL STOCKHOLDERS' DEFICIT	(749,240)	(8
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	$ 3,692,249	$ 3,7

See accompanying notes to financial statements.

AMERICAN TECHNOLOGY CORPORATION
STATEMENTS OF OPERATIONS
(Unaudited)

	For the three months ended March 31, 2003	2002	For the six Mar 2003
REVENUES:			
Product sales	$ 145,611	$ 99,155	$ 533,578
Contract and license	92,331	100,278	127,663
Total revenues	237,942	199,433	661,241
Cost of revenues	350,784	122,385	672,419
GROSS (LOSS) PROFIT	(112,842)	77,048	(11,178)
OPERATING EXPENSES:			
Selling, general and administrative	908,992	610,463	1,665,309
Research and development	727,298	987,060	1,308,719
Total operating expenses	1,636,290	1,597,523	2,974,028
Loss from operations	(1,749,132)	(1,520,475)	(2,985,206)
OTHER INCOME (EXPENSE):			

Interest income	1,321	9,910	3,652
Interest expense	(104,828)	(464,918)	(602,730)
Other	(1,667)	-	(1,667)
Total other income (expense)	(105,174)	(455,008)	(600,745)
NET LOSS	$(1,854,306)	$(1,975,483)	$(3,585,951)
Imputed dividends on convertible Preferred Stock	810,412	2,959	965,291
NET LOSS AVAILABLE TO COMMON STOCKHOLDERS	$(2,664,718)	$(1,978,442)	$(4,551,242)
NET LOSS PER SHARE OF COMMON STOCK - BASIC AND DILUTED	$ (0.18)	$ (0.14)	$ (0.31)
AVERAGE WEIGHTED NUMBER OF COMMON SHARES OUTSTANDING	14,897,662	14,273,238	14,629,077

See accompanying notes to financial statements.

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AMERICAN TECHNOLOGY CORPORATION

STATEMENTS OF CASH FLOWS
(Unaudited)

	For the six months ended March 31,	
	2003	2002
INCREASE (DECREASE) IN CASH		
OPERATING ACTIVITIES:		
Net loss	$(3,585,951)	$(3,684,626
Adjustments to reconcile net loss to net cash used in operations:		
Depreciation and amortization	339,290	362,826
Allowance for doubtful accounts	(12,100)	-
Warranty reserves	41,542	-
Common stock issued for services and compensation	410,816	7,199
Write-down on patents	40,321	-
Options and warrants granted for services	-	137,590
Amortization of debt discount	405,000	810,000
Changes in assets and liabilities:		
Trade accounts receivable	86,682	(48,551
Inventories	(294,875)	27,005
Prepaid expenses and other	(52,870)	34,503
Accounts payable	(255,891)	254,479
Accrued liabilities	197,690	112,081
Net cash used in operating activities	(2,680,346)	(1,987,494
INVESTING ACTIVITIES:		
Purchase of equipment	(9,700)	(27,086
Patent costs paid	(32,749)	(55,476

Net cash used in investing activities	(42,449)	(82,562
FINANCING ACTIVITIES:		
Payments on capital lease	(4,368)	-
Proceeds from issuance of convertible promissory notes	500,000	-
Proceeds from the issuance of preferred stock	2,407,500	-
Cash paid for offering costs	(141,222)	-
Proceeds from issuance of convertible promissory notes	-	1,225,000
Proceeds from exercise of stock options	19,500	-
Net cash provided by financing activities	2,781,410	1,225,000
Net increase (decrease) in cash	58,615	(845,056
Cash, beginning of year	1,807,720	1,354,072
Cash, end of year	$ 1,866,335	$ 509,016
SUPPLEMENTAL DISCLOSURES OF CASH INFORMATION:		
Cash paid during the period for:		
Interest	$ 72,305	$ -
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Issuance of stock warrants in connection with convertible debt	$ -	$ 624,750
Increase in additional paid in capital for the beneficial conversion feature of convertible debt	$ -	$ 600,250
Common stock issued on conversion of Series B preferred stock	$ -	$ 2,102,412
Sale of equipment for accounts payable	$ 117,000	$ -
Secured Notes converted into Series E Preferred Stock	$ 1,000,000	$ -
Issuance of Series E Preferred Stock for Subscription receivable	$ 25,000	$ -

See accompanying notes to financial statements.

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AMERICAN TECHNOLOGY CORPORATION
NOTES TO INTERIM FINANCIAL STATEMENTS
(Unaudited)

1. OPERATIONS

American Technology Corporation is engaged in design, development and commercialization of sound, acoustic and other technologies. Our primary focus is on marketing four of our proprietary sound reproduction technologies and supplying components based on these technologies to customers.

2. STATEMENT PRESENTATION

The accompanying unaudited interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. In the opinion of management, the interim financial statements reflect all adjustments of a normal recurring nature necessary for a fair presentation of the results for interim periods. Operating results for the three and six month periods are not necessarily indicative of the results that may be expected for the year. The interim financial statements and notes thereto should be read in conjunction with the Company's audited financial statements and notes thereto for the year ended September 30, 2002 included in the Company's annual report on Form 10K.

The Company's financial statements are presented on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The ability of the Company to continue as a going concern is contingent upon it obtaining sufficient financing to sustain its operations and its ability to ultimately generate profits and positive cash flow from operations. The Company has funded its operations primarily through the issuance of securities and debt financings. Other than cash of $1,866,335 at March 31, 2003 the Company has no other material unused sources of liquidity at this time. Based on our current cash position and projections for future revenues and currently planned expenditures, we will need to raise additional capital of approximately $2 million to continue operations at planned levels during the next twelve months. While we believe that investment capital in sufficient amounts will be available to us, there can be no guarantee that we will be able to raise funds on terms acceptable to us, or at all. The Company has significant debt that comes due in December 2003 and December 2004.

Based on its current plan and assumptions, the Company anticipates that it will be able to meet its cash requirements for the next twelve months. Management believes increased product sales may provide additional operating funds and believes that any additional investment capital will be available if required. Management has significant flexibility to adjust the level of research and development and selling and administrative expenses based on the availability of resources.

Management expects to incur additional operating losses as a result of expenditures for research and development and marketing costs for sound and other products and technologies. The timing and amounts of these expenditures and the extent of the Company's operating losses will depend on many factors, some of which are beyond management's control. Management anticipates that the commercialization of the Company's technologies may require increased operating costs, however management cannot currently estimate the amounts of these costs.

There can be no assurance that any funds required during the next twelve months or thereafter can be generated from operations or that such required funds would be available from the aforementioned or other potential sources. The lack of sufficient funds from operations or additional capital could force the Company to curtail, scale back operations, or cease operations and would therefore have a material adverse effect on the Company's business.

As such, there is substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments necessary to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the possible inability of the Company to continue as a going concern.

3. NET LOSS PER SHARE

The Company applies Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share." SFAS No. 128 provides for the calculation of "Basic" and "Diluted" earnings per share ("EPS"). Basic EPS includes no dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution of securities that could share in the earnings of an entity. The Company's net losses for the periods presented cause the inclusion of potential common stock instruments outstanding to be antidilutive and, therefore, in accordance with SFAS No. 128, the Company is not required to present a diluted EPS. Convertible preferred stock, convertible promissory notes, stock options and warrants convertible or exercisable into approximately 6,445,474 and 3,786,805 shares of common stock were outstanding at March 31,

2003 and 2002, respectively. These securities were not included in the computation of diluted EPS because of the net losses but could potentially dilute EPS in future periods.

The Series C Preferred Stock provides for an accretion in the conversion value of 6% or $1.20 per share per annum. The Series D Preferred Stock provides for an accretion in the conversion value of 6% or $0.60 per share per annum. The Series E Preferred Stock provides for an accretion in the conversion value of 6% or $0.60 per share per annum. The accrued accretion increases the net loss available to common stockholders. Net loss available to common stockholders is computed as follows:

	Three months ended March 31 2003	2002	Six months 2003
Net Loss	$ (1,854,306)	$ (1,975,483)	$(3,585,951)
Series D Preferred Stock imputed deemed dividends based on discount at issuance	(616,477)	-	(678,447)
Imputed deemed dividends on warrants issued with Series D Preferred Stock	(60,475)	-	(114,760)
Series E Preferred Stock imputed deemed dividends based on discount at issuance	(61,145)	-	(61,145)
Imputed deemed dividends on warrants issued with Series E Preferred Stock	(17,256)	-	(17,256)
Accretion on Series C, D, and E Preferred Stock at stated rate	(55,059)	(2,959)	(93,683)
Net loss available to common stockholders	$ (2,664,718)	$ (1,978,442)	$(4,551,242)

4. RECENT ACCOUNTING PRONOUNCEMENTS
In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires the fair value of a liability for an asset retirement obligation to be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. SFAS No. 143 is effective for the Company for the fiscal year ending September 30, 2003. The Company adopted this statement effective October 1, 2002. The adoption of this statement did not have a material impact on its financial statements.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lives Assets". SFAS 144 requires that those long-lived assets be measured at the lower of carrying amount or fair value, less cost to sell, whether reported in continuing operations or in discontinued operations. Therefore, discontinued operations will no longer be measured at net realizable value or include amounts for operating losses that have not yet occurred. SFAS 144 is effective for financial statements issued for fiscal years beginning after December 15, 2001 and, generally, is to be applied prospectively. The adoption of this statement did not have a material impact on its financial statements.

In April 2002, the FASB issued SFAS No. 145, Rescission of FASB No. 4, 44 and 64, Amendment of FASB No.13, and Technical Corrections. SFAS rescinds FASB No. 4 Reporting Gains and Losses from Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements. This statement also rescinds SFAS No.44 Accounting for Intangible Assets of Motor Carriers and amends SFAS No.13, Accounting for Leases, to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. This Statement also amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions. This statement is effective for fiscal years beginning after May 15, 2002. The adoption of this statement did not have a material impact on its financial statements.

In June 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. SFAS No. 146 addresses accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring). SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized and measured initially at fair value when the liability is incurred. SFAS No. 146 is effective for exit or disposal activities that are initiated after March 31, 2003, with early application encouraged. The Company does not expect the

adoption of this statement to have a material effect on its financial statements.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure -- an Amendment of FASB Statement No. 123." This statement amends SFAS No. 123, "Accounting for Stock-Based Compensation", to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company adopted the disclosure requirements effective October 1, 2002, in its financial statements.

In November 2002, the FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"). FIN 45 clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and initial measurement provisions of FIN 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The disclosure requirements of FIN 45 are applicable for financial statements of interim periods ending after December 15, 2002. The Company the disclosure requirements of FIN 45 in the 1st quarter of 2002 and has include the new disclosure requirements in the Notes to the Financial Statements (see Note 6).

5. INVENTORIES
Inventories are valued at the lower of cost or market. Cost is determined using the first-in, first-out (FIFO) method. Inventories consist of the following:

	March 31, 2003	September 30,2002

Finished goods	$ 214,885	$ 78,361
Raw materials	236,871	78,520
Reserve for obsolete inventory	(20,000)	(20,000)
	$ 431,756	$ 136,881

6. PRODUCT WARRANTY COST

At the time revenue is recognized, the Company provides for estimated cost of product warranties as provided under contractual arrangements. Warranty obligations are affected by product failure rates and service delivery costs incurred in correcting a product failure. Should such failure rates or costs differ from these estimates, accrued warranty costs would be adjusted in the period that such events or costs become known.

Changes in the warranty reserves during the six months ended March 31, 2003 were as follows:

Balance at October 1, 2002	$ 6,313
Accruals for warranty during the six months ended March 31, 2003	41,542
Balance at March 31, 2003	$47,855

7. PURCHASED TECHNOLOGY
In April 2000, the Company acquired all rights to certain loudspeaker technology owned by David Graebener ("Graebener"), Stephen M. Williams ("Williams") and Hucon Limited, a Washington corporation ("Hucon"). The purchase price consisted of $300,000 cash plus 200,000 shares of common stock. The 200,000 shares of common stock were issued in June 2000 and were valued at $962,500. The Company agreed to pay up to an additional 159,843 shares of common stock to Williams and Graebener contingent upon the achievement of certain performance milestones relating to gross revenues received by the Company from the purchased technology. Contingent shares are recorded as compensation expense when earned. During fiscal 2002, a total of 50,000 contingent shares were issued. In fiscal 2003, the Company issued the balance of 109,843 contingent shares and recorded $410,816 in compensation expense. The Company agreed to employ Mr. Williams and Mr. Graebener for a term of three years subject to certain terms and conditions. The Company did not renew the employment agreements, which terminated on February 15, 2003.

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AMERICAN TECHNOLOGY CORPORATION
NOTES TO INTERIM FINANCIAL STATEMENTS
(Unaudited)

8. SENIOR SECURED AND CONVERTIBLE SUBORDINATED PROMISSORY NOTES
8% Senior Secured Promissory Notes

On September 30, 2002, the Company issued to accredited investors 8% Senior Secured Promissory Notes ("Senior Notes") for cash proceeds of $1,500,000. The Senior Notes bear interest at a rate of eight percent (8%) per annum on the principal outstanding until the earlier to occur of (i) December 31, 2003 or (ii) when declared due and payable by the Holder upon the occurrence of an Event of Default (the "Maturity Date"). Interest is payable on a quarterly basis with the first payment due January 2, 2003. The Senior Notes are secured by accounts receivable, certain equipment and inventory. The Senior Notes are convertible at the option of the Company. In January 2003, the Company received an additional $500,000 in cash proceeds from the issuance of a Senior Note to one accredited investor. The terms of this note are the same as the 8% Senior Secured Notes discussed above. In connection with the Series E Financing, the Company amended its Senior Notes (i) to allow the holders of the Notes to convert all or a portion of the principal balance of the Senior Notes into Series E Preferred Stock and (ii) to extend the due date of the unconverted balance of the Senior Notes from December 31, 2003 to December 31, 2004. The Senior Notes were converted into Series E Preferred Stock at a conversion price equal to the outstanding principal balance of the Senior Notes. All accrued but unpaid interest on the converted principal balances plus an amount equal to two months interest on the converted principal balances was paid in cash on the day of conversion. At March 31, 2003 an aggregate of $1,000,000 was converted into Series E Preferred Stock. The Senior Notes are also subject to mandatory redemption upon the closing of a sale of equity securities in an amount exceeding $3,000,000. The amendment to the Senior Notes clarified that Senior Note balances converted to Series E Stock would not be included for purposes of determining whether mandatory redemption of the remaining Senior Note balance is required.

12% Convertible Subordinated Promissory Notes

In September and October 2001, the Company sold for cash in a private offering an aggregate of $2,025,000 of unsecured 12% Convertible Subordinated Promissory Notes ("Notes") to accredited investors and related parties. The Notes were originally due December 31, 2002, but the maturity date was extended to December 31, 2003 by amendment dated November 19, 2002. The principal and interest amount of each Note may, at the election of the Note holder, be converted one or more times into fully paid and nonassessable shares of common stock, at a price of $2.00 per share. The Notes may be called by the Company for conversion if the market price exceeds $5.00 per share for five days and certain conditions are met. Each purchaser was granted a warrant to purchase one common share of the Company at $2.00 per share until September 30, 2006 (the "Warrant") for each $2.00 of Notes (aggregate Warrants exercisable into 1,012,500 shares). At March 31, 2003, the Notes could have been converted into 1,193,738 shares of common stock.

The Notes and Warrants have antidilution rights reducing the conversion and exercise price for certain issuances of equity securities by the Company at an effective price below the applicable conversion or exercise price. In connection with the Notes and Warrants, the Company recorded a $2,025,000 discount to the notes to reflect the value of the beneficial conversion feature of the Notes and the value of the Warrants. The Warrants were valued using the Black-Scholes model with a dividend yield of zero percent; expected volatility of 89 to 90 percent; risk free interest rate of 4 percent; and an expected life of five years. The value was reflected as a discount to the debt. This debt discount was being amortized as non-cash interest expense over the original term of the Notes. For the six month period ending March 31, 2003, $405,000 was amortized as non-cash interest expense.

9. STOCKHOLDERS' DEFICIT
At March 31, 2003, the 10,000 shares of Series C Preferred Stock outstanding were automatically converted into 41,130 shares of Common stock.

In May 2002, the Company sold 235,400 shares of Series D Convertible Preferred Stock ("Series D Stock"), at $10.00 per share for gross cash proceeds of $2,354,000. A total of 250,000 shares of Series D Stock have been authorized. The dollar amount of Series D Stock, increased by $0.60 per share accretion per annum and other adjustments, is convertible one or more times into fully paid shares of common stock at a conversion price which is the lower of (i) $4.50 per share or (ii) 90% of the volume weighted average market price for the five days prior to conversion, but in no event less than $2.00 per share, subject to adjustment, provided however, that no such conversion could be made prior to January 1, 2003 at a conversion price of less than $4.50 per share. The shares of Series D Stock may be called by the Company for conversion if the market price of the common stock exceeds $9.50 per share for ten days and certain conditions are met. The Series D Stock is subject to automatic conversion on March 31, 2006. The purchasers of the Series D Stock were granted warrants to purchase an aggregate of 517,880 common shares of the Company at $4.50 per share until March 31, 2007 ("D Warrants"). The Series D Stock and the D Warrants have

antidilution rights reducing the floor conversion and warrant exercise price for certain issuances of equity securities by the Company at an effective price below the applicable floor conversion or warrant exercise price. In connection with the Series D Stock financing, the Company incurred closing costs of $78,752.

During the six months ending March 31, 2003, 170,400 shares of Series D Stock were converted into 647,720 shares of common stock. As of March 31, 2003 the 65,000 remaining outstanding shares of Series D Stock (based on 360-day year) would have been convertible into 208,986 shares of common stock.

In connection with the Series D Stock and D Warrants, the Company recorded $994,310 and $871,000 as the value of the discount at issuance of the Series D Stock and the value of the D warrants, respectively. The D warrants were valued using the Black-Scholes model with a dividend yield of zero percent; expected volatility of 78 percent; risk free interest rate of 4.94 percent; and an expected life of five years. The Series E Financing resulted in a repricing of the 517,880 outstanding D warrants from $4.50 per share to $3.01 per share in accordance with repricing provisions of such warrants. In connection with the repricing the Company recorded $158,519 in additional warrant value. For the six months ended March 31, 2003, $678,447 and $114,760 were amortized as a deemed dividend related to the value of the discount at issuance and the value of the D warrants.

Subsequent to March 31, 2003, 10,000 shares of Series D Stock were converted into 35,624 shares of common stock.

In March 2003, the Company sold $3,432,500 of Series E Preferred Stock, par value $.00001, at $10.00 per share (the "Series E Stock") to a limited number of investors (the "Series E Financing"). In connection with the Series E Financing, the Company amended its 8% Senior Secured Promissory Notes (the "Notes") (i) to allow the holders of the Senior Notes to convert all or a portion of the principal balance of the Notes into Series E Stock and (ii) to extend the due date of the unconverted balance of the Senior Notes from December 31, 2003 to December 31, 2004. The Company raised an aggregate of $2,432,500 in new cash, a subscription receivable and converted Senior Notes with an aggregate value of $1,000,000. A total of $1,000,000 in principal amount of the Senior Notes remains outstanding.

The dollar amount of Series E Stock, increased by $0.60 per share accretion per annum and other adjustments, is convertible one or more times into fully paid shares of common stock at a conversion price which is the lower of (i) $3.25 per share or (ii) 90% of the volume weighted average market price for the five days prior to conversion, but in no event less than $2.00 per share, subject to adjustment, provided however, that no such conversion can be made prior to September 30, 2003 at a conversion price of less than $3.25 per share. The shares of Series E Stock may be called by the Company for conversion if the market price of the common stock exceeds $9.50 per share for ten days and certain conditions are met. The Series E Stock is subject to automatic conversion on December 31, 2006. Each purchaser of Series E Preferred Stock was also granted a warrant to purchase 1.5 shares of common stock for each share of Series E Preferred Stock purchased, exercisable until December 31, 2007 at a price of $3.25 per share. In connection with the Series E financing, we issued warrants exercisable for an aggregate of 514,875 shares ("E Warrants"). In connection with the Series E Stock financing, the Company incurred closing costs of $141,222.

As of March 31, 2003 the outstanding Series E Stock (based on 360-day year) would have been convertible into 1,061,270 shares of common stock.

In connection with the Series E Stock and E Warrants, the Company recorded $2,677,000 and $755,500 as the value of the discount at issuance of the Series E Stock and the value of the warrants, respectively. The warrants were valued using the Black-Scholes model with a dividend yield of zero percent; expected volatility of 76.5 percent; risk free interest rate of 4.0 percent; and an expected life of five years. For the six months ended March 31, 2003, $61,145 and $17,256 were amortized as a deemed dividend related to the value of the discount at issuance and the value of the E warrants.

In March 2003, the Company issued a $25,000 subscription receivable related to the sale of Series E Stock. The receivable was collected in April 2003.

The cash proceeds of the preferred stock were allocated prorata between the relative fair values of the preferred stock and warrants at issuance using the Black Scholes valuation model for valuing the warrants. After allocating the proceeds between the preferred stock and warrant, an effective conversion price was calculated for the convertible preferred stock to determine the beneficial conversion discount for each share. The value of the beneficial conversion

discount is recorded as a deemed dividend. The resultant combined discount to the preferred stock is accreted as an deemed dividend over the conversion period of the preferred stock. The following is a summary of the components of the discount recorded upon issuance of the preferred stock and warrants:

					COMPONENTS OF DEEMED DIVIDEND		
ISSUANCE DATE	PREFERRED STOCK SERIES	PURCHASE PRICE	NUMBER OF PREFERRED SHARES	NUMBER OF WARRANTS	BENEFICIAL CONVERSION	WARRANTS	TOTAL
May 2002	Series D	$2,354,000	235,400	517,880	$ 994,310	$ 871,000	$1,865,310
March 2003	Series E	$3,432,500	343,250	514,875	$ 2,677,000	$ 755,500	$3,432,500

The following table summarizes information about the Series D Preferred Stock and deemed dividend activity during the six months ended March 31, 2003:

	SERIES D DEEMED DIVIDEND	SERIES D PREFERRED SHARES OUTSTANDING	WAR OUTST
Deemed dividend for warrants and beneficial conversion May 2002	$1,865,310	235,400	5
Accretion of deemed dividend	(195,936)	-	
Balance as of September 30, 2002	1,669,374	235,400	5
Deemed dividend accreted on preferred stock converted	(643,647)	(170,400)	
Additional deemed dividend for Series D warrant repricing	158,519	-	
Accretion of deemed dividend	(149,560)	-	
Balance as of March 31, 2003	$1,034,686	65,000	5

The following table summarizes information about the Series E Preferred Stock and deemed dividend activity during the six months ended March 31, 2003:

	SERIES E DEEMED DIVIDEND	SERIES E PREFERRED SHARES OUTSTANDING
Deemed dividend for warrants and beneficial conversion March, 2003	$3,432,500	343,250
Accretion of deemed dividend	(78,401)	-
Deemed dividend for warrants and beneficial conversion March 31, 2003	$3,354,099	343,250

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AMERICAN TECHNOLOGY CORPORATION
NOTES TO INTERIM FINANCIAL STATEMENTS
(Unaudited)

The following table summarizes changes in equity components from transactions during the six months ended March 31, 2003:

	Preferred Stock Shares	Preferred Stock Amount	Common Stock Shares	Common Stock Amount
Balance as of October 1, 2002	245,400	$ 2	14,351,476	$ 144
Stock issued upon exercise of stock options	-	-	6,500	-

Stock issued for services	-		-	109,844		1
Stock issued on conversion of Series D Preferred Stock	(170,400)		(1)	647,720		6
Stock issued on conversion of Series C Preferred Stock	(10,000)		-	41,130		-
Issuance of Series E Preferred Stock, net of offering costs of $141,222	343,250	$	3	-		-
Net loss	-		-	-		-
Balance as of March 31, 2003	408,250	$	4	15,156,670	$	151

The following table summarizes information about stock option activity during the six months ended March 31, 2003:

	Number of Options		Weighted Average exercise price
Outstanding October 1, 2002	1,459,175	$	3.97
Canceled/expired	(84,450)	$	4.25
Exercised	(6,500)	$	3.00
Granted	293,000	$	3.37
Outstanding March 31, 2003	1,661,225	$	3.86
Exercisable at March 31, 2003	1,289,559	$	3.86

Options outstanding are exercisable at prices ranging from $2.50 to $9.03 and expire over the period from 2003 to 2008 with an average life of 3 years.

The following table summarizes information about warrant activity during the six months ended March 31, 2003:

	NUMBER OF WARRANTS	WEIGHTED AVERAGE EXERCISE PRICE
Outstanding October 1, 2002	2,105,380	$ 4.85
Canceled/expired	(300,000)	11.00
Exercised	-	-
Granted	514,875	3.25
Outstanding March 31, 2003	2,320,255	$ 3.36

NOTES TO INTERIM FINANCIAL STATEMENTS
(Unaudited)

At March 31, 2003, the Company had the following warrants outstanding arising from offerings and other transactions, each exercisable into one Common Share:

Number	Exercise Price	Expiration Date
50,000	$ 16.00	May 12, 2003
50,000	$ 10.00	January 5, 2004
75,000	$ 11.00	March 31, 2005
1,012,500	$ 2.00	September 30, 2006
517,880	$ 3.01	March 31, 2007
100,000	$ 4.25	September 30, 2007
514,875	$ 3.25	December 31, 2007
2,320,255	$ 3.36	

At March 31, 2003, the Company has two stock-based employee compensation plans. The Company accounts for those plans under the recognition and measurement principles of APB Opinion No. 25, "Accounting for Stock Issued to Employees, and related Interpretations". No stock-based employee compensation cost is reflected in net loss available to common shareholders, as all options granted under those plans had an exercise price equal to or greater than the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net loss available to common shareholders and basic and diluted loss per common share if the Company had applied the fair value recognition provisions of SFAS No. 123:

	For the three months ended March 31,		For the six M
	2003	2002	2003
Net loss available to common shareholders			
Net loss as reported	$ (2,664,718)	$ (1,978,442)	$ (4,551,24
Deduct:			
Total stock-based employee compensation determined under fair value based method for all awards, net of related tax effects	136,076	148,718	258,15
Pro forma net loss	$ (2,800,794)	$ (2,127,160)	$ (4,809,39
Net loss per common share			
As reported	$ (0.18)	$ (0.14)	$ (0.3
Pro forma	$ (0.19)	$ (0.15)	$ (0.3

10. INCOME TAXES
At September 30, 2002, a valuation allowance has been provided to offset the net deferred tax asset as management has determined that it is more likely than not that the deferred tax asset will not be realized. The Company has for federal income tax purposes net operating loss carryforwards of approximately $23,259,000 which expire through 2022 of which certain amounts are subject to limitations under the Internal Revenue Code of 1986, as amended.

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

THE FOLLOWING DISCUSSION INCLUDES FORWARD-LOOKING STATEMENTS WITH RESPECT TO OUR FUTURE FINANCIAL PERFORMANCE. ACTUAL RESULTS MAY DIFFER MATERIALLY FROM THOSE CURRENTLY ANTICIPATED AND FROM HISTORICAL RESULTS DEPENDING UPON A VARIETY OF FACTORS, INCLUDING THOSE DESCRIBED BELOW UNDER THE SUB-HEADING, "BUSINESS RISKS." ALSO SEE OUR ANNUAL REPORT ON FORM 10-K FOR THE YEAR ENDED SEPTEMBER 30, 2002.

OVERVIEW

We are focused on commercializing our proprietary HyperSonic Sound ("HSS"), NeoPlanar, PureBass and HIDA sound technologies. Our HyperSonic Sound technology employs a laser-like beam to project sound to any listening environment. Our NeoPlanar technology is a thin film magnetic speaker that uses unique films and materials, which we believe results in superior sound quality and volume for any given size with low distortion. PureBass is an extended range woofer designed to complement our HSS, NeoPlanar technologies and other high performance satellite systems. Our HIDA technology employs proprietary techniques and components to produce variable intensity directional acoustical sound intended for use as a hailing device or supercharged megaphone or as a non-lethal weapon. Our strategy is to commercialize these technologies through licensing and product sales to customers, distributors and OEMs. We believe our HSS, NeoPlanar and PureBass technologies meet customer and OEM requirements. These technologies have been licensed to OEMs and are being transferred to production. We expect product sales and royalties to commence in fiscal 2003 from these technologies. We are also producing HSS and NeoPlanar systems for sale to customers, distributors and OEMs. We are in the early stage of sales and licensing of our sound technologies with many customers purchasing systems for evaluation and demonstration.

We incurred net losses of $8,220,132, $5,046,219 and $3,068,046 in the fiscal years ended September 30, 2002, 2001 and 2000 and a net loss of $3,585,951 for the six months ended March 31, 2003. We have substantial research and development and general administrative expenses, and our revenues from our audio technologies and portable consumer products have not yet been sufficient to offset these costs. We expect to incur additional operating losses during the balance of fiscal 2003, and we anticipate that we will need to raise additional capital of approximately $2 million to continue operations at planned levels during the next twelve months. See "Liquidity and Capital Resources" below. As a result of our need for capital and our net losses to date, our independent auditors noted in their audit report on our financial statements for the fiscal year ended September 30, 2002 substantial doubt about our ability to continue as a going concern. We will need to generate additional revenue to achieve profitability and generate positive cash flow from operations in future periods.

We license our technologies for production by others. When we license an audio technology, we typically receive a flat fee up-front, with the balance of payments based upon a percentage of net revenues of the products in which our technology is incorporated. Revenues from up-front license fees are recognized ratably over the specified term of the particular license. Contract fees are recorded as services are performed.

In other instances we supply complete systems or components used in other products to customers, distributors or OEMs. In these cases we include our intellectual property fees in the selling prices of the systems or components. We currently produce HSS systems and NeoPlanar panels which are installed as a component of a sound system.

Our various technologies are high risk in nature. Unanticipated technical obstacles can arise at any time and disrupt sales or licensing activities and result in lengthy and costly delays. There can be no assurance commercially viable sound products offered by us or by our customers, distributors or OEMs will meet with market acceptance or that such products will perform on a cost-effective basis.

Our future is largely dependent upon the success of our sound technologies. We invest significant funds in research and development and on patent applications related to our proprietary technologies. There can be no assurance our technologies will achieve market acceptance sufficient to sustain operations or achieve future profits. See "Business Risk" below.

Effective in October 2002, we discontinued our portable consumer product line in order to focus financial, personnel and facility resources on our sound technologies, which we expect to provide substantially all of our fiscal 2003 revenues. For the six months ended March 31, 2003 and for fiscal 2002 we recorded revenues of $78,680 and $301,116, respectively for portable consumer products. These revenues represented products sourced by us, private labeled under our name and resold to sporting good stores and other retailers. Historically, portable consumer product revenues accounted for the majority of our revenues.

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Demand for our sound technologies and products is subject to significant month to month variability resulting from seasonal demand fluctuations and the limited number of customers and market penetration achieved by us to date. Further, we expect future sales may be concentrated with a limited number of customers. We are also reliant on outside suppliers for components of our products and outside manufacturers for assembly and there can be no assurance of future supply. The markets for our products and future products and technologies are subject to rapidly changing customer tastes and a high level of competition. Demographic trends in society, marketing and advertising expenditures, and product positioning in retail outlets, technological developments, seasonal variations and general economic conditions influence demand for our products. Because these factors can change rapidly, customer demand can also shift quickly. We may not be able to respond to changes in customer demand because of the time required to change or introduce products, production limitations and/or limited financial resources.

CRITICAL ACCOUNTING POLICIES

We have identified the policies below as critical to our business operations and the understandings of our results of operations. The impact and any associated risks related to these policies on our business operations is discussed throughout Management's Discussion and Analysis of Financial Condition and Results of Operations when such policies affect our reported and expected financial results.

In the ordinary course of business, we have made a number of estimates and assumptions relating to the reporting of results of operations and financial condition in the preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America. Actual results could differ significantly from those estimates under different assumptions and conditions. We believe that the following discussion addresses our most critical accounting policies, which are those that are most important to the portrayal of our financial condition and results of operations and require our most difficult, subjective, and complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

We do not have off-balance sheet arrangements, financings, or other relationships with unconsolidated entities or other persons, also known as "special purpose entities" (SPEs).

REVENUE RECOGNITION

We derive our revenue primarily from two sources: (i) product revenue and (ii) contract and license fee revenue. Product revenues are recognized in the periods that products are shipped to customers, FOB shipping point, if a signed contract exists, the fee is fixed and determinable, collection of resulting receivables is probable and there are no resulting obligations. Revenues from ongoing per unit license fees are earned based on units shipped incorporating our patented proprietary technologies and are recognized in the period when the manufacturers' units shipped information is available to us and collectibility is reasonably assured. Revenues from up-front license and other fees and annual license fees are recognized ratably over the specified term of the particular license or agreement.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses are salaries and related expenses associated with the development of our proprietary sound technologies and include compensation paid to engineering personnel and fees to outside contractors and consultants.

DEFERRED TAX ASSET

We have provided a full valuation reserve related to our substantial deferred tax assets. In the future, if sufficient evidence of our ability to generate sufficient future taxable income in certain tax jurisdictions becomes apparent, we may be required to reduce our valuation allowances, resulting in income tax benefits in our consolidated statement of operations. We evaluate the realizability of the deferred tax assets and assess the need for valuation allowance quarterly. The utilization of the net operating loss carryforwards could be substantially limited due to restrictions imposed under federal and state laws upon a change in ownership.

RESULTS OF OPERATIONS

Total revenues for the six month period ended March 31, 2003 and 2002 were $661,241and $456,054, respectively. Total revenues for the three month period ended March 31, 2003 and 2002 were $237,942 and $199,433, respectively. Product revenues for the six months ended March 31, 2003 were $533,578 a 65% increase from the comparable six month total of $324,110 for the prior year. For the six months ended March 31, 2003 product sales included $78,680 of consumer portable product sales and $454,898 from the sale of NeoPlanar, HIDA and HSS products. For the six months ended March 31, 2002 product sales included $165,463 of consumer portable product sales and $158,647 from the sale of NeoPlanar, HIDA and HSS products. Product revenues for the second quarter ended March 31, 2003 and 2002 were $145,611 and $99,155, respectively. We experienced manufacturing quality control problems with some of our initial commercial HSS units, which negatively impacted product sales during the second quarter of fiscal 2003. We have worked closely with our contract manufacture to resolve these issues, but

because our HSS emitters are a new and unique product, we may continue to experience manufacturing problems that could adversely impact product sales in future periods. Consumer product revenues were historically volatile due to changing customers and product offerings and reliance on a limited number of customers. Since we have discontinued our portable consumer products line, fiscal 2003 revenues for these products will be substantially below those for fiscal 2002, and will be limited to sales of inventory on hand. Sales of sound products are also expected to be volatile as a result of manufacturing startup requirements and the need to recruit new customers for products not previously available in the marketplace.

Contract and license revenues for the quarters ended March 31, 2003 and 2002 were $127,663 and $131,944, respectively. We recognize upfront fees and advance revenues over the term of respective license agreements. At March 31, 2003 and September 30, 2002 we had $388,168 and $276,667, respectively, collected and recorded as unrecognized revenue for existing contracts and licenses.

At March 31, 2003, we received purchase orders for approximately $240,000 for military product expected to ship during our fiscal third quarter ending June 30, 2003. Anticipated shipments are subject to change due to a variety of factors, many outside our control. Our customers may modify or cancel orders and delay or change schedules. Shipments may also be delayed due to production delays, component shortages and other production related issues.

Cost of revenues for the six months ended March 31, 2003 was $672,419 resulting in a gross loss of $11,178 or 1.7%. This compares to a gross profit of $217,209 or 48% for the comparable period of the prior year. It is difficult to compare historical gross profit percentages due to changes in contract and license revenues as a percentage of total revenues and changes in the product mix in each year. Cost of revenues for the three months ended March 31, 2003 and 2002 were $350,784 and $122,385 resulting in a gross loss of 47% and a gross profit of 39%, respectively. The lower gross profit percentage in the six and three months ended March 31, 2003 resulted from lower margins on consumer product sales, and establishing a warranty reserve and startup production costs for HSS and NeoPlanar products. Gross profit percentage is highly dependent on sales prices, volumes, purchasing costs and overhead allocations. Overall gross margins will also be impacted by future contract and licensing revenues and the types of products sold to customers. Margins may vary significantly from period to period.

Selling, general and administrative expenses for the six months ended March 31, 2003 and 2002 were $1,665,309 and $1,103,120, respectively. The $562,189 increase resulted from an increase in legal costs and fees of $166,055, an increase in professional services of $61,461, an increase in personnel and related costs of $333,972 and an increase of $8,284 for print advertising. The increase in personnel costs included four new hires. Selling, general and administrative expense for the three month period ending March 31, 2003 increased by $298,529 or 49% from the comparable prior year period. We may expend additional resources on marketing our sound technologies in future quarters, which may increase selling, general and administrative expenses in future periods.

Research and development expenses for the six months ended March 31, 2003 were $1,308,719 compared to $1,880,997 for the comparable six months of the prior year. The $572,278 decrease resulted from a reduction of $386,470 for supplies and materials used in the development of our sound technologies and a decrease of $314,468 for consulting services offset by an increase in personnel and related costs of $182,798. The increase in personnel and related costs can be attributed to the addition of an engineer administrative assistant, two lab technicians and a quality control director. Research and development costs for the three months ended March 31, 2003 decreased by $259,762 or 26% from the comparable prior year period. Research and development costs vary quarter by quarter due to the timing of projects, the availability of funds for research and development and the timing and extent of use of outside consulting, design and development firms. We expect that fiscal 2003 research and development costs may be at lower levels than the prior year based on current staffing and budgeting as we focus resources on sales of products from developed technologies.

We recorded in selling, general and administrative expenses $3,600 for the six months ended March 31, 2002 for services paid through the issuance of 1,425 shares of common stock.

We experienced a loss from operations of $2,985,206 during the six months ended March 31, 2003, compared to a loss from operations of $2,766,908 for the comparable six months ended March 31, 2002. The $218,298 increase is primarily due to the decrease in our gross profit on product sales reflecting production start up costs.

Interest expense of $602,730 for the six months ended March 31, 2003 included $405,000 of noncash amortization of debt discount, $121,529 of accrued interest on convertible subordinated promissory notes and $72,305 of paid interest on senior secured promissory notes.

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The net loss available to common stockholders for the six months ended March 31, 2003 of $4,551,242 included $93,683 of accretion on the Series C, D and E Preferred Stock and also included $678,447 and $61,145 on Series D and Series E Preferred Stock imputed deemed dividends based on discount at issuance, respectively, and $114,760 and $17,256 on imputed deemed dividends on warrants issued in connection with the Series D and Series E Preferred Stock, respectively. The net loss available to common stockholders for the three months ended March 31, 2003 of $2,664,718 included $55,059 of accretion on the Series C, D and E Preferred Stock and also included $616,477 and $61,145 on Series D and Series E Preferred Stock imputed deemed dividends based on discount at issuance, respectively, and $60,475 and $17,256 on imputed deemed dividends on warrants issued in connection with the Series D and Series E Preferred Stock, respectively.

The net loss available to common stockholders for the six months ended March 31, 2002 of $3,707,541 included $22,915 of accretion on the Series C Preferred Stock. The net loss available to common stockholders for the three months ended March 31, 2002 of $1,978,442 included $2,959 of accretion on the Series C Preferred Stock.

We have federal net loss carryforwards of approximately $23,259,000 for federal tax purposes expiring through 2022. The amount and timing of the utilization of our net loss carryforwards may be limited under Section 382 of the Internal Revenue Code. A valuation allowance has been recorded to offset the related net deferred tax asset as management was unable to determine that it is more likely than not that the deferred tax asset will be realized.

Future operations are subject to significant variability as a result of licensing activities, product sales and margins, timing of new product offerings, the success and timing of new technology exploitation, decisions regarding future research and development and variability in other expenditures.

LIQUIDITY AND CAPITAL RESOURCES

We have experienced significant negative cash flow from operating activities developing and introducing our sound technologies. Due to our need for additional capital and our net losses, our independent auditors have noted in their report on our financial statements a substantial doubt about our ability to continue as a going concern. Our negative cash flow from operating activities was $2,680,346 for the six months ended March 31, 2003. As of March 31, 2003, the net loss of $3,585,951 included certain expenses not requiring the use of cash totaling $1,124,869. In addition, cash was used in operating activities through an increase of $294,875 in inventories, an increase of $52,870 in prepaid expenses and other and a decrease of $255,891 in accounts payable. Cash provided by operating activities included an $86,682 decrease in accounts receivable and a $197,690 increase in accrued liabilities.

At March 31, 2003, we had gross accounts receivable of $44,995 as compared to

$131,677 at September 30, 2002. This represented approximately 25 days of sales. Terms with individual customers vary greatly. We typically require pre-payment or a maximum of thirty day terms for our sound technology products. Our receivables can vary dramatically due to overall sales volumes and due to quarterly and seasonal variations in sales and timing of shipments to and receipts from large customers.

For the six months ended March 31, 2003, we used approximately $9,700 for the purchase of laboratory and computer equipment and made a $32,749 investment in patents and new patent applications. We anticipate a continued investment in patents in fiscal 2003. Dollar amounts to be invested on these patents are not currently estimable by management.

At March 31, 2003, we had negative working capital of $979,997 compared to working capital of $554,713 at September 30, 2002.

We have financed our operations primarily through the sale of preferred stock, exercises of stock options, sale of convertible and non-convertible notes, proceeds from the sale of investment securities and margins from product sales. At March 31, 2003, we had cash of $1,866,335, representing an increase of $58,615 from cash at September 30, 2002. The increase resulted from cash used in operating activities offset by proceeds from Series E Preferred Stock, a subscription receivable and an 8% Senior Note, in aggregate amount of $2,932,500.

During the quarter ended March 31, 2003, we raised an additional $500,000 through the sale of an 8% Senior Secured Note. We previously issued $1,500,000 of such notes on September 30, 2002. In connection with our sale of Series E Preferred Stock, all of the outstanding senior notes were amended in February 2003:

- to allow the holders of the senior notes to convert all or a portion of the principal balance of the senior notes into Series E Preferred Stock; and
- to extend the due date of the unconverted balance of the senior notes from December 31, 2003 to December 31, 2004.

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The senior notes bear interest at a rate of eight percent per annum. Interest is payable on a quarterly basis with the first payment due January 2, 2003. The senior notes are secured by accounts receivable, certain equipment and inventory. The senior notes are also subject to mandatory redemption upon the closing of a sale of equity securities in an amount exceeding $3,000,000. The February 2003 amendment clarified that senior note balances converted to Series E Preferred Stock would not be included for purposes of determining whether mandatory redemption of the remaining senior note balance is required.

During the quarter ended March 31, 2003, we sold 343,250 shares of Series E Preferred Stock at $10.00 per share, and issued 514,875 related common stock purchase warrants exercisable at $3.25 per share. Through this sale, we raised approximately $2,266,278 in new cash after deducting offering costs, a subscription receivable and converted outstanding senior secured promissory notes with an aggregate principal value of $1,000,000. The terms of the Series E Preferred Stock and related warrants are described under Part II, Item 2 below.

Based on our current cash position and assuming (a) currently planned expenditures and level of operations, (b) continuation of product sales and (c) expected royalty and licensing proceeds; we believe we will require approximately $2 million of additional cash for operations for the next twelve months. We believe increased sales of HSS and NeoPlanar products may provide a portion of this cash. We believe that any required investment capital will be available to us, but there can be no guarantee that we will be able to raise funds on terms acceptable to us, or at all. We have significant flexibility to adjust the level of research and development and selling and administrative expenses based on the availability of resources. However reductions in expenditures could delay development and adversely affect our ability to generate future revenues.

Any equity-based source of additional funds could be dilutive to existing equity holders and the dilution could be material. The lack of sufficient funds from operations or additional capital could force us to curtail or scale back operations and would therefore have an adverse effect on our business. Other than cash and cash equivalents, we have no unused sources of liquidity at this time. We expect to incur additional operating losses as a result of expenditures for research and development and marketing costs for our sound products and technologies. The timing and amounts of these expenditures and the extent of our operating losses will depend on many factors, some of which are beyond our control. Accordingly, there can be no assurance that our current expectations regarding required financial resources will prove to be accurate. We anticipate that the commercialization of our technologies may require increased operating costs; however, we cannot currently estimate the amounts of these costs.

CONTRACTUAL COMMITMENTS AND COMMERCIAL COMMITMENTS

The following table summarizes our contractual obligations, including purchase commitments at March 31, 2003, and the effect such obligations are expected to have on our liquidity and cash flow in future periods:

	Payments Due by Period			
Contractual Obligations	Less than 1 Year	1-3 Year	4-5 Years	After 5 Years
Capital leases	$ 9,110	$ 28,497	$ -	$ -
Operating lease	63,964	-	-	-
Employment agreements	386,000	536,250	-	-
Convertible promissory notes due December 31, 2003	2,569,890(1)	-	-	-
Senior secured promissory notes due December 31, 2004	-	1,159,726	-	-
Total contractual cash obligations	$ 3,028,964	$1,724,473	$ -	$ -