APPLIED ENERGETICS, INC.
Form 10-Q
November 13, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2012

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 001-14015

APPLIED ENERGETICS, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**77-0262908**
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification Number)

4585 S Palo Verde Road, Suite 405	
Tucson, Arizona	85714
(Address of Principal Executive Offices)	(Zip Code)

Registrant’s telephone number, including area code (520) 628-7415

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer: ¨	Accelerated filer: ¨	Non-accelerated filer: ¨ (Do not check if a smaller reporting company)	Smaller reporting company: x

Indicate by check mark whether the Registrant is a shell company (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 equity, as of the latest practicable date. As of November 2, 2012 there were 91,735,662 shares of the issuer's common stock, par value $.001 per share, outstanding.

APPLIED ENERGETICS, INC.

QUARTERLY REPORT ON FORM 10-Q

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

APPLIED ENERGETICS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2012 (Unaudited)	December 31, 2011
ASSETS		
Current assets		
Cash and cash equivalents	$ 3,089,132	$ 3,937,135
Accounts receivable	103,353	494,744
Inventory	69,133	141,676
Prepaid expenses and deposits	42,328	249,215
Other receivables	-	99,447
Total current assets	3,303,946	4,922,217
Long term receivables	-	205,313
Property and equipment - net	94,241	2,366,180
TOTAL ASSETS	$ 3,398,187	$ 7,493,710
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 46,647	$ 318,330
Accrued expenses	73,676	415,880
Short term financing	-	212,526
Accrued compensation	99,129	293,671
Customer deposits	14,190	49,046
Billings in excess of costs	-	2,152
Total current liabilities	233,642	1,291,605
Total liabilities	233,642	1,291,605
Commitments and contingencies - See Note 9		
Stockholders' equity		
Series A Convertible Preferred Stock, $.001 par value, 2,000,000 shares authorized;107,172 shares issued and outstanding at September 30, 2012 and at December 31, 2011	107	107
	91,736	91,670

Common stock, $.001 par value, 500,000,000 shares authorized; 91,735,662 shares issued and outstanding at September 30, 2012 and 91,670,192 at December 31, 2011		
Additional paid-in capital	79,208,069	79,155,518
Accumulated deficit	(76,135,367)	(73,045,190)
Total stockholders’ equity	3,164,545	6,202,105
TOTAL LIABILITIES AND STOCKHOLDERS’ EQUITY	$ 3,398,187	$ 7,493,710

See accompanying notes to condensed consolidated financial statements (unaudited).

-1-

APPLIED ENERGETICS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	For the three months ended September 30, 2012	2011
Revenue	$311,992	$611,206
Cost of revenue	263,687	633,868
Gross profit (loss)	48,305	(22,662)
Operating expenses		
General and administrative	378,220	844,135
Selling and marketing	36,344	220,522
Research and development	-	677,665
Total operating expenses	414,564	1,742,322
Operating loss	(366,259)	(1,764,984)
Other (expense) income		
Interest expense	-	(1,392)
Interest income	192	707
Total other (expense) income	192	(685)
Net loss	(366,067)	(1,765,669)
Preferred stock dividends	(43,539)	(45,830)
Net loss attributable to common stockholders	$(409,606)	$(1,811,499)
Net loss per common share – basic and diluted	$(0.00)	$(0.02)
Weighted average number of shares outstanding, basic and diluted	91,735,247	91,100,100

See accompanying notes to condensed consolidated financial statements (unaudited).

APPLIED ENERGETICS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	For the nine months ended September 30,	
	2012	2011
Revenue	$1,215,506	$4,450,549
Cost of revenue	1,018,277	4,233,710
Gross profit	197,229	216,839
Operating expenses		
General and administrative	2,286,954	2,742,705
Selling and marketing	711,846	886,422
Research and development	157,313	1,309,453
Total operating expenses	3,156,113	4,938,580
Operating loss	(2,958,884)	(4,721,741)
Other (expense) income		
Interest expense	(1,651)	(3,732)
Interest income	974	2,847
Total other (expense) income	(677)	(885)
Net loss	(2,959,561)	(4,722,626)
Preferred stock dividends	(130,616)	(137,500)
Net loss attributable to common stockholders	$(3,090,177)	$(4,860,126)
Net loss per common share – basic and diluted	$(0.03)	$(0.05)
Weighted average number of shares outstanding, basic and diluted	91,691,796	90,969,324

See accompanying notes to condensed consolidated financial statements (unaudited).

APPLIED ENERGETICS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	For the nine months ended September 30,	
	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$(2,959,561)	$(4,722,626)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	174,312	254,069
Impairment loss on property held for sale	708,000	-
Net gain on building, land and equipment disposal	(98,505)	4,793
Provision for inventory reserves	-	(73,830)
Non-cash stock based compensation expense	52,617	237,081
Changes in assets and liabilities:		
Accounts receivable	391,391	1,647,965
Other receivable	99,447	(1,956)
Inventory	72,543	663,620
Prepaid expenses, deposits and other assets	206,887	302,813
Long term receivables - net	205,313	-
Accounts payable	(271,683)	(540,030)
Billings in excess of costs	(2,152)	(4,646)
Accrued expenses and deposits	(784,128)	(1,099,084)
Net cash used in operating activities	(2,205,519)	(3,331,831)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of equipment	(2,363)	(214,567)
Proceeds from disposal of building, land and equipment	1,490,495	3,400
Net cash provided by (used in) investing activities	1,488,132	(211,167)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Dividends paid (preferred stock)	(130,616)	-
Exercise of stock options	-	23,975
Net cash provided by (used in) financing activities	(130,616)	23,975
Net decrease in cash and cash equivalents	(848,003)	(3,519,023)
Cash and cash equivalents, beginning of period	3,937,135	8,983,281
Cash and cash equivalents, end of period	$3,089,132	$5,464,258

See accompanying notes to condensed consolidated financial statements (unaudited).

1.BASIS OF PRESENTATION

The accompanying interim unaudited condensed consolidated financial statements include the accounts of Applied Energetics, Inc. and its wholly owned subsidiaries, Ionatron Technologies, Inc. and North Star Power Engineering, Inc. as of September 30, 2012 (collectively, "company," "Applied Energetics," "we," "our" or "us"). All intercompany balances and transactions have been eliminated. In the opinion of management, all adjustments (which include normal recurring adjustments) necessary for a fair presentation of the results for the interim periods presented have been made. The results for the three- and nine-month periods ended September 30, 2012, may not be indicative of the results for the entire year. The interim unaudited condensed consolidated financial statements should be read in conjunction with the company's audited consolidated financial statements contained in our Annual Report on Form 10-K.

Recent Developments

The U.S. Government defense spending continues to be weak, especially within the area of research and development of new technologies. We continue to seek U.S. Government funding for our technologies and systems, with several proposals submitted and awaiting funding decisions. We have one funded Government contract, and have completed several small development efforts during the past quarter. We have suspended company investment in the development of new technologies for both the commercial and Government sectors in an effort to conserve limited cash resources. We will continue to market our USP laser technologies and high voltage systems in commercial markets and protect our intellectual property rights. At September 30, 2012, our backlog of orders approximated $146,000.

As a result of the decrease in U.S. Government funding, we have significantly reduced our workforce to a level consistent with our expected operations, maintaining key technical, management and administrative personnel required to fulfill our contractual obligations, resume Government and commercial contract activities when and if funding is received, and maintain our status as a fully compliant public company.

We continue to consider and investigate strategic alternatives, including mergers, joint ventures, strategic teaming arrangements, the acquisition of one or more businesses or technologies, and/or the disposition of one or more of our existing businesses.

On September 28, 2012 we closed on the sale of the building which we have occupied since our inception in 2002. The building represented a sizable asset which was much larger than that required to support our present operations. We have entered into 1-year lease agreements to lease facilities consistent with the present level of activity. These facilities provide adequate space for our commercial applications centers, fabrication of laser and high voltage systems and performance of development activities and testing as contained within the outstanding proposals to the

Government, and will provide us secure storage for company assets and Government equipment.

We believe that we have sufficient funds for 2012 operations. Our continuance in business beyond 2012 is dependent on successful development of commercial customers, sales of our USP laser systems, obtaining new contracts from Department of Defense customers and additional financing necessary to fund our operations and achieving profitability.

The accompanying unaudited financial statements have been prepared on a going concern basis, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. For the nine months ended September 30, 2012, the company incurred a net loss of $3.0 million, had negative cash flows from operations of $2.2 million and may incur additional future losses due to the reduction in Government contract activity. These matters raise substantial doubt as to the company’s ability to continue as a going concern. The financial statements do not include any adjustments relating to the recoverability of assets and the amount or classification of liabilities that might be necessary should the company be unable to continue as a going concern.

As of October 31, 2012, the company had $3.0 million in cash and cash equivalents.

USE OF ESTIMATES

The preparation of consolidated financial statements in conformity with United States Generally Accepted Accounting Principles ("GAAP") requires management to make estimates, judgments and assumptions that affect the amounts reported in the financial statements and accompanying notes. Management bases its assumptions on historical experiences and on various other estimates that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. In addition, management considers the basis and methodology used in developing and selecting these estimates, the trends in and amounts of these estimates, specific matters affecting the amount of and changes in these estimates, and any other relevant matters related to these estimates, including significant issues concerning accounting principles and financial statement presentation. Such estimates and assumptions could change in the future, as more information becomes known which could materially impact the amounts reported and disclosed herein. Significant estimates include revenue recognition under the percentage of completion method of contract accounting, estimating costs at completion on a contract, the valuation of inventory, carrying amount of long-lived assets, expected forfeiture rate on stock-based compensation and measurements of income tax assets and liabilities.

CASH AND CASH EQUIVALENTS

Cash equivalents are investments in money market funds or securities with an initial maturity of three months or less. These money market funds are invested in government and US treasury based securities.

FAIR VALUE OF CURRENT ASSETS AND LIABILITIES

The carrying amount of accounts receivable and accounts payable approximate fair value due to the short maturity of these instruments.

RECENT ACCOUNTING PRONOUNCEMENTS

The FASB has issued Accounting Standards Update (ASU) No. 2012-02, Intangibles—Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment. This ASU states that an entity has the option first to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount in accordance with Codification Subtopic 350-30, Intangibles—Goodwill and Other, General Intangibles Other than Goodwill.

Under the guidance in this ASU, an entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. An entity will be able to resume performing the qualitative assessment in any subsequent period.

The amendments in this ASU are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted, including for annual and interim impairment tests performed as of a date before July 27, 2012, if a public entity's financial statements for the most recent annual or interim period have not yet been issued. The adoption of the standard is not expected to have a significant impact on the company's consolidated financial statements, as we currently do not have goodwill and other intangibles recorded on our financial statements.

2. ACCOUNTS RECEIVABLE

Accounts receivable consists of the following:

	September 30, 2012	December 31, 2011
Contracts receivable	$ 101,903	$ 494,395
Costs and estimated earnings on uncompleted contracts	1,450	349
Accounts receivable, net	103,353	494,744
Short term receivable (contract retention)	-	47,817
Long term receivable (contract retention)	-	205,313
	$ 103,353	$ 747,874

-6-

Contracts receivable are expected to be collected within a year.

Costs and Estimated Earnings on Uncompleted Contracts

	September 30, 2012	December 31, 2011
Costs incurred on uncompleted contracts	$ 6,234,714	$ 33,898,851
Estimated earnings	599,148	2,563,744
Total billable costs and estimated earnings	6,833,862	36,462,595
Less:		
Billings to date	6,832,412	36,464,398
Total	$ 1,450	$ (1,803)
Included in accompanying balance sheet**:**		
Unbilled costs and estimated earnings on uncompleted contracts included in accounts receivable	$ 1,450	$ 349
Billings in excess of costs and estimated earnings on uncompleted contracts	-	(2,152)
Total	$ 1,450	$ (1,803)

3. INVENTORY

Our inventories consist of the following:

	September 30, 2012	December 31, 2011
Raw materials	$ 84,643	$ 81,303
Reserve for obsolescence	(15,537)	-
Work-in-process	27	60,373
Total	$ 69,133	$ 141,676

4. PROPERTY AND EQUIPMENT

Our property and equipment consist of the following:

	September 30, 2012	December 31, 2011
Land	$ -	$ 410,728
Buildings and improvements, leasehold improvements	2,363	2,278,264
Equipment		