

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

BION ENVIRONMENTAL TECHNOLOGIES INC
Form 10KSB
October 14, 2003

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

FORM 10-KSB

Annual report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934 for the fiscal year ended June 30, 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 No. 001-31437

BION ENVIRONMENTAL TECHNOLOGIES, INC.
(Exact name of registrant as specified in its charter)

Colorado 84-1176672
(State of Incorporation) (I.R.S. Employer Identification Number)

18 E. 50th Street, 10th Floor
New York, New York 10022
(Address of principal executive offices, including zip code)

(212) 758-6622
(Registrant's telephone number, including area code)

Securities registered under Section 12(b) of the Exchange Act:

Title of each class	Name of exchange on which registered
Common Stock, no par value	Philadelphia Stock Exchange

Securities registered under Section 12(g) of the Exchange Act:

Common Stock, no par value

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 No

Indicate by check mark if there is no disclosure of delinquent filers pursuant to Item 405 of Regulation S-B contained herein, and will not be contained, to the best of the issuer's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

State issuer's revenues for its most recent fiscal year: \$116,029

As of September 30, 2003 the issuer had outstanding 5,298,221 shares of common stock. This includes 1,900,000 shares held by a majority-owned subsidiary.

The aggregate market value of the Common Stock held by nonaffiliates as of September 30, 2003 was approximately \$3,552,000 based on a closing price for the Common Stock of \$1.25 on the OTC Bulletin Board on such date.

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

BION ENVIRONMENTAL TECHNOLOGIES, INC.

ANNUAL REPORT ON FORM 10-KSB

THIS REPORT INCLUDES FINANCIAL STATEMENTS (AND NOTES ATTACHED THERETO) FOR THE YEAR ENDED JUNE 30, 2003 WHICH HAVE BEEN INTERNALLY PREPARED AND WHICH HAVE NOT BEEN REVIEWED OR AUDITED BY ANY INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS. WHILE WE BELIEVE THAT THE FINANCIAL STATEMENTS ARE ACCURATE AND COMPLETE IN ALL MATERIAL RESPECTS, IT IS POSSIBLE THAT AN AUDIT MAY RESULT IN ADJUSTMENTS, SOME OF WHICH MAY BE MATERIAL.

TABLE OF CONTENTS

PART I	3
Item 1. Description of Business	3
Item 2. Description of Properties	17
Item 3. Legal Proceedings	18
Item 4. Submission of Matters to a Vote of Security Holders	18
PART II	19
Item 5. Market for Bion Environmental Technologies, Inc.'s Common Equity and Related Stockholder Matters	19
Item 6. Management's Discussion and Analysis of Financial Condition and Results of Operations	20
Item 7. Unaudited Financial Statements	28
Item 8. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	29
Item 8.A Controls and Procedures	29
PART III	30
Item 9. Directors and Executive Officers of Bion Environmental Technologies, Inc	30
Item 10. Executive Compensation	33
Item 11. Security Ownership of Certain Beneficial Owners and Management	38
Item 12. Certain Relationships and Related Transactions	40
PART IV	50
Item 13. Exhibits and Reports on Form 8-K	50
Item 14. Principal Accountant Fees and Services	54
Signatures	

PART I

Statements made in this Form 10-KSB that are not historical or current facts are "forward-looking statements" within the meaning of section 27A of the Securities Act of 1933, as amended (the "Securities Act") and section 21E of the Securities Exchange Act of 1934, as amended. These statements often can be identified by the use of terms such as "may," "will," "expect," "believe," "anticipate," "estimate," or "continue" or the negative thereof. Bion intends that such forward-looking statements be subject to the safe harbors for such statements. We wish to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. Any forward-looking statements represent management's best judgment as to what may occur in the future. However, forward-looking statements are subject to risks, uncertainties and important factors beyond our control that could cause actual results and events to differ materially from historical results of operations and events and those presently anticipated or projected.

These factors include adverse economic conditions, entry of new and stronger competitors, inadequate capital, unexpected costs, failure to gain product approval in the United States or foreign countries and failure to capitalize upon access to new markets. Additional risks and uncertainties that may affect forward-looking statements about Bion's business and prospects include the possibility that a competitor will develop a more comprehensive or less expensive environmental solution, delays in market awareness of Bion and our systems and soil, or possible delays in Bion's marketing strategies, each of which could have an immediate and material adverse effect by placing us behind our competitors. For a fuller description of some of these important factors that could cause actual results to differ materially from those currently anticipated or projected, please see "Management's Discussion and Analysis of Financial Condition and Results of Operations." Bion disclaims any obligation subsequently to revise any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

Item 1. Description of Business

Overview

BION ENVIRONMENTAL TECHNOLOGIES, INC. ("BION," "WE," "US," OR "OUR") HAS BEEN SUFFERING FROM SEVERE FINANCIAL DIFFICULTIES SINCE APPROXIMATELY LATE JANUARY OF 2003, AS DISCLOSED IN OUR PERIODIC AND OTHER REPORTS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION COMMENCING WITH OUR CURRENT REPORT ON FORM 8-K DATED FEBRUARY 7, 2003. THESE FINANCIAL DIFFICULTIES RESULTED IN THE RESIGNATION OF NEARLY ALL OF OUR OFFICERS AND DIRECTORS DURING FEBRUARY AND MARCH OF 2003, AND THE TERMINATION OF MOST OF OUR EMPLOYEES. WE HAVE RETAINED A CORE TECHNICAL STAFF, BUT WE HAVE DRASTICALLY CURTAILED OUR BUSINESS ACTIVITIES TO INCLUDE ONLY THOSE ACTIVITIES THAT ARE DIRECTLY NEEDED TO COMPLETE DEVELOPMENT AND TESTING OF OUR SECOND GENERATION TECHNOLOGY.

OUR FINANCIAL DIFFICULTIES RESULTED PRIMARILY FROM OUR INABILITY TO RAISE ADDITIONAL FUNDS DUE TO CONTRACTUAL ANTI-DILUTION PROVISIONS THAT WERE CONTAINED IN THE AGREEMENTS RELATED TO THE FINANCING TRANSACTIONS THAT WERE COMPLETED IN JANUARY OF 2002 (SEE OUR FORM 10-KSB FOR THE YEAR ENDED JUNE 30, 2002 AND OUR CURRENT REPORT ON FORM 8-K DATED DECEMBER 12, 2001 AND THE EXHIBITS AND AMENDMENT THERETO) WHICH PREVENTED ANY REASONABLE FINANCING FROM BEING COMPLETED. WHEN WE BECAME AWARE OF THE NEGATIVE IMPLICATIONS OF THESE ANTI-DILUTION PROVISIONS WHILE ATTEMPTING TO STRUCTURE A PLANNED FINANCING (WHICH FINANCING ATTEMPTS ULTIMATELY FAILED IN JANUARY OF 2003), WE ATTEMPTED

TO EITHER FIND ALTERNATIVE FINANCING METHODS WHICH COULD BE REASONABLY COMPLETED AND/OR NEGOTIATE AN AMENDMENT TO SUCH PROVISIONS. AFTER MONTHS OF NEGOTIATIONS, AGREEMENTS RELATED TO AMENDING SUCH PROVISIONS WERE ENTERED INTO DURING THE SPRING OF 2003 (SEE OUR CURRENT REPORT ON FORM 8-K DATED APRIL 12, 2003) AND THE PROVISIONS WERE FINALLY AMENDED EFFECTIVE AUGUST 27, 2003 (SEE OUR CURRENT REPORT ON FORM 8-K DATED AUGUST 25, 2003 AND EXHIBITS THERETO).

ALTHOUGH WE WERE ABLE TO COMPLETE A SMALL FINANCING THROUGH ONE OF OUR SUBSIDIARIES DURING AUGUST OF 2003 WHICH WILL ALLOW US TO CONTINUE LIMITED WORK ON OUR SECOND GENERATION TECHNOLOGY (SEE OUR CURRENT REPORT ON FORM 8-K DATED AUGUST 25, 2003), OUR OPERATIONS HAVE BEEN SEVERELY DAMAGED DURING THE PAST YEAR. NOT ONLY DID WE HAVE TO TERMINATE MOST OF OUR ACTIVITIES AND EMPLOYEES, BUT WE HAVE SUFFERED SUCH DIRE FINANCIAL CONSTRAINTS (AS WE WERE FACED WITH THE LIKELY POSSIBILITY OF A BANKRUPTCY FILING) THAT WE HAVE LOST CREDIBILITY WITH OUR VENDORS, CREDITORS, THE FINANCIAL COMMUNITY AND OUR EXISTING SHAREHOLDERS AND INVESTORS. AS A RESULT, THE MARKET PRICE FOR OUR STOCK FELL. IN ORDER TO CONTINUE WITH OUR BUSINESS ACTIVITIES AND SAVE THE COMPANY WE HAVE HAD TO STRUCTURE INTERIM FINANCING ON EXTREMELY DILUTIVE TERMS WHICH HAS NEGATIVELY AFFECTED OUR SHAREHOLDERS AND WILL PROBABLY CONTINUE TO NEGATIVELY IMPACT OUR ABILITY TO OBTAIN FUTURE FINANCING ON REASONABLE TERMS. WE STILL FACE A SEVERE WORKING CAPITAL SHORTAGE AND SINCE WE HAVE NO REVENUES WE WILL NEED TO OBTAIN ADDITIONAL CAPITAL TO SATISFY OUR EXISTING CREDITORS (SEE "MANAGEMENT'S DISCUSSION AND ANALYSIS" AND "FINANCIAL STATEMENTS"), THERE IS NO ASSURANCE WE WILL BE ABLE TO OBTAIN THE FUNDS THAT WE NEED TO STAY IN BUSINESS OR TO SUCCESSFULLY DEVELOP OUR BUSINESS.

We are in the process of developing and testing a second generation of our technology ("Bion NMS" or "NMS" or "System" or "Technology") to provide waste management solutions to the agricultural industry, focusing on livestock waste from confined animal feeding operations, such as large dairy and hog farms. In the past we have engaged in two main areas of activity by utilizing the first generation of our technology (which we discontinued marketing during calendar year 2001) (which areas we intend to re-enter during the current fiscal year pending results of field testing our second generation NMS technology during fiscal year 2004):

- 1) WASTE STREAM REMEDIATION. The removal of pollutants (primarily nitrogen and phosphorus) which pollute soil and water and reduction of emissions of gases to the atmosphere which result in acid rain, smog, ground-level ozone or produce "greenhouse warming" effects). We intend to pursue this area of activity primarily through licensing our second generation technology: a) to retrofit existing confined animal feeding operations installations (with emphasis on large dairy farms utilizing anaerobic lagoons for the next 12 months) and b) for use in newly constructed dairy farms; and
- 2) BIONSOIL SALES. The production and sale of organic BionSoil fertilizer products made from the waste solids produced by use of our technology.

In addition, we intend to pursue what we call the "Dairy Park Opportunity," which reflects what we believe is the potential for the Bion technology to allow very large dairy farms to vertically integrate (with pasteurization, cream separation, milk bottling, and/or cheese plants, etc.) and pursue site integration (with ethanol plants, methane production, organic farming, etc.) on relatively small plots of land.

All of these activities are completely dependent upon two factors, neither of which can be assured at this date:

1) successful completion of the field testing of our second generation technology which is presently taking place in Texas for the purpose of demonstrating its capacity for nutrient (primarily nitrogen and phosphorus)removal from the dairy confined animal feeding operations waste stream) (which will be followed, if successful, by a demonstration/test(either at the Texas site or in California pursuant to existing agreements) of our technology's capacity to reduce polluting gaseous emissions from confined animal feeding operations operation); and

2) our ability to raise sufficient funds to allow us to finance our activities and pay our existing creditors.

We believe that our waste remediation technology will provide confined animal feeding operations (primarily in the dairy and swine industries) with treatment for their animal waste outputs. Our systems are designed to microbiologically treat their entire waste stream while reducing air emissions and nutrient discharges and creating solids which are in turn the basis for the creation of organic soil and fertilizer products. We are attempting to develop our soil and fertilizer products for use in a variety of applications.

Currently, the majority of confined animal feeding operations dispose of their animal waste by spreading it on cropland (before or after placement in anaerobic lagoons). In many parts of the United States, the operation and expansion of confined animal feeding operations are severely restricted due to a combination of the amount of land that is necessary to dispose of the animal waste at an environmentally sustainable rate, and the pollution of existing land and water due to prior disposal of excess nutrients and/or air pollution emissions. Confined animal feeding operations are enormous polluters of our air, water and land and are under significant pressure from state and federal regulatory agencies, the media, environmental groups and the public to reduce their role as a major source of excess nutrient pollution and harmful air emissions. Although nutrient pollution from these feeding operations has gone largely unregulated in the past, they are now subject to stringent regulation under the Federal Clean Water Act and are required to become zero-discharge facilities. Air emissions from these operations are increasingly being evaluated for potential regulation under the Federal Clean Air Act and/or similar state statutes (including without limitation a law recently passed in California which explicitly makes large dairies subject to such regulation). The livestock industry and regulatory agencies are searching for affordable waste treatment solutions to this widespread and immediate problem.

Corporate Background

The Company is a Colorado corporation organized on December 31, 1987. Our principal executive offices are located at 18 East 50th Street, 10th Floor, New York, New York 10022. Our telephone number at that address is (212) 758-6622. We have no additional offices at this time. References in this Form 10-KSB to the "Company", "Bion," "we" or "us" mean Bion Environmental Technologies, Inc., and its subsidiaries on a consolidated basis, unless the context otherwise requires.

Development of our Business

Substantially all of our business and operations are conducted through three wholly-owned subsidiaries, Bion Technologies, Inc. (a Colorado corporation organized September 20, 1989), BionSoil, Inc. (a Colorado corporation organized June 3, 1996) and Bion Dairy Corporation (formerly Bion

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Municipal, Inc., a Colorado corporation organized July 23, 1999). Bion is also

5

the parent of Bion International, Inc. (a Colorado corporation organized July 23, 1999), which is a wholly-owned, presently inactive subsidiary. Bion is also the parent of Dairy Parks, LLC (a Delaware entity organized July 25, 2001). In January 2002, Bion entered into a series of transactions, whereby the Company became a 57.7% owner of Centerpoint Corporation (a Delaware corporation organized August 9, 1995) ("Centerpoint").

Although we have been conducting business since 1989, we recently have, effectively, re-entered the "development stage" pending completion of testing/demonstration of our second generation technology during the current fiscal year. Our original systems were wastewater treatment systems for dairy farms and food processing plants. The basic design was modified in late 1994 to create Nutrient Management Systems (NMS) that produced organic soil products as a by-product of remediation of the waste stream when installed on large dairy or swine farms. Through June 30, 2001, we sold and subsequently installed, in the aggregate, 32 of these first generation systems in 7 states., of which 19 were still in operation through June 30, 2002. There are presently approximately 12 first generation Bion NMS soil production system installations operating in 3 states.

We discontinued marketing of our first generation NMS systems during calendar 2001. We were unable to produce a business model based on the first generation technology which would generate sufficient revenues to create a profitable business. While continuing to market and operate the first generation systems, during the second half of calendar year 2000 we began to focus our activities on developing the next generation of the Bion NMS technology. We no longer operate any of the first generation NMS systems.

As a result of our research and development efforts during the last three years, the second generation of our technology has been developed. We have designed and tested NMS systems that use state-of-the-art, computerized, real-time monitoring and system control that have the potential to be remotely accessed for both reporting requirements and control functions. These systems are smaller, faster and require less capital per animal than our first generation NMS systems. The new generation of NMS system is designed to harvest solids used to produce our BionSoil(R) products in a few weeks as compared to six to twelve months with our first generation systems.

The first phase of this research and development, which was conducted during the summer and fall of 2000 at DreamMaker Dairy, our research facility located outside Buffalo, New York (which is now closed), accelerated the speed of the Bion process in a NMS which was substantially less than 20% of the size of a comparable first generation system.

We began the second phase during the winter of 2000-2001, based on the faster, smaller system at the DreamMaker Dairy. We placed the NMS into a configuration of enclosed tanks that fully contained the process. This configuration allowed control and monitoring of the entire system from all inputs through all outputs. This closed tank system gave us the ability to perform complete mass balance calculations (measuring all inputs of the animal waste stream and all outputs from the system, including nitrogen and phosphorus, which are the two elements of most critical concern from a nutrient and water pollution control standpoint, and hydrogen sulfide and ammonia, which are two of the main compounds of critical concern from an air pollution control standpoint) on the system to produce the scientific/technical data necessary to demonstrate definitively the performance of our NMS technology. Essentially, the tank configuration

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

enabled our technical staff to convert the outputs of confined animal feeding operations waste streams to a point-source equivalent for mass balance

6

analysis. As we announced in September 2001, initial results of the mass balance calculations demonstrated that phosphorus and nitrogen removals from the total waste stream approximated 80%. Additionally, measurements on the primary odor producing compounds indicate levels low enough to essentially eliminate odor problems associated with Confined animal feeding operations waste handling.

In January 2002, we announced that we completed development and testing of the fully contained Bion NMS prototype at Dreammaker Dairy in upstate New York. The goals of that initiative (which were successfully reached) were to:

- * Increase the efficiencies of the first generation system;
- * Convert the core Bion NMS technology into a platform-based system that could be potentially integrated with complementary technologies; and
- * Develop a computerized monitoring and control system, capable of precise measurements and adjustments and remote reporting.

We continued to undertake further NMS research and development through the entire 2002 calendar year. This research included (without limitation) work on:

- * System acceleration in order to further increase capacity and lower capital and operating costs;
- * Integration of the Bion NMS with complementary technologies such as a methane digestion system and water cleaning technologies to enhance the performance of the system (Phase Three development); and
- * Development of commercial designs for application in our second generation NMS.

As a result of this entire research program, we have currently installed, and are presently testing, a second generation Bion NMS as a retrofit to an anaerobic lagoon system on a 1250 cow dairy farm in Texas. Results are anticipated during the fall of 2003. The results of this installation are crucial to the survival and progress of the Company. Success in this demonstration will be the basis for marketing the second generation NMS in areas with nutrient pollution problems.

Assuming that the Texas installation successfully demonstrates nutrient removal of 80% or greater of nitrogen and phosphorus from the dairy waste stream, we will proceed (assuming we have adequate funds, of which there is no assurance) to install a tank-based NMS (either at the Texas location or in California pursuant to an existing agreement) to demonstrate the efficacy of the Bion NMS at mitigation/reduction of the production of polluting gases which contribute to acid rain, smog, ground-level ozone and greenhouse gas. Success of this demonstration (of which there is no assurance) regarding atmospheric pollution will be the basis for marketing the second generation NMS system in areas which face air pollution problems (alone or in addition to problems with nutrient pollution of soil and/or water).

Management is cautiously optimistic that, if we have sufficient funds to

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

complete these two sets of demonstrations, the installations will more than meet the expected criteria as we have previously carried out similar tests at the DreamMaker facility described above.

7

We also have had for many years an ongoing research program related to our BionSoil(R) product lines. However, this research and development program, which has included work related to harvesting and processing, blending of specialty product mixes for specific market segments and tests of the effectiveness of various blends in a number of plants in a variety of growing environments, has been severely curtailed over the past year. This program has a lower priority than the second generation NMS system development and testing described above. However, if we obtain adequate funding, we will continue to pursue this research.

Acquisition of Centerpoint/Transactions with Centerpoint

On January 15, 2002, Bion issued 1,900,000 shares of its restricted common stock, valued at \$7.50 per share, to Centerpoint, in exchange for \$8,500,000 in cash and the assignment of claims relating to Centerpoint's transaction with Aprilia and other rights owned by Centerpoint for total consideration of \$14,250,000. On August 12, 2002, the Company filed a registration statement to allow Centerpoint to distribute these shares of common stock of Bion to the Centerpoint stockholders.

Immediately upon consummation of the transaction with Centerpoint, Bion purchased a 57.7% majority interest in Centerpoint from Centerpoint's Italian parent, OAM, S.p.A. ("OAM") by issuing 100,000 shares of our common stock to OAM, a warrant to purchase an additional 100,000 shares of common stock valued at \$380,000 using the Black-Scholes pricing model, \$3,700,000 of cash, assignment of a loan receivable valued at \$3,263,000 and its rights acquired under claims receivable acquired from Centerpoint valued at \$2,487,000. Bion intends to distribute the 57.7% majority interest in Centerpoint, totaling 3,459,997 shares, to Bion stockholders.

The above transactions were structured as a result of our negotiations with OAM and its parent corporation as Centerpoint's controlling stockholders. The net proceeds from the Centerpoint and OAM transactions were acquired to fund continuing operations. The transactions were structured so that we obtained the desired amount of capital, we acquired control of Centerpoint, we obtained rights to certain claims that Centerpoint has, and, as a Centerpoint stockholder, we will receive back approximately 57% of the 1.9 million shares that we issued in connection with the transaction which will then be cancelled if such shares are ever distributed to Centerpoint's shareholders.

Additional Bion shares were required to be issued to Centerpoint and OAM if the Company raised equity at a price less than \$7.50 per share until the cumulative investment in the Company, from unaffiliated third parties, from the date of this transaction, equals \$5 million. The number of additional shares to be issued would have been determined by calculating the additional number of shares Centerpoint and OAM would have received if the transactions were consummated at the price per share of the subsequent equity financing.

The Centerpoint transaction triggered the conversion of \$14,256,779 of notes payable including interest into 1,900,911 shares of our common stock. In addition, warrants to purchase 213,263 shares of our common stock had their exercise price decreased to \$7.50 and \$6.00. As described above, if the Company raised equity at a price less than \$7.50 per share, the Company might have needed to issue additional shares to the note holders as if the notes were converted into shares of the Company's common stock at the price per

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

share of the subsequent equity financing. In addition, the exercise prices for 17,596 warrants might have been decreased to the price per share of the subsequent equity financing and the exercise prices for 195,174 warrants might have been decreased to 80% of the price per share of the subsequent equity

8

financing. Also, in the event of a subsequent equity financing below \$7.50, additional warrants might have been required to be issued on 1,037,343 warrants currently outstanding to increase these warrants to reflect 20% of the fully diluted shares outstanding as of January 15, 2002, after giving effect to the above adjustments. These warrants might also have had their exercise price lowered to the price per share of the subsequent equity financing.

The adjustment provisions in these agreements (as connected with the conversions/adjustments for the converted notes/warrants described above) made it impossible for Bion to raise additional needed funds from the middle of 2002 thru February 2003 (at which time Bion had run out of cash and liquid resources). This resulted in the financial crisis (and subsequent management turnover and curtailment of Bion's activities) described above. These provisions were finally amended in August 2003 as described below. (See our Current Reports on Form 8-K dated April 12, 2003 and August 25, 2003 and the exhibits thereto.)

In March 2002, the Company and Centerpoint entered into an agreement effective January 15, 2002 whereby Centerpoint agreed to pay the Company \$12,000 a month and issued a warrant to purchase 1,000,000 shares of Centerpoint's common stock at \$3.00 per share exercisable until March 14, 2007 for management services, support staff and office space. In addition, the Company agreed to advance to Centerpoint funds needed to cure its delinquencies with the SEC, distribute the Company's common shares to Centerpoint shareholders, to locate and acquire new business opportunities and for on-going expenses. The Company had no obligation to make any advances in excess of \$500,000. All funds due the Company were evidenced by a convertible revolving promissory note, which bore interest at 1% per month, payable with accrued interest on March 15, 2003. This date was extendable by agreement between the Company and Centerpoint. The Company had the right to convert, at any time, all or a portion of the amount due under the promissory note in shares of Centerpoint's common stock at a conversion price of \$3.00 per share. As of June 30, 2002 the Company had advanced Centerpoint \$186,257.

During March 2003, the Company and Centerpoint entered into an agreement (amended on April 23, 2003) which forgave sums due from Centerpoint to Bion (approximately \$450,000 at that time) and cancelled the warrants issued by Centerpoint to Bion in consideration of amending the terms of the January 2002 agreement between Bion and Centerpoint to remove the adjustment provisions (and other related provisions) described above. (See our Current Report on Form 8-K dated April 12, 2003 and the exhibits thereto). This agreement was ratified by the shareholders of Centerpoint (including an overwhelming majority of the shares not owned by Bion) on August 25, 2003. Such ratification enabled Bion to complete an agreement with OAM, S.p.A. on August 27, 2003 which removed the balance of the adjustment provisions (see our current report on form 8-K dated August 25, 2003 and exhibits thereto).

Centerpoint had owned the Moto Guzzi motorcycle business, which it sold in August 2000. Since that time it had been seeking an investment opportunity for the cash it received from the sale. Other than seeking an investment opportunity, Centerpoint has been inactive since the time of the sale of Moto Guzzi. If and when all or a substantial portion of the shares of Bion common stock owned by Centerpoint are distributed to the Centerpoint stockholders,

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Centerpoint will have only nominal assets and will effectively be a publicly-held shell corporation. Centerpoint's Board of Directors will evaluate what, if any, business opportunities are available to Centerpoint, following such distribution, if any.

9

Reverse Stock Split

On July 8, 2002, the Company completed a 1 for 10 reverse stock split (the "stock split"). The stock split has been retroactively reflected in the Company's consolidated balance sheet and consolidated statement of operations, consolidated statements of changes in stockholders equity, notes to consolidated financial statements and to all references to share and per share amounts, except as noted.

Recent Developments

Bion Dairy Corporation Financing

On August 25, 2003, Bion Dairy Corporation ("Dairy"), of which we own all 4,000,000 shares of its common stock outstanding, closed an initial stage of financing totaling \$1,117,500 (including \$600,000 of prior advances from Bright Capital, Ltd. ("Brightcap") and \$65,000 of prior advances from affiliates of David Mitchell, our former CEO) of secured convertible debt ("Notes"). Through September 30, 2003 an additional \$65,000 of the Notes were sold to Mark A. Smith our president, for a total issuance of \$1,182,500. Up to a total of \$2,065,00 of such Notes may be issued. The largest holder of these Notes is Chris-Dan, LLC, which is owned by Dominic Bassani, General Manager of Dairy and a consultant to Bion. The Notes are secured by: a) all of the intellectual property of Bion (and its subsidiaries) (which previously secured obligations to Bright Capital, Ltd. which is owned by Mr. Bassani), b) all of the outstanding shares of Dairy, and c) all of the shares of Centerpoint owned by Bion. The Notes are convertible into the common stock of Dairy at a price of \$1.00 (principal and accrued interest on the Notes) under various conditions specified in the financing documentation, one or more of which conditions precedent to conversion may never be met. Under additional specified conditions (which also have no assurance of being met), the Notes (or Dairy common stock received pursuant to the conversion thereof) may in the future be exchanged for shares of the common stock of Bion. If conversion of the Notes into the common stock of Dairy takes place, all of Bion's business opportunity in the dairy industry world-wide will be conducted through Dairy, and the board of directors of Dairy will consist of three members, two of which will be designated by the majority of the shareholders of Dairy and only one will be designated by Bion. The financing restricts the use of its proceeds and, unless Dairy and/or Bion raise substantial additional funds, there will be no substantial funds available for Bion to pay its creditors and carry out its business. See Exhibit 10.1 to our Current Report on Form 8-K dated August 25, 2003 for further details.

Although Dairy, our subsidiary, recently received the financing described above (which financing was not large enough to repay our creditors and is subject to a limiting "Use of Proceeds" which does not permit significant payment to our existing creditors) and we are currently seeking other outside sources of capital, as of this date we have not been able to secure the level of financing that is necessary for our current and future operations and/or to repay our existing indebtedness and there can be no assurance that sufficient funds will be available from external sources. Further, there can be no

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

assurance that any such required funds, if available, will be available on attractive terms or that they will not have a significantly dilutive effect on our existing shareholders. Since we do not yet have the ability to generate cash flow from operations, we have substantially curtailed our current business activities and we may need to cease operations if we are not able to

10

raise capital from outside sources. This would have a material adverse effect on our business and our shareholders.

Centerpoint Shareholders Meeting/Removal of Contractual Problems

A meeting of the Centerpoint Corporation ("Centerpoint") stockholders which commenced on July 31, 2003 was concluded on August 25, 2003. Centerpoint's stockholders approved the ratification of the Amended Centerpoint Agreement, with 96% of the shares present at the meeting voted in favor, including shares owned by Bion. Of the shares present at the meeting, 85% (1,179,405 shares) other than the shares owned by Bion voted in favor of the ratification and only 1,490 shares voted against the ratification (with the balance of such shares abstaining). See our Current Reports on Form 8-K dated April 12, 2003 and August 25, 2003 and the exhibits thereto for further details regarding the matters being ratified.

On August 27, 2003, Bion paid the sum of \$90,000 to OAM, S.p.A. (and its designees) to complete the transaction described in our Current Report on Form 8-K dated April 12, 2003 (set forth in Exhibit 99.2 thereto) as a result of the favorable vote by Centerpoint's stockholders.

As a result, the contractual impediments to future financing described in our Current Report on Form 8-K dated April 12, 2003 (see Exhibits 99.2 and 99.3 thereto) have now been removed.

Principal Products and Services

NMS

We believe our NMS solution, when testing is completed during the current fiscal year, will address the needs of confined animal feeding operations by providing, in one system:

- * An economically viable,
- * A regulatory compliant, and
- * An environmentally sound solution.

The second generation NMS uses patented biological processes to achieve substantial and certifiable reductions of nutrients and air emissions from confined animal feeding operations. These second generation systems will incorporate computerized monitoring and control equipment that identifies air & nutrient emissions, documents the emission reductions by maintaining set point process control parameters and reports the results remotely. The NMS will allow rebalancing of the nutrient levels at the farm site by both reducing excess nutrient loading in the effluent stream and by removing a significant amount (80% or more) of the nutrients from the farm through sale as commercially-desirable, environmentally-friendly BionSoil(R) organic products. In addition, the NMS will reduce odors, atmospheric emissions,

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

greenhouse gas and precursors to greenhouse gas emissions by 95% or better. We believe that Bion second generation NMS platform will also enables additional technologies, such as anaerobic digestion to produce energy.

11

The Bion NMS will offers a comprehensive solution that allows Bion to serve as a "utility" for confined animal feeding operations facilities by incorporating solids removal, waste and water treatment, and energy production into a single integrated system. The various benefits provided by the systems afford Bion the opportunity for multiple revenue streams, which may include without limitation, technology license fees, waste management fees on a per animal basis, sales from BionSoil(R) products, sales revenue from energy and/or clean water production, as well as environmental credits.

Additionally the second generation NMS may create the possibility for Bion to participate in the "Dairy Park Opportunity" which we believe arises from the potential for the Bion technology to allow very large dairy farms to vertically integrate (with pasteurization, cream separation, milk bottling and/or cheese plants, etc.) and pursue site integration (with ethanol plants, methane digestion, hydroponic growing, and/or organic farming, etc.) on relatively small plots of land.

BionSoil(R) Products

Bion's NMS systems will potentially allow Bion to produce and market BionSoil(R) products which will be sold as fertilizers and soil enhancements which supply slow-release nutrients and high-quality organic matter in a consistent, stable form, free from offensive odors, toxic substances and pathogens. These products will enhance the physical, biological and chemical properties of the soil, which results in improved plant growth and health, compared to conventional fertility practices. We believe that these products can be economically transported and will be produced in quantities sufficient for national distribution if a large enough (as yet unknown) number of second generation Bion NMS systems are sold and placed in operation in relatively concentrated geographic areas, of which there is no assurance. The exact properties and attributes of the products are not known at this time.

Marketing and Distribution

NMS

Until we complete the testing and demonstration of our second generation NMS systems, it will not be possible to fully specify the manner in which such systems will be marketed. We anticipate that such marketing plans will be developed during the second half of fiscal year 2004 if the testing/demonstrations described above are successful and will be largely based on the NMS performance which will have been demonstrated.

However, we anticipate that our NMS marketing plan for the next 12-15 months will focus on marketing the NMS primarily to the dairy industries based on the benefits which the second generation NMS can provide to those industries, assuming that these benefits have been successfully documented in the tests/demonstrations discussed above. Our program will emphasize, in addition to environmental compliance, the potential improvement of the economics of their operations attainable through the installation of a Bion

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

NMS, including larger herd size, less land area devoted to waste disposal, reduction of the risks of environmental problems, and the positive perception of regulatory agencies and the public of their involvement in environmental protection. Bion's primary marketing will be directed to potential users who need to retrofit their existing installations to meet environmental standards

12

and/or are seeking to expand their existing operations or build new installations.

Bion began preliminary pre-marketing of various capabilities from its second generation system during 2002 based on the results at DreamMaker Dairy described above. The nutrient management capabilities of this new generation of systems will help break one of the major barriers facing those portions of the dairy and protein growing businesses in the U.S. which desire to expand. Our second generation system will allow them to meet ever stricter environmental standards for larger farms and raise more animals on less land while meeting or exceeding all requirements to protect the environment.

BionSoil(R) Products

BionSoil(R) are intended to be 100% natural, odorless fertilizer and soil enhancement products. We believe that our technology will allow us to manufacture a soil and fertilizer product line which acts as a natural time-released growth agent (with low leaching, bound nitrogen and phosphorus which potentially maintain a 95% WIN (water insoluble nitrogen)) ratio. Our marketing efforts will be based primarily on these product attributes. However, no detailed marketing plan will be implemented until after second generation NMS marketing is well under way.

Competition

There are a significant number of competitors in the waste treatment industry who are working on animal-related pollution issues. This competition is increasing with the growing governmental and public concern focused on pollution due to confined animal feeding operations wastes. Anaerobic lagoons are the most common traditional treatment process for animal waste on large farms within the hog raising and dairy industries. These lagoons are coming under increasing regulatory pressure due to associated odor, nutrient management and water quality issues and are facing possible phase-out in some states such as North Carolina. Although we believe that we have the most economically and technologically viable solution for the current problems, other alternatives do exist including, for example, synthetic lagoon covers, methane digesters, multistage anaerobic lagoons and solids separators. Additionally, many efforts are underway to develop and test new technologies, including the program under the supervision of North Carolina State University in which Bion is a participant.

Our ability to compete is dependent upon our ability to obtain required approvals and licenses from regulatory authorities and upon our ability to introduce and sell our systems in the appropriate markets.

There is also extensive competition in the potting soil, organic soil amendment, fertilizer and organic fertilizer markets. There are many companies that are already selling products to satisfy demand in the sectors of these markets we are trying to enter. Many of these companies have established marketing and sales organizations and retail customer commitments, are supporting their products with advertising, sometimes on a national basis,

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

and have developed brand name recognition and customer loyalty in many cases.

We believe that our competitive advantage is that we offer a superior service and technology with our NMS solution and that we offer a superior line of products with our BionSoil(R) and Bion Fertilizer products.

13

Dependence on One or a Few Major Customers

We are not dependent upon one or a few major customers. Our operating revenues from system sales are not dependent upon a limited number of contracts. The nature of our business is such that significant system sales are generally expected to be "one-time" contracts pursuant to which one or more single systems are sold and designed, with income to be received by us after the first year of system operation from the sale of BionSoil products. Note, however, that the confined animal feeding operations industries have been undergoing substantial concentration in recent years. While the dairy industry is not very consolidated, a relatively small number of companies dominate the swine, poultry and feedlot confined animal feeding operations industries. At some future point we could become dependent on one or a few major customers in one or more confined animal feeding operations segments.

Commercial BionSoil(R) products are not currently being marketed, and therefore, we have no dependence on one or a few major customers.

Patents

We are the sole owner of six United States patents and one Canadian patent:

- * U.S. Patent No. 5,078,882, Bioconversion Reactor and System, expires January 2009.
- * U.S. Patent No. 5,472,472, Animal Waste Bioconversion System, expires December 2012.
- * U.S. Patent No. 5,538,529, Bioconverted Nutrient Rich Humus, expires July 2013.
- * U.S. Patent No. 5,755,852, Bioconverted Nutrient Rich Humus, expires May 2015.
- * U.S. Patent No. 4,721,569, Phosphorus Treatment Process, expires January 2005.
- * U.S. Patent No. 5,626,644, Storm Water Remediation Bioconversion System, expires May 2014.
- * Canadian Patent No. 1,336,623, Aqueous Stream Treatment Process, expires August 2012.

We are also the exclusive U.S. licensee of the following patent from BioBalance A/S of Denmark for the life of the patent for use in the field of agricultural applications for treating/converting animal waste into soil-like products with a content of nutrients and organic matter:

- * U.S. Patent No. 5,906,746, Method for the Control of Biodegradation.

In addition to such factors as innovation, technological expertise and experienced personnel, we believe that a strong patent position is increasingly important to compete effectively in the systems and soil business. In November 2000, we filed a patent application which is related to low oxygen organic waste bioconversion features of the Bion process and extends the range of Bion's intellectual property position. We have received

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

a Notice of Allowance and have filed a Divisional Application associated with it.

It is likely that we will file applications for additional patents in the future. There is, however, no assurance that any such patents will be granted.

14

It may become necessary or desirable in the future for us to obtain additional patent and technology licenses from other companies relating to technologies that may be employed in future products or processes. To date, we have not received notices of claimed infringement of patents based on our existing processes or products, but due to the nature of the industry, we may receive such claims in the future.

We generally require all of our employees and consultants, including our management, to sign a non-disclosure and invention assignment agreement upon employment with us.

Research and Development

NMS

During the year ended June 30, 2003 we spent approximately \$423,411 on undertaking further NMS research and development including, among other things, work related to design and installation of the second generation NMS facility now being tested and demonstrated in Texas and design work related to a subsequent NMS instation to be constructed (in Texas or California) to test and demonstrate the capabilities of the second generation NMS in preventing atmosheric discharge of polluting gases from animal raising facilities. Only a small portion of the funds spent during the year related to BionSoil research.

During the year ended June 30, 2002, we spent approximately \$487,000 on undertaking further NMS research and development which was focused on: 1) system acceleration in order to further increase capacity and lower costs; 2) integration of the Bion NMS with a methane digestion system in order to create additional revenue streams from the sale of electricity and natural gas and to take advantage of energy generated for heat utilization; and 3) development of pre-commercial designs for application in our second generation NMS. Additional research is being focused on water cleaning technologies as an integrated enhancement to the Bion NMS in order to make available clean process water as an additional product from the system.

During the year ended June 30, 2001, we spent approximately \$947,000 on research and development activities including, without limitation, system design, testing, consulting fees and installation expenses related to reducing the physical size of the system by implementing a higher rate biological process. These second generation closed tank systems are utilizing state-of-the-art, computerized, real-time monitoring and system control that can be remotely accessed for both reporting requirements and control functions.

NMS development is expected to run through fiscal year 2004 with research and development costs currently estimated to be not less than \$500,000 (subject to availability of funds, which budget could be expanded substantially. In fiscal year 2004, we plan to complete the testing/demonstration related to nutrient removal at the Texas installation

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

and then install/test/demonstrate the capacities of the second generation NMS related to atmospheric discharges of polluting gases. Assuming success in such tests/demonstrations, additional funds would be expended on producing commercial designs/engineering related to the second generation NMS for various climates and applications. However, there is no assurance that such tests will be successful or, if successful, that we will have sufficient funds to carry out the needed work. The major purposes of this research would be to

15

allow documentation and publishing by independent investigators such as state land grant universities of papers describing the air and nutrient emission reduction data related to the Bion NMS versus existing industry baseline standards and to further refine the second generation NMS while further researching integration possibilities.

BionSoil(R) Products

During the year ended June 30, 2003, due to financial constraints, we substantially curtailed our BionSoil related research and spent approximately \$136,348.

During the year ended June 30, 2002, we expended approximately \$249,000 in research and development for trials and tests of our BionSoil(R) and Bion Fertilizer products with the focus shifting from testing pure BionSoil(R) and Bion Fertilizer to evaluation of blends incorporating the Bion products. The Bion products are being tested on a blended basis in the turf grass market, high value fruit crops (such as wine grapes), potting mix market for both consumers and the container nursery market and the greenhouse vegetable market. These blended Bion products are being tested primarily for their growth capabilities and disease suppression capabilities.

Bion conducted over twenty clinical trials during fiscal 2001, in-house and by various academic, industry and professional organizations at a direct cost to us of approximately \$315,000 in the year ended June 30, 2001. We have been testing the BionSoil(R) and Bion Fertilizer products in order to analyze the effectiveness of the product on a number of crops in a variety of different growing environments, and to measure the success of nutrient release and limited leaching qualities.

These activities may recommence during fiscal 2004, and future years, provided funds are available. We have no preliminary estimated budget amount for 2004 at present.

Environmental Protection/Regulation

We are a provider of systems and services that result in the reduction of pollution and, therefore, we are not under direct enforcement or regulatory pressure. We are involved, however, in waste treatment and are impacted by environmental regulations in at least three different ways:

- * Our marketing and sales success depends, to a substantial degree, on the pollution clean-up requirements of various governmental agencies, from the Environmental Protection Agency (EPA) at the federal level to state and local agencies;
- * Our system design and performance criteria must be responsive to the changes in federal, state and local environmental agencies' effluent standards and other requirements; and

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

- * Our system installations and operations require governmental permit approvals in many jurisdictions.

We are also intend to be a manufacturer and provider of BionSoil(R) products such as potting soils, soil amendmets and fertilizers. Some state and federal regulatory agencies have standards these products must meet to be sold as soil amendment or fertilizer products in various markets. The

16

production and sale of our BionSoil(R) products currently meet relevant federal and state requirements. These regulations can, however, experience change, which creates a level of unpredictability in future outcomes. We are continually reviewing current regulations and potential changes that may affect our business and are making necessary compliance efforts in all jurisdictions in which we do business.

Employees

As of September 30, 2003, we had five employees, all of whom were full time. Our future success depends in significant part on the continued service of our key technical and senior management personnel. The competition for highly qualified personnel is intense, and there can be no assurance that we will be able to retain our key managerial and technical employees or that we will be able to attract and retain additional highly qualified technical and managerial personnel in the future. None of our employees is represented by a labor union, and we consider our relations with our employees to be good. None of our employees is covered by "key person" life insurance.

Item 2. Description of Properties

Our executive offices are located at 18 E. 50th Street, 10th Floor, New York, New York 10022 under a lease which, as renegotiated during fiscal 2003, expires on December 31, 2003. Bion currently pays no rent and occupies a small portion of the leased space at no monthly cost pursuant to agreements between and among the landlord (an unaffiliated party), Bion, and entities connected with David Mitchell (our former C.E.O. and Director) and Salvatore Zizza (our former Secretary and Director). We amended our New York City office lease effective March 1, 2003. Under this amendment the expiration date was changed to December 31, 2003, from the previous expiration date of December 31, 2010. The amendment calls for the drawdown of the letter of credit provided to the landlord for the full amount of \$120,561 to be used to pay arrearages and future rent. In addition, two of our new subtenants, Mitchell & Co. and Zizza & Co., which are controlled by David Mitchell and Salvatore Zizza, respectively, are former officers and directors of Bion, and have personally guaranteed the lease with the landlord. It is possible that we will not incur additional cash outflows in connection with this lease as a result of the drawdown of the letter of credit, the subrental income and the personal guarantees. See our Current Report dated March 25, 2003 and the exhibits thereto. However, Bion may have certain liabilities at the end of the lease term which cannot be fully determined at this time but which we estimate will be less than \$20,000. The lease and sublease agreements cover approximately 5,700 square feet.

We have no additional offices at this time but may have liability in connection with prior office leases related to space we have vacated including without limitation: a) space at 8899 Main Street, Williamsville, New York 14221 under a lease that expires on November 30, 2004 and provides for annual base rents of approximately \$18,600 and covers approximately 1,800 square

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

feet; and b) space at 138 Uzzle Industrial Drive, Clayton, North Carolina 27520 under a lease that expired June 30, 2003 and provides for annual base rents of approximately \$15,000 and covers approximately 4 acres and an office building of approximately 2,350 square feet. Except as described above, all leases and rental agreements are with non-affiliated parties.

We do not own any of these facilities, nor are we obligated under any mortgages for the properties. We believe that, under our current operations, the facilities are adequate, but, if our second generation NMS testing is

17

successful and we obtain additional financing, we will need additional office and other space.

Item 3. Legal Proceedings

On September 30, 2003, Morrison Cohen Singer & Weinstein, LLP ("MCSW") filed a complaint in the Supreme Court of the State of New York, County of New York, against us alleging that we owe MCSW approximately \$114,000 for legal services provided. We have not yet filed an answer in that proceeding. Because we have already recorded a liability for these legal services, we do not believe that this lawsuit will have a material adverse effect on our financial condition.

On July 22, 2002, Thomas Keith Barefoot ("Barefoot"), doing business as Quin Deca Farm ("Quin Deca"), an unaffiliated party, filed a complaint against the Company in the Superior Court of the County of Harnett in the State of North Carolina regarding the Company's first generation Bion NMS System on Quin Deca Farm and the harvesting of BionSoil. The complaint includes breach of contract claims asserting that the Company abandoned the NMS system on Quin Deca Farm and the failure of the Company to harvest BionSoil. The second claim is for fraud regarding misrepresentation of the state of the technology of the first generation NMS. The third claim is for unfair and deceptive trade practices for misrepresentation of the state of the technology of the NMS System. The fourth claim is for negligent misrepresentation made by Bion in connection with the work it performed and its suitability for the intended purpose. The fifth claim is for equity/specific performance in that Bion left Quin Deca with an economically and technically deficient waste management system that cannot continue to be used without adequate and alternative methods of waste removal. Quin Deca is seeking \$830,000 in damages plus punitive damages and to have its damages trebled, reasonable attorney fees and principles of equity requiring Bion to install its second generation Bion NMS system. We have filed an answer and counterclaims. The action has been removed to the U.S. District Court for the Eastern District of North Carolina which court recently ruled that most of the substantive claims should be arbitrated. The Company does not believe that the claims against it have merit and, assuming that we have the funds to properly defend this action, we that the ultimate resolution of this litigation will not have a material adverse effect on the Company, its operations or its financial condition.

On May 6, 2002, Arab Commerce Bank Ltd. ("ACB"), an unaffiliated party, filed a complaint against the Company in the Supreme Court of the State of New York regarding \$100,000 of the Company's convertible bridge notes ("Notes") that were issued to ACB in March of 2000. The complaint includes breach of contract claim asserting that the Company owes ACB \$265,400 plus interest or \$121,028 including interest based on ACB's interpretation of the terms of the Notes and subsequent amendments. Effective June 30, 2001, the Company issued ACB 5,034 shares of common stock on conversion in full payment of the Notes based on the Company's interpretation of the Notes, as amended. The Company has filed an answer to the complaint denying the allegations. Assuming that we

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

have the funds to properly defend this action. The Company does not believe that the ultimate resolution of this litigation will have a material adverse effect on the Company, its operations or its financial condition.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of our stockholders during the quarter ended June 30, 2003.

18

PART II

Item 5. Market for Bion Environmental Technologies, Inc. Common Equity and Related Stockholder Matters

(a) Market Information

During the past two years, we have had only limited volumes of trading in our common stock in the over-the-counter market, and there is no assurance that such trading will expand or even continue. We are also listed on the Philadelphia Stock Exchange, but no trading has occurred on that exchange.

Our common stock is quoted on the OTC Bulletin Board under the symbol "BNET." The following quotations reflect inter-dealer prices, without retail mark-up, markdown or commission and may not represent actual transactions.

Fiscal Year Ending June 30,	2002		2003	
	High	Low	High	Low
First Fiscal Quarter	\$ 20.10	\$ 8.80	\$ 5.20	\$ 2.85
Second Fiscal Quarter	\$ 9.90	\$ 7.00	\$ 3.75	\$ 1.60
Third Fiscal Quarter	\$ 17.00	\$ 7.20	\$ 3.50	\$ 0.55
Fourth Fiscal Quarter	\$ 10.20	\$ 5.00	\$ 1.35	\$ 0.30

(b) Holders

The number of holders of record of our common stock at September 30, 2003 was approximately 1,500. Many of our shares of common stock are held by brokers and other institutions on behalf of stockholders, so we are unable to estimate the number of stockholders represented by these record holders.

The transfer agent for our common stock is Corporate Stock Transfer, Inc., 3200 Cherry Creek Drive South, Suite 430, Denver, Colorado 80209.

(c) Dividends

We have never paid any cash dividends on our common stock. Our board of directors does not intend to declare any cash dividends in the foreseeable future, but instead intends to retain earnings, if any, for use in our business operations. The payment of dividends, if any, in the future is within the discretion of the board of directors and will depend on our future earnings, if any, our capital requirements and financial condition, and other relevant factors.

Recent Sales of Unregistered Securities

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

There were no sales of securities in the three-month period ended June 30, 2003 without registration under the Securities Act of 1933, as amended.

19

Item 6. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Report includes financial statements (and notes attached thereto) for the year ending June 30, 2003 which have not been reviewed or audited by independent certified public accountants and other items derived therefrom which may not fully conform the requirements/regulations governing the content of Form 10-KSB.

Statements made in this Form 10-KSB that are not historical or current facts are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and section 21E of the Securities Exchange Act of 1934, as amended. These statements often can be identified by the use of terms such as "may," "will," "expect," "believe," "anticipate," "estimate," or "continue" or the negative thereof. Bion intends that such forward-looking statements be subject to the safe harbors for such statements. We wish to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. Any forward-looking statements represent management's best judgment as to what may occur in the future. However, forward-looking statements are subject to risks, uncertainties and important factors beyond our control that could cause actual results and events to differ materially from historical results of operations and events and those presently anticipated or projected.

These factors include adverse economic conditions, entry of new and stronger competitors, inadequate capital, unexpected costs, failure to gain product approval in the United States or foreign countries and failure to capitalize upon access to new markets. Additional risks and uncertainties that may affect forward-looking statements about Bion's business and prospects include the possibility that a competitor will develop a more comprehensive or less expensive environmental solution, delays in market awareness of Bion and our systems and soil, or possible delays in Bion's marketing strategies, each of which could have an immediate and material adverse effect by placing us behind our competitors. Bion disclaims any obligation subsequently to revise any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

The following discussion should be read in conjunction with our consolidated financial statements and accompanying notes.

Overview

BION ENVIRONMENTAL TECHNOLOGIES, INC. ("BION," "WE," "US," OR "OUR") HAS BEEN SUFFERING FROM SEVERE FINANCIAL DIFFICULTIES SINCE APPROXIMATELY LATE JANUARY OF 2003, AS DISCLOSED IN OUR PERIODIC AND OTHER REPORTS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION COMMENCING WITH OUR CURRENT REPORT ON FORM 8-K DATED FEBRUARY 7, 2003. THESE FINANCIAL DIFFICULTIES RESULTED IN THE RESIGNATION OF NEARLY ALL OF OUR OFFICERS AND DIRECTORS DURING FEBRUARY AND MARCH OF 2003, AND THE TERMINATION OF MOST OF OUR EMPLOYEES. WE HAVE RETAINED

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

A CORE TECHNICAL STAFF, BUT WE HAVE DRASTICALLY CURTAILED OUR BUSINESS ACTIVITIES TO INCLUDE ONLY THOSE ACTIVITIES THAT ARE DIRECTLY NEEDED TO COMPLETE DEVELOPMENT AND TESTING OF OUR SECOND GENERATION TECHNOLOGY.

OUR FINANCIAL DIFFICULTIES RESULTED PRIMARILY FROM OUR INABILITY TO RAISE ADDITIONAL FUNDS DUE TO CONTRACTUAL ANTI-DILUTION PROVISIONS THAT WERE CONTAINED IN THE AGREEMENTS RELATED TO THE FINANCING TRANSACTIONS THAT WERE COMPLETED IN JANUARY OF 2002 (SEE OUR FORM 10-KSB FOR THE YEAR ENDED JUNE 30,

20

2002 AND OUR CURRENT REPORT ON FORM 8-K DATED DECEMBER 12, 2001 AND THE EXHIBITS AND AMENDMENT THERETO) WHICH PREVENTED ANY REASONABLE FINANCING FROM BEING COMPLETED. WHEN WE BECAME AWARE OF THE NEGATIVE IMPLICATIONS OF THESE ANTI-DILUTION PROVISIONS WHILE ATTEMPTING TO STRUCTURE A PLANNED FINANCING (WHICH FINANCING ATTEMPTS ULTIMATELY FAILED IN JANUARY OF 2003), WE ATTEMPTED TO EITHER FIND ALTERNATIVE FINANCING METHODS WHICH COULD BE REASONABLY COMPLETED AND/OR NEGOTIATE AN AMENDMENT TO SUCH PROVISIONS. AFTER MONTHS OF NEGOTIATIONS, AGREEMENTS RELATED TO AMENDING SUCH PROVISIONS WERE ENTERED INTO DURING THE SPRING OF 2003(SEE OUR CURRENT REPORT ON FORM 8-K DATED April 12, 2003) AND THE PROVISIONS WERE FINALLY AMENDED EFFECTIVE AUGUST 27, 2003 (SEE OUR CURRENT REPORT ON FORM 8-K DATED AUGUST 25, 2003 AND EXHIBITS THERETO).

ALTHOUGH WE WERE ABLE TO COMPLETE A SMALL FINANCING THROUGH ONE OF OUR SUBSIDIARIES DURING AUGUST OF 2003 WHICH WILL ALLOW US TO CONTINUE LIMITED WORK ON OUR SECOND GENERATION TECHNOLOGY (SEE OUR CURRENT REPORT ON FORM 8-K DATED AUGUST 25, 2003), OUR OPERATIONS HAVE BEEN SEVERELY DAMAGED DURING THE PAST YEAR. NOT ONLY DID WE HAVE TO TERMINATE MOST OF OUR ACTIVITIES AND EMPLOYEES, BUT WE HAVE SUFFERED SUCH DIRE FINANCIAL CONSTRAINTS (AS WE WERE FACED WITH THE LIKELY POSSIBILITY OF A BANKRUPTCY FILING) THAT WE HAVE LOST CREDIBILITY WITH OUR VENDORS, CREDITORS, THE FINANCIAL COMMUNITY AND OUR EXISTING SHAREHOLDERS AND INVESTORS. AS A RESULT, THE MARKET PRICE FOR OUR STOCK FELL IN ORDER TO CONTINUE WITH OUR BUSINESS ACTIVITIES AND SAVE THE COMPANY WE HAVE HAD TO STRUCTURE INTERIM FINANCING ON EXTREMELY DILUTIVE TERMS WHICH HAS NEGATIVELY AFFECTED OUR SHAREHOLDERS AND WILL PROBABLY CONTINUE TO NEGATIVELY IMPACT OUR ABILITY TO OBTAIN FUTURE FINANCING ON REASONABLE TERMS. WE STILL FACE A SEVERE WORKING CAPITAL SHORTAGE AND SINCE WE HAVE NO REVENUES WE WILL NEED TO OBTAIN ADDITIONAL CAPITAL TO SATISFY OUR EXISTING CREDITORS (SEE "MANAGEMENT'S DISCUSSION AND ANALYSIS" AND "FINANCIAL STATEMENTS"). THERE IS NO ASSURANCE WE WILL BE ABLE TO OBTAIN THE FUNDS THAT WE NEED TO STAY IN BUSINESS OR TO SUCCESSFULLY DEVELOP OUR BUSINESS.

We are in the process of developing and testing a second generation of our technology ("Bion NMS" or "NMS" or "System" or "Technology") to provide waste management solutions to the agricultural industry, focusing on livestock waste from confined animal feeding operations, such as large dairy and hog farms. In the past we have engaged in two main areas of activity by utilizing the first generation of our technology (which we discontinued marketing during calendar year 2001) (which areas we intend to re-enter during the current fiscal year pending results of field testing our second generation NMS technology during fiscal year 2004):

- 1) WASTE STREAM REMEDIATION. The removal of pollutants (primarily nitrogen and phosphorus) which pollute soil and water and reduction of emissions of gases to the atmosphere which result in acid rain, smog, ground-level ozone or produce "greenhouse warming" effects). We intend to pursue this area of activity primarily through licensing our second generation technology: a) to retrofit existing confined animal feeding operations installations (with emphasis on large dairy farms utilizing anaerobic lagoons for the next 12 months) and b) for use in newly constructed dairy farms; and

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

2) BIONSOIL SALES. The production and sale of organic BionSoil fertilizer products made from the waste solids produced by use of our technology.

In addition, we intend to pursue what we call the "Dairy Park Opportunity," which reflects what we believe is the potential for the Bion technology to allow very large dairy farms to vertically integrate (with pasteurization, cream separation, milk bottling, and/or cheese plants, etc.)

21

and pursue site integration (with ethanol plants, methane production, organic farming, etc.) on relatively small plots of land.

Note that all of these activities completely are dependent upon two things, neither of which can be assured at this date:

1) successful completion of the field testing of our second generation technology which is presently taking place in Texas for the purpose of demonstrating its capacity for nutrient (primarily nitrogen and phosphorus)removal from the dairy confined animal feeding operations waste stream (which will be followed, if successful, by a demonstration/test(either at the Texas site or in California pursuant to existing agreements) of our technology's capacity to reduce polluting gaseous emissions from confined animal feeding operations operation); and

2) our ability to raise sufficient funds to allow us to finance our activities and pay our existing creditors.

We believe that our waste remediation technology will provide confined animal feeding operations (primarily in the dairy and swine industries) with treatment for their animal waste outputs. In this regard, our systems are designed to microbiologically treat their entire waste stream while reducing air emissions and nutrient discharges and creating solids which are in turn the basis for the creation of organic soil and fertilizer products. We are attempting to develop our soil and fertilizer products for use in a variety of applications.

Currently, the majority of confined animal feeding operations dispose of their animal waste by spreading it on cropland (before or after placement in anaerobic lagoons). In many parts of the United States, the operation and/or expansion of confined animal feeding operations are severely restricted due to a combination of the amount of land that is necessary to dispose of the animal waste at an environmentally sustainable rate, and the pollution of existing land and water due to prior disposal of excess nutrients and/or air pollution emissions. Confined animal feeding operations are enormous polluters of our air, water and land and are under significant pressure from state and federal regulatory agencies, the media, environmental groups and the public to reduce their role as a major source of excess nutrient pollution and harmful air emissions. Although nutrient pollution from these feeding operations has gone largely unregulated in the past, they are now subject to stringent regulation under the Federal Clean Water Act and are required to become zero-discharge facilities. Air emissions from these operations are increasingly being evaluated for potential regulation under the Federal Clean Air Act and/or similar state statutes (including without limitation a law recently passed in California which explicitly makes large dairies subject to such regulation). The livestock industry and regulatory agencies are searching for affordable waste treatment solutions to this widespread and immediate problem.

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Although we have been conducting business since 1989, we recently have, effectively, re-entered the "development stage" pending completion of testing/demonstration of our second generation technology during the current fiscal year. Our original systems were wastewater treatment systems for dairy farms and food processing plants. The basic design was modified in late 1994 to create Nutrient Management Systems (NMS) that produced organic soil products as a by-product of remediation of the waste stream when installed on large dairy or swine farms. Through June 30, 2001, we sold and subsequently installed, in the aggregate, 32 of these first generation systems in 7 states., of which 19 were still in operation through June 30, 2002. There are

22

presently approximately 12 first generation Bion NMS soil production system installations operating in 3 states.

We discontinued marketing of our first generation NMS systems during calendar 2001. We were unable to produce a business model based on the first generation technology which would generate sufficient revenues to create a profitable business. While continuing to market and operate the first generation systems, during the second half of calendar year 2000 we began to focus our activities on developing the next generation of the Bion NMS technology. We no longer operate any of the first generation NMS systems.

As a result of our research and development efforts during the last three years, the second generation of our technology has been developed. We have designed and tested NMS systems that use state-of-the-art, computerized, real-time monitoring and system control that have the potential to be remotely accessed for both reporting requirements and control functions. These systems are smaller, faster and require less capital per animal than our first generation NMS systems. The new generation of NMS system is designed to harvest solids used to produce our BionSoil(R) products in a few weeks as compared to six to twelve months with our first generation systems.

Critical Accounting Policies and Significant Use of Estimates in Financial Statements

The Securities and Exchange Commission ("SEC") recently issued disclosure guidance for "critical accounting policies." The SEC defines "critical accounting policies" as those that require application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods.

The following list of critical accounting policies is not intended to be a comprehensive list of all of our accounting policies. Our significant accounting policies are more fully described in Note 2 to the consolidated financial statements included in this Annual Report on Form 10-KSB. In many cases, the accounting treatment of a particular transaction is specifically dictated by generally accepted accounting principles with no need for management's judgment in their application. There are also areas in which management's judgment in selecting any available alternative would not produce a materially different result. We have identified the following to be critical accounting policies of the Company:

Revenue recognition: Revenues from fixed-price system development and construction projects are recognized on the percentage-of-completion method. For contracts accounted for under the percentage-of-completion method, the amount of revenue recognized is the percentage of the total contract price that the costs expended to date bear to the anticipated final total cost based

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

upon current estimates of the cost to complete the contract. Contract costs includes all labor and benefits, materials unique to or installed in the project, subcontract costs and allocations of indirect costs. General and administrative costs are charged to expense. Provisions for estimated losses on uncompleted contracts are provided when determined, regardless of the completion percentage. As contracts can extend over one or more accounting periods, revisions in costs and earnings estimated during the course of the work are reflected during the accounting period in which the facts that require such revisions become known. Project managers make assumptions concerning cost estimates for labor hours, consultant hours and other project costs. Due to uncertainties inherent in the estimation process and potential

23

changes in customer needs as projects progress, it is at least reasonably possible that completion costs for some uncompleted projects may be further revised in the near term, and that such revisions may be material.

Revenue from the sale of BionSoil(R) products and associated fees are recognized when shipped, as the Company has no continuing obligations.

Stock-based compensation: The Company accounts for its stock-based compensation arrangements with its employees in accordance with the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and complies with the disclosure provisions of SFAS 123, "Accounting for Stock-Based Compensation." SFAS 123 established a fair-value-based method of accounting for stock-based compensation plans. Stock-based awards to nonemployees are accounted for at fair value in accordance with the provisions of SFAS 123.

Income taxes: Deferred income taxes are determined by applying enacted statutory rates in effect at the balance sheet date to the differences between the tax bases of assets and liabilities and their reported amounts in the consolidated financial statements. A valuation allowance is provided based on the weight of available evidence, if it is considered more likely than not that some portion, or all, of the deferred tax assets will not be realized.

Use of estimates: The preparation of financial statements in conformity with generally accepted accounting principles in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. Actual results could differ from those estimates and assumptions.

Results of Operations - Comparison of Fiscal Year Ended June 30, 2003
with Fiscal Year Ended June 30, 2002

We recorded \$116,029 of BionSoil(R) sales during the fiscal year ended June 30, 2003 ("2003"). This compares to total sales of \$69,382 for the fiscal year ended June 30, 2002 ("2002"), consisting of \$116,029 of BionSoil(R). In 2003 we began harvesting the solids from our first generation nutrient management systems. We did not harvest any solids from these systems in 2002 as we were focusing our efforts on the development of our second generation system. The increase in solids allowed us to sell more soil during 2003 compared to 2002. Cost of soil was \$692,138 for 2003 and \$546,117 for 2002. The increase in cost of goods sold was principally due to an increase in sales. The decrease in the gross loss as a percentage of sales is principally due to economies of scale.

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

General and administrative expenses decreased to \$2,373,800 for 2003 from \$2,498,400 for 2002. The decrease is primarily attributable to a decrease in salaries and office expense offset by an increase in legal fees.

Research and development costs decreased by \$175,863 during the year ended June 30, 2003. This decrease is primarily the result of the construction during 2002 of the second generation prototype system built at Dreammaker Dairy. We did not incur construction costs on the prototype during 2003.

Non-cash expenses for services and compensation decreased to \$30,000 for 2003 from \$4,968,000 for 2002. During 2002, non-cash charges for services and compensation included the issuance of warrants as inducement to convert debt of \$3,710,000, an increase of stock issued for services compensation and

24

interest of \$307,000, and an increase in notes payable issued for management fees of \$180,000.

Interest expense decreased to \$9,846 for 2003 from \$8,612,000 for 2002. Interest expense for 2002 included non-cash interest expense of \$131,000, a charge for the beneficial conversion feature of debt converted to common stock of \$5,547,000 and a charge for the change in the terms of warrants issued in conjunction with convertible bridge notes of \$297,000. These increases were offset by a decrease in amortization on debt discount of \$381,000.

We did not record income tax expense during the years ended June 30, 2003 and 2002, as a result of our net losses. A valuation allowance of \$15,394,000 at June 30, 2002, was established because we have not been able to determine that it is more likely than not that the deferred tax asset will be realized.

WE HAVE NOT YET HAD THE RESOURCES (FINANCIAL AND PERSONNEL) TO ADDRESS OUR TAX ITEMS FOR THE YEAR ENDED JUNE 30, 2003. HOWEVER, AS SET FORTH IN THE FINANCIAL STATEMENTS, IT IS CLEAR THAT WE HAD ADDITIONAL LOSSES DURING THE YEAR.

At June 30, 2002, we had net operating loss carry-forwards of approximately \$32,582,000, with expirations through 2022. The utilization of a portion of the loss carry-forwards may be limited under Section 382 of the Internal Revenue Code.

DUE TO OUR INABILITY TO OBTAIN ACCOUNTING SERVICES, WE ARE UNABLE TO DETERMINE THE AMOUNTS OF THE VALUATION ALLOWANCES OR CARRY-FORWARDS AT JUNE 30, 2003.

The net loss and comprehensive loss decreased \$13,675,767 (80%) during the year ended June 30, 2003. The decrease primarily related to a decrease of non-cash interest expense that was offset by a decrease in general and administrative expenses of \$124,600, a decrease in non-cash expenses for services and compensation, a decrease in research and development and a decrease in cumulative change in accounting principle. During the year ended June 30, 2001, the Company applied Emerging Issues Task Force Issue No. 00-27 ("EITF 00-27"), "Application of EITF Issue No. 98.5, Accounting for Convertible Securities with Beneficial Conversion Features of Contingently Adjustable Conversion Ratios, to Certain Convertible Instruments", which is effective for all such instruments. This issue clarifies the accounting for instruments with beneficial conversion features or contingently adjustable conversion ratios. As a result of this adoption, the Company modified the previous calculation of the beneficial conversion features associated with previously issued convertible bridge notes and recorded an additional warrant

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

discount on the convertible bridge notes issued during the year ended June 30, 2000 of \$1,050,000 due to the beneficial conversion feature calculated on the intrinsic value of the allocated proceeds received in the financing. Since the notes were automatically convertible into common stock one year from the date of issuance, the Company recorded \$481,250 as a cumulative effect of change in accounting principle for the year ended June 30, 2001. The Company also recorded a discount on convertible bridge notes issued during the year ended June 30, 2001 of \$701,000.

Basic and diluted loss per common share decreased by \$6.36 from \$7.18 to \$0.82. The decrease in the loss per share is attributable to the increase in the amount of shares outstanding due to the conversion of all our debt, other than trade payables, to common stock, and the decrease in non-cash charges.

25

Seasonality

Bion's installation capability is restricted in cold weather climates to approximately eight months per year. However, when weather conditions limit construction activity in southern market areas, projects in northern markets can proceed, and when northern area weather is inappropriate, southern projects can proceed. BionSoil(R) harvests on the existing installed base is semi-annual and is timed for spring and fall, with harvested soils being available for sale during the next spring or fall. BionSoil(R) and Bion Fertilizer product sales are expected to exhibit a somewhat seasonal sales pattern with emphasis on spring, summer and fall sales.

Liquidity and Capital Resources

Our principal sources of liquidity, which consist of cash and cash equivalents, are \$9,386 as of June 30, 2003. We believe we will not generate sufficient operating cash flow to meet our needs without additional external financing. THE LACK OF ADDITIONAL CAPITAL RESULTING FROM THE INABILITY TO GENERATE CASH FLOW FROM OPERATIONS OR TO RAISE CAPITAL FROM EXTERNAL SOURCES HAVE ALREADY FORCED THE COMPANY TO SUBSTANTIALLY CURTAIL OPERATIONS, CAUSED US TO REDUCE STAFF, AND MAY CAUSE THE COMPANY TO CEASE OPERATIONS AND WOULD, THEREFORE, HAVE A MATERIAL ADVERSE EFFECT ON ITS BUSINESS. There can be no assurances that any financing will be available or that the terms will be acceptable to us, or that any financing will be consummated. Any failure on our part to do so will have a material adverse impact on us and may cause us to cease operations.

The level of funding required to accomplish our objectives is ultimately dependent on the success of our research and development efforts, which at this time is unknown.

Effective February 12, 2003, in order to eliminate an impediment to a possible future financing, we entered into an agreement with Centerpoint Corporation, our majority-owned subsidiary, to immediately cancel Section 2.4 "Post-Closing Adjustment" and Section 1.2(b) "Failure to Register or Lapse of Effectiveness" from the January 2002 Subscription Agreement between us and Centerpoint. Our management believes that it is in the best interest of all of the shareholders of both companies that these obstacles to a possible future financing be removed. As majority stockholder, we have fiduciary obligation to act in the best interests of the Centerpoint minority stockholders.

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

As consideration to Centerpoint for canceling the sections noted above we will forgive all amounts due from Centerpoint, totaling approximately \$450,000 (this amount has been eliminated in consolidation). In addition, we will return to Centerpoint, for cancellation, warrants to purchase one million shares of Centerpoint's common stock.

During the period from January 2003 to June 30, 2003, Bright Capital LLC ("Brightcap"), an entity owned and controlled by Dominic Bassani, a consultant whose services were provided to us as a part of our management agreement with D2CO, LLC ("D2"), advanced us \$593,800. These advances were made for the purpose of providing funds to allow us to be able to pay operating expenses that are critical to our operations primarily consisting of salaries paid to retain critical personnel (which now consists of six employees), to take actions to protect and expand our intellectual property and to commence work on the system installation in Texas. On August 25, 2003, in connection with

26

the financing of Bion Dairy Corporation ("Dairy"), \$600,000 of advances from Brightcap were converted into secured convertible debt of Dairy. (See Item 1. Description of Business - Recent Developments.)

Going Concern

IN CONNECTION WITH THEIR REPORT ON OUR CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEAR ENDED JUNE 30, 2002, BDO SEIDMAN, LLP, OUR INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS, EXPRESSED SUBSTANTIAL DOUBT ABOUT OUR ABILITY TO CONTINUE AS A GOING CONCERN BECAUSE OF RECURRING NET LOSSES AND NEGATIVE CASH FLOW FROM OPERATIONS. SINCE THAT DATE, BION'S FINANCIAL SITUATION HAS GREATLY WORSENEED AND HAS EXPERIENCED SUBSTANTIAL FINANCIAL AND MANAGEMENT DISTRESS. (SEE ITEM 1. DESCRIPTION OF BUSINESS, ABOVE).

At June 30, 2003, we had stockholders' deficit of \$1,760,155, an accumulated deficit of \$60,107,394. We have no significant current revenues and substantial current operating losses. Our operations are not currently profitable; therefore, readers are further cautioned that our continued existence is uncertain if we are not successful in obtaining outside funding in an amount sufficient for us to meet our operating expenses at our current level. Management is currently engaged in seeking additional capital or other financing arrangements to fund operations until Bion system and BionSoil(R) are sufficient to fund operations.

Consolidated Working Capital

Consolidated working capital decreased to a deficit of \$2,217,185 at June 30, 2003 from \$1,814,000 at June 30, 2002. This decrease is primarily due to the loss incurred during the year and our inability to raise funds to replace the funds expended.

Analysis of Cash Flows

Cash used in operating activities decreased to \$2,330,000 in 2003 from \$3,870,000 in 2002.

Cash used in investing activities increased to \$75,000 in 2003 compared to \$4,818,000 cash provided by investing activities in 2002. The decrease is primarily the result of minimal investing activities in 2003.

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Cash provided by financing activities increased to \$592,000 in 2003 compared to \$435,000 cash used for financing activities in 2002. The increase is primarily the result of new advances from affiliates in 2003 verses payment of loans in the amount of \$898,000 in 2002. This is in contrast to \$2,527,000 received for the issuance of notes in a private placement in 2001.

We currently have no commitments for material capital expenditures except as to ongoing work related to our Texas installation/demonstration which is being funded through Dairy, our subsidiary. See Item 1. Description of Business, above.

Recent Accounting Pronouncements

The following information is as of June 30, 2002. Due to our inability to obtain accounting services, we are unable to update this information.

27

In July 2001, the FASB issued Financial Accounting Standards No. 141, "Business Combinations" ("SFAS 141"), which supersedes APB Opinion No. 16.

SFAS 141 eliminates the pooling-of-interests method of accounting for business combinations and modifies the application of the purchase accounting method. The elimination of the pooling-of-interests method is effective for transactions initiated after June 30, 2001. The remaining provisions of SFAS 141 will be effective for transactions accounted for using the purchase method that are completed after June 30, 2001. The adoption of SFAS No. 141 did not have an effect on our financial condition or the results of operations.

In July 2001, the FASB also issued Statement of Financial Accounting Standards No. 142, "Goodwill and Intangible Assets," ("SFAS 142"), which supersedes APB Opinion No. 17. SFAS 142 eliminates the current requirement to amortize goodwill and indefinite-lived intangible assets, addresses the amortization of intangible assets with a defined life and addresses the impairment testing and recognition for goodwill and intangible assets. SFAS 142 will apply to goodwill and intangible assets arising from transactions completed before and after the statement's effective date. SFAS 142 is effective for fiscal 2002. The adoption of SFAS No. 142 will not have an effect on our financial condition or the results of operations.

In August 2001, the FASB issued SFAS No. 144, Accounting for the Impairment of Disposal of Long-Lived Assets. SFAS No. 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 occurred. SFAS No. 144 is effective for financial statements issued for fiscal years beginning after December 15, 2001 and, generally, is to be applied prospectively. The Company is currently evaluating the potential impact of SFAS No. 144 on its results of operations and financial position.

In July 2002, the FASB issued SFAS No. 146, Accounting for Restructuring Costs. SFAS No. 146 applies to costs associated with an exit activity (including restructuring) or with a disposal of long-lived assets. Those activities can include eliminating or reducing product lines, terminating employees and contracts, and relocating plant facilities or personnel. Under SFAS No. 146, a company will record a liability for a cost associated with an exit or disposal activity when that liability is incurred and can be measured at fair value. SFAS No. 146 will require a company to disclose information

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

about its exit and disposal activities, the related costs, and changes in those costs in the notes to the interim and annual financial statements that include the period in which an exit activity is initiated and in any subsequent period until the activity is completed. SFAS No. 146 is effective prospectively for exit or disposal activities initiated after December 31, 2002 with earlier adoption encouraged. Under SFAS No. 146, a company may not restate its previously issued financial statements and the new Statement grandfathers the accounting for liabilities that a company had previously recorded under Emerging Issues task Force Issue 94-3. The Company is currently evaluating the potential impact of SFAS No. 144 on its results of operations and financial position.

Item 7. Financial Statements

THE FINANCIAL STATEMENTS ATTACHED HERETO (TOGETHER WITH THE NOTES THERETO AND THE NUMBERS DERIVED THEREFROM AND OTHER RELATED ITEMS) ON PAGES F-1 THROUGH F-44 IN RESPONSE TO THIS ITEM HAVE NOT BEEN REVIEWED OR AUDITED BY INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS DUE TO THE FACT THAT WE LACK THE

28

FINANCIAL RESOURCES TO PAY OUTSTANDING BILLS FROM OUR AUDITORS, WE HAVE NOT BEEN ABLE TO OBTAIN AN AUDIT OR REVIEW. HOWEVER, THE FINANCIAL STATEMENTS FOR THE YEAR ENDED JUNE 30, 2002 ARE DERIVED FROM FINANCIAL STATEMENTS THAT WERE PREVIOUSLY AUDITED.

Item 8. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

This Form 10-KSB (and our prior filing on Form 10-QSB for the quarters ended December 21, 2002 and March 31, 2003) have not been reviewed by BDO Seidman, LLP, our independent certified public accountants, as required by Item 310(a) of Regulation S-B. BDO Seidman, LLP has not performed the audit (or prior reviews) initially because they had not reviewed the impact on the Company's accounts and operations of the various items disclosed in our Form 8-K dated February 7, 2003. No review or audit has been performed since that date. We are not aware of any dispute with BDO Seidman, LLP as to any accounting matters. We owe approximately \$125,000 to BDO Seidman, LLP which must be paid or otherwise resolved in order to eliminated independence issues prior to any review or audit of our financial statements.

Item 8A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to management, including the chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure. Management necessarily applied its judgment in assessing the costs and benefits of such controls and procedures, which, by their nature, can provide only reasonable assurance regarding management's control objectives.

With the participation of management, our chief executive officer and interim chief financial officer evaluated the effectiveness of the design and operation of our disclosure controls and procedures at the conclusion of the period ended June 30, 2003. Based upon this evaluation, the chief executive

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

officer and chief financial officer concluded that our disclosure controls and procedures were effective in ensuring that material information required to be disclosed is included in the reports that it files with the Securities and Exchange Commission.

Changes in Internal Controls

There were no significant changes in our internal controls or, to the knowledge of our management, in other factors that could significantly affect internal controls subsequent to the date of most recent evaluation of our disclosure controls and procedures utilized to compile information included in this filing.

Within the twenty-four (24) months prior to the date of our most recent Financial Statements and through the date of this report, we have had no disagreements with our accountants on accounting or financial disclosure.

29

PART III

Item 9. Directors, Executive Officers, Promoters and Control Persons; Compliance With Section 16(a) of the Exchange Act

Our directors, executive officers and significant employees, along with their respective ages and positions are as follows:

Name	Age	Position
-----	---	-----
Director and Officers		
Mark A. Smith(1)	53	President, Interim Chief Financial Officer and Director
Jere Northrop	61	Senior Technology Director and Director
Jon Northrop(2)	58	Secretary and Director
Significant Employees		
George W. Bloom	48	Chief Operating Officer of Subsidiary
James W. Morris	52	Chief Technology Officer of Subsidiary
Dominic Bassani	56	General Manager of Subsidiary

(1) Mark A. Smith replaced David J. Mitchell as our President on March 25, 2003.

(2) Jon Northrop became Secretary and a Director on March 25, 2003.

Mark A. Smith has served as our President and a Director since March 2003. Since that time, he has also served as the sole director and President of our wholly-owned subsidiaries, including Bion Dairy Corporation. Since mid-February 2003 Mr. Smith has served as sole director and President of Bion's majority-owned subsidiary, Centerpoint Corporation. Previously, from May 21, 1999 through January 31, 2002, Mr. Smith served as a director of Bion. From July 23, 1999 when he became President of Bion until mid-2001 when he ceased to be Chairman, Mr. Smith served in senior positions with Bion on a

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

consulting basis. Additionally, Mr. Smith was the president of RSTS Corporation prior to its acquisition of Bion Technologies, Inc. in 1992. Mr. Smith received a Juris Doctor Degree from the University of Colorado School of Law, Boulder, Colorado (1980) and a BS from Amherst College, Amherst, Massachusetts (1971). Mr. Smith has engaged in the private practice of law in Colorado since 1980. In addition, Mr. Smith has been active in running private family companies, Stonehenge Capital Corporation (until 1994) and LoTayLingKyur, Inc. (1994-2002), and currently serves as the president of LoTayLingKyur Foundation. Until returning to Bion during March 2003, Mr. Smith had been in retirement with focus on charitable work and spiritual retreat.

Jere Northrop currently serves as our Senior Technology Officer and has been a Director since April 9, 1992. Dr. Northrop is a founder of Bion Technologies, Inc. and was its President from October 1989 to July 23, 1999. Prior to founding Bion he had ten years experience in the management of operations and process control at a large municipal advanced wastewater treatment plant in Amherst, New York (1979-1989). He also has twenty-five years of experimental research on both individual and complex systems of microorganisms. Dr. Northrop has a bachelor's degree in biology from Amherst

30

College, Amherst, Massachusetts (1964), a doctorate degree in biophysics from Syracuse University, Syracuse, New York, (1969), and has done post doctoral work at both the University of California at Davis, Davis, California and The Center for Theoretical Biology, State University of New York at Buffalo, Buffalo, New York.

Jon Northrop has served as our Secretary and a Director since March of 2003. Since September 2001 he has been self employed as a consultant with a practice focused on business buyer advocacy. Mr. Northrop is one of our founders and served as our Chief Executive Officer and a Director from our inception in September 1989 until August 2001. Before founding Bion Technologies, Inc., he served in a wide variety of managerial and executive positions. He was most recently the Executive Director of Davis, Graham & Stubbs, one of Denver's largest law firms, from 1981 to 1989. Prior to his law firm experience, Mr. Northrop worked at Samsonite Corporation's Luggage Division in Denver, Colorado, for over 12 years. His experience was in all aspects of manufacturing, systems design and implementation, and planning and finance, ending with three years as the Division's Vice President, Finance. Mr. Northrop has a bachelors degree in Physics from Amherst College, Amherst, Massachusetts (1965), an MBA in Finance from the University of Chicago, Chicago, Illinois (1969), and spent several years conducting post-graduate research in low energy particle physics at Case Institute of Technology, Cleveland, Ohio. Jon Northrop is the brother of Jere Northrop.

George W. Bloom has been with our Bion Technologies, Inc. subsidiary since December 2000 and has served as Chief Operating Officer since January 15, 2002. From 1986 through December 2000, Mr. Bloom was employed by Woodard & Curran, Inc., an environmental consulting firm, where he held the position of Chief Engineer of the Municipal Business Center upon his departure. Mr. Bloom is a registered professional engineer with over twenty years environmental engineering and consulting experience specializing in the planning, design, construction and operation of waste treatment facilities. Mr. Bloom is responsible at Bion for oversight of the planning, design and construction of waste treatment systems and solids processing facilities. He has his BS in Environmental Science from Cornell University.

James W. Morris has served as Chief Technology Officer of our Bion

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Technologies, Inc. subsidiary since February 2002. Prior to joining Bion, Dr. Morris provided the Company with technical assistance and technical advise for over two years as a consultant. Other consulting work included eight years acting as the senior technical consultant for a large environmental consulting firm and the formation of James W. Morris & Associates, Inc. that allowed him to serve clients ranging from small commercial establishments, to municipalities and corporations, as well as a sub consultant to several larger engineering firms. Dr. Morris is a licensed professional engineer in Maine and Vermont. He earned his BSCE and MSCE at Tennessee Technological University and a Ph.D. from Cornell University. He is a member of the American Society of Civil Engineers, Water Environment Federation, Institute of Food Technologists, American Society of Agricultural Engineers, Agricultural Engineering Society, Aquacultural Engineering Society and American Water Works Association.

Dominic Bassani has been an investor in and consultant to Bion since December 1999. He has served as General Manager of our subsidiary, Bion Dairy Corporation since August 2003. He is an independent investor and since 1990 has owned and operated Bright Capital Ltd., a management consulting company which provides management services to early stage technology companies. In 1998, he was retained to reorganize Internet Commerce Corp (ICCA) a leader in business-to-business transactions using the internet. From January 2000 to the

31

present he has been an investor and consultant to Bion Environmental Technologies, Inc. He is presently an investor in numerous private and public companies primarily in technology related businesses. Prior to 1990, Mr. Bassani was a consultant specializing in providing management reorganization services to small operating companies since 1978.

During the year ended June 30, 2003, David J. Mitchell, Salvatorre Zizza, Andy Gould, and Howard Chase all resigned as Directors. Directors are elected to serve until the next annual meeting of shareholders at each annual meeting of shareholders. Officers serve at the discretion of the Board of Directors, subject to rights, if any, under contracts of employment.

Family Relationships

There are currently no family relationships among our Directors and Executive Officers except that Jon Northrop and Jere Northrop are brothers.

Indemnification

The Articles of Incorporation and the Bylaws provide that we may indemnify our officers and directors for costs and expenses incurred in connection with the defense of actions, suits, or proceedings where the officer or director acted in good faith and in a manner he reasonably believed to be in our best interest and is a party to such actions by reason of his status as an officer or director.

Insofar as indemnification for liabilities arising under the Securities Act of 1933 (the "Act") may be permitted to directors, officers and controlling persons pursuant to the foregoing provisions or otherwise, we have been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable.

Compliance with Section 16(a) of the Exchange Act

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Section 16(a) of the Exchange Act requires our officers and directors, and stockholders owning more than ten percent of a registered class of our equity securities, to file reports of ownership and changes in ownership with the Securities and Exchange Commission. Executive officers, directors and such stockholders are required by SEC regulations to furnish us with copies of all forms they file pursuant to these requirements. Based solely on our review of the copies of such forms that we have received, or written representations from reporting persons, we believe that during the fiscal year ending June 30, 2003, all executive officers, directors and such stockholders complied with all applicable filing requirements on a timely basis, except that Jon Northrop, an officer and a director, filed a Form 3 late, David J. Mitchell, a former officer, director and 10% or greater shareholder, did not file Form 4's or a Form 5 reporting at least two transactions, and Atlantic Partners LLC, a former 10% or greater shareholder, did not file a Form 4 reporting one transaction.

32

Item 10. Executive Compensation

The following table sets forth the compensation paid to or accrued for each of our current and former executive officers during each of our last three fiscal years and the compensation paid to or accrued for each of our significant employees and consultants for the same period.

Summary Compensation Table

Name and Principal Position	Fiscal Year	Annual Compensation		Long Term Compensation Awards	
		Salary(1)	Bonus	Securities Underlying Options (#)	A Co
Current Executive Officers					
Mark A. Smith President and Interim Chief Financial Officer since March 25, 2003	2003	\$ 37,500	(2)	-	-
	2002	0		-	2500
	2001	\$600,000	(3)	-	-
Jere Northrop Senior Technology Officer	2003	\$ 56,000	(4)	-	-
	2002	\$123,750		-	2500
	2001	\$150,000		-	-
Jon Northrop Secretary since March 25, 2003 (and Executive Vice President from December 1999 to August 2001)	2003	0		-	-
	2002	\$ 0		-	-
	2001	\$150,000		-	-

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Past Executive Officers

David Mitchell	2003	\$546,935 (5)	-	-	
Chairman (A), Chief Executive Officer and President until March 25, 2003	2002	\$550,000 (6)	-	-	\$3
	2001	\$370,000 (7)	-	-	\$2
David Fuller	2003	\$ 88,121	-	-	
Principal Accounting Officer until February 7, 2003	2002	\$125,000	-	-	
	2001	\$ 8,333	-	4,254	
Lawrence R. Danziger	2003	\$101,792	-	20,000	
Chief Financial Officer until April 30, 2003					
Significant Employees and Consultants					
Dominic Bassani	2003	\$75,000 (10)	-	-	
Consultant					
George W. Bloom	2003	\$150,000	-	-	
Chief Operating Officer of Subsidiary	2002	\$150,000	-	12,000	
James W. Morris	2003	\$150,000	-	-	
Chief Technology Officer of Subsidiary	2002	\$ 62,500	-	12,000	

(A) David Mitchell initially replaced Mark Smith as Chairman of the Company on September 6, 2001, but Mark Smith then replaced David Mitchell as President and a Director on March 25, 2003 when Mr. Mitchell resigned.

(1) Includes compensation paid by Bion Technologies, Inc., our wholly owned subsidiary.

33

(2) Mr. Smith has agreed to provide consulting services to us and Dairy through March 31, 2004 in consideration of our accruing deferred consulting fees of \$150,000 per annum that will be payable to him in the future and the granting of 50,000 options (effective August 31, 2003). Through June 30, 2003 \$37,500 had been accrued. We have agreed that accrued deferred compensation to Mr. Smith (see Exhibit 99.1 to our Current Report on Form 8-K dated June 9, 2003 for details) for his services commencing during March 2003 will be converted into shares of our common stock at market price with a cap on the conversion price of \$3.00 per share; provided, however, that once, if ever, we inform Mr. Smith of our intent to pay for such services in cash, the prior outstanding balances will be immediately convertible into shares of our common stock at the election of Mr. Smith.

(3) Includes consulting fees received according to agreements between LoTayLingKyur, Inc., Mark A. Smith and Bion.

(4) Includes \$15,000 of deferred, accrued compensation convertible into Bion common stock on the same terms as the deferred compensation to Mark A. Smith described above.

(5) Compensation of \$546,935 issued as convertible notes to the Trust under Deferred Compensation Plan for D2Co, LLC.

(6) Compensation of \$550,000 issued as 58,247 shares of common stock of the

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Company to the Trust Under Deferred Compensation Plan for D2CO, LLC.

(7) Includes compensation of \$120,000 that was added to the balance of the 2000 D2 Convertible Bridge Note (this balance plus accrued interest was converted into 18,200 shares of common stock); compensation of \$125,000 was added to the balance of the 2000 Convertible Bridge Note for the Trust Under Deferred Compensation Plan for D2CO, LLC (this balance plus accrued interest was converted into 18,241 shares of common stock); and compensation of \$125,000 was added to the balance of the 2001 Convertible Bridge Note for the Trust Under Deferred Compensation Plan for D2CO, LLC (this balance plus accrued interest was converted into 17,824 shares of common stock).

(8) Represents the value of 1,037,345 adjusted warrants issued to Atlantic Partners LLC in January 2002.

(9) Represents the difference between the value of warrants to purchase 650,000 shares of common stock purchased by Southview, Inc. (later assigned to Atlantic Partners LLC), a company owned by David J. Mitchell, and the amount paid.

(10) Mr. Bassani and an entity owned by him have agreed to provide consulting services to us and Dairy through March 31, 2005 in consideration of our accruing deferred consulting fees of \$300,000 per annum that will be payable to him in the future and the granting of 200,000 options (effective August 31, 2003). We have agreed that accrued deferred compensation to Mr. Bassani (see Exhibit 10.1 to our Current Report on Form 8-K dated June 9, 2003 and the exhibits thereto for details) for his services commencing during March 2003 will be converted into shares of our common stock at market price with a cap on the conversion price of \$3.00 per share; provided, however, that once, if ever, we inform Mr. Bassani of our intent to pay for such services in cash, the prior outstanding balances will be immediately convertible into shares of our common stock at the election of Mr. Bassani. In addition, certain adjustments were made to outstanding warrants owned by family members (and trusts for family members) of Mr. Bassani pursuant to prior existing agreements and understandings. The agreements with Mr. Bassani are "interim"

34

agreements which were assembled under time and financial constraints. We are presently in negotiations with Mr. Bassani regarding more formal and comprehensive agreements (anticipated to be executed during the current fiscal year) which will include extensions to the term of the agreement, specific incentives to Mr. Bassani when and if we reach certain benchmarks/goals and other matters.

Option Grants in Fiscal Year 2003

The following table sets forth the options that were granted during the fiscal year ended June 30, 2003 to Executive Officers and Significant Employees and Consultants:

Name	Number of Securities Underlying Options Granted	Percent of Total Options Granted to Employees in Fiscal 2003	Exercise Price Per Share	Expiration Date
-----	-----	-----	-----	-----

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Mark A. Smith	-	-	-	-
David Mitchell	-	-	-	-
Jere Northrop	-	-	-	-
Jon Northrop	-	-	-	-
Larry Danziger	20,000	66.6%	\$7.50	7/29/07
David Fuller	-	-	-	-
Dominic Bassani	-	-	-	-
George W. Bloom	-	-	-	-
James W. Morris	-	-	-	-

Aggregated Option Exercises and Option Value Table as of June 30, 2003

The following table sets forth the options exercises during the fiscal year ended June 30, 2003 and the value of exercisable and unexercisable options outstanding as of June 30, 2003.

Name	Shares Acquired on Exercise	Value Realized	Number of Securities Underlying Unexercised Options at June 30, 2003 Exercisable/Unexercisable	Value of Unexercised Money Options at F Exercisable/Unexercisable
Mark A. Smith	-	-	2,500/0	\$0/\$0
David Mitchell	-	-	0/0	\$0/\$0
Jere Northrop	-	-	2,500/0	\$0/\$0
Jon Northrop	-	-	9,000/0	\$0/\$0
Larry Danziger	-	-	20,000/0	\$0/\$0
David Fuller	-	-	2,836/1,418	\$0/\$0
Dominic Bassani	-	-	0/0	\$0/\$0
George W. Bloom	-	-	0/0	\$0/\$0
James W. Morris	-	-	0/0	\$0/\$0

35

Employment Agreements

As of February 15, 2003, due to a financial crisis, all of the employment and consulting agreements between Bion and each of its employees/consultants were terminated. Each employee consultant who continued to work for Bion after that date is or has been working without a contract except as set forth below. All agreements with David Mitchell and D2CO, LLC were terminated upon his resignation on March 25, 2003.

Mark A. Smith, our President, has agreed to serve on a consulting basis as President and as a director of the Company until March 31, 2004 for deferred compensation of \$150,000 which shall be deferred for three years from the end of the calendar year in which earned and then paid out in equal annual installments during the following three calendar years (unless each party agrees otherwise) in common stock at the lesser of the market price or \$3.00

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

per share. However, the Board of Directors has agreed to review or reopen this provision upon the occurrence of certain events. Effective August 31, 2003 Mr. Smith also received an option grant (effective August 31, 2003) of 50,000 vested options to purchase our common stock at \$3.00 per share until August 31, 2008. See our Current Reports on Form 8-K dated June 9, 2003 and August 25, 2003.

Jere Northrop, our Senior Technology Officer, agreed to defer \$2,500 of his salary effective January 1, 2003. The deferred portion of his salary will be on the same terms as Mark Smith's compensation. Effective August 31, 2003 Mr. Northrop also received 40,000 options to purchase shares of our common stock at \$3.00 per share until July 31, 2008, of which 20,000 options were immediately vested and the remainder vest in 2,500 option increments each three months.

Dominic Bassani, General Manager of Dairy, has agreed to serve as a consultant to Bion and Dairy until March 31, 2005 for deferred compensation of \$300,000 per year which will have the same terms as the deferred compensation of Mark Smith. Effective August 31, 2003, Mr. Bassani also received an option to purchase 200,000 shares of our common stock at \$3.00 per share until August 31, 2008. See Exhibit 10.1 to our Current Reports on Form 8-K dated June 9, 2003 and August 25, 2003. The agreements with Mr. Bassani are "interim" agreements which were assembled under time and financial constraints. We are presently in negotiations with Mr. Bassani regarding more formal and comprehensive agreements (anticipated to be executed during the current fiscal year) which will include extensions to the term of the agreement, specific incentives to Mr. Bassani when and if we reach certain benchmarks/goals and other matters.

Other Agreements

In December 1999, the Company entered into a three year agreement for management and consulting services with D2CO., LLC ("D2") (pursuant to which D2 provided the services of Mr. Dominic Bassani to the Company). The agreement requires total annual consideration of \$240,000 payable in common stock of Bion or cash, at the option of the Company. On August 10, 2000 we amended the D2 Management Agreement by extending the term of the agreement by one year. On December 1, 2000, the Company made further amendments to the D2 Management Agreement by extending the term of the agreement by 18 months, increasing the annual base consideration from \$240,000 as follows: calendar year 2001 - \$500,000; calendar year 2002 - \$600,000; and calendar year 2003 -

36

\$750,000. Effective January 1, 2001, the Company agreed to make the payments due under the consulting agreement under a deferred compensation plan to the Trust Under Deferred Compensation Plan for D2CO, LLC for the benefit of D2. All agreements with D2 and/or David Mitchell terminated March 25, 2003 upon Mr. Mitchell's resignation. See Item 12 - Certain Relationships and Related Transactions.

On December 1, 1997, we entered into an employment agreement with Jere Northrop. During the year ending June 30, 2002, this agreement was amended from an end date of December 31, 2002 and an annual base salary of \$150,000 to an end date of December 31, 2003 and an annual base salary of \$60,000. For the 2003 calendar year, we are also accruing the sum of \$2500 per month of deferred compensation to Jere Northrop.

Director Compensation

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Members of the Board of Directors do not currently receive any cash compensation for their services as Directors, but are entitled to be reimbursed for their reasonable expenses in attending meetings of the Board.

Howard Chase joined our Board of Directors on January 21, 2002 and resigned in February 2003. In addition to his duties as a director, Mr. Chase, through Hollandbrook Group LLC (Hollandbrook), Inc. provided us consulting services. Bion paid Hollandbrook \$1,000 per month and issue to Hollandbrook \$9,000 in Bion common stock at a price per share of \$15.00. 900 shares were issued to Hollandbrook during 2002, all of which were returned during March 2003.

Stock Option Plans

The 1994 Incentive Plan (the "1994 Plan") provides for incentive stock options to be granted to employees. Options to purchase up to 238,055 shares of the Company's common stock (or 20% of the Company's outstanding stock which ever is greater) may be granted under the Plan. Terms of exercise and expiration of options granted under the 1994 Plan may be established at the discretion of an administrative committee appointed to administer the Plan, or by the Board of Directors if no committee is appointed, but no option may be exercisable for more than ten years. As of June 30, 2003, options to purchase 18,500 shares of the Company's common stock are outstanding under the 1994 Plan.

The 1996 Non-employee Director Stock Plan ("the Director Plan") provides for each non-employee director to receive annually, an option to purchase 500 shares of the Company's common stock at an exercise price of 50% of the average market price of the Company's common stock for the preceding twelve months. The options were ultimately issued with an exercise price equal to the market value of the Company's common stock at its issuance date, and therefore no compensation had been recorded. No option may be exercisable for more than five years. Options to purchase up to 10,000 shares of the Company's common stock may be granted under the Director Plan. As of June 30, 2003, options to purchase 18,500 shares of the Company's common stock are outstanding under the Director Plan.

The 2000 Incentive Plan (the "2000 Plan") provides for incentive stock options to be granted to selected employees and directors of the Company, and selected non-employee advisors to the Company. Options to purchase up to 100,000 shares of the Company's common stock may be granted under the 2000

37

Plan. Terms of exercise and expiration of options granted under the 2000 Plan may be established at the discretion of an administrative committee appointed to administer the 2000 Plan, but no option may be exercisable for more than five years. As of June 30, 2003, options to purchase 3,891 shares of the Company's common stock are outstanding under the 2000 Plan.

The 2001 Incentive Plan (the "2001 Plan") provides for incentive stock options to be granted to selected employees and directors of the Company, and selected non-employee advisors to the Company. Options to purchase up to 150,000 shares of the Company's common stock may be granted under the 2001 Plan. Terms of exercise and expiration of options granted under the 2001 Plan may be established at the discretion of an administrative committee appointed to administer the 2001 Plan, but no option may be exercisable for more than ten years. As of June 30, 2003, options to purchase 10,612 shares of the Company's common stock are outstanding under the 2001 Plan.

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

The 2002 Incentive Plan (the "2002 Plan") provides for incentive stock options to be granted to selected employees and directors of the Company, and selected non-employee advisors to the Company. Options to purchase up to 300,000 shares of the Company's common stock may be granted under the 2002 Plan. Terms of exercise and expiration of options granted under the 2002 Plan may be established at the discretion of an administrative committee appointed to administer the 2002 Plan, but no option may be exercisable for more than ten years. As of June 30, 2003, there were no options outstanding under the 2002 Plan. However, as of the date of this report, 110,000 options are outstanding under the 2002 Plan.

The 2003 Incentive Plan (the "2003 Plan") provides for incentive stock options to be granted to selected employees and directors of the Company, and selected non-employee advisors to the Company. Options to purchase up to 750,000 shares of the Company's common stock may be granted under the 2003 Plan. Terms of exercise and expiration of options granted under the 2003 Plan may be established at the discretion of an administrative committee appointed to administer the 2003 Plan, but no option may be exercisable for more than ten years. As of June 30, 2003, there were no options outstanding under the 2002 Plan. However, as of September 30, 2003, 431,333 options were outstanding under the 2003 Plan.

Item 11. Security Ownership of Certain Beneficial Owners and Management

The following table sets forth certain information regarding the beneficial ownership of our common stock as of September 30, 2003 by:

- * each person that is known by us to beneficially own more than 5% of our common stock;
- * each of our directors;
- * each of our executive officers named in the summary compensation table in Item 10 above; and
- * all our directors and executive officers as a group.

Under the rules of the Securities and Exchange Commission, beneficial ownership includes voting or investment power with respect to securities and includes the shares issuable under stock options that are exercisable within sixty (60) days of September 30, 2003. Those shares issuable under stock options are deemed outstanding for computing the percentage of each person holding options but are not deemed outstanding for computing the percentage of any other person. The percentage of beneficial ownership schedule is based upon 5,298,221 shares outstanding as of September 30, 2003. The address for those individuals for which an address is not otherwise provided is c/o Bion

38

Environmental Technologies, 18 East 50th Street, 10th Floor, New York, NY 10022. To our knowledge, except as indicated in the footnotes to this table and pursuant to applicable community property laws, the persons named in the table have sole voting power and investment power with respect to all shares of common stock listed as owned by them.

Name and Address	Number	Shares of Common Stock Beneficially Owned	
		Outstanding	Entitled to Vote (1)

		Percent of Class	

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Principal Stockholders:			
Centerpoint Corporation (1) 18 East 50th Street New York, NY 10022	1,900,000	35.7%	-
Dominic Bassani 18 East 50th Street New York, NY 10022	306,086 (2)	5.8%	8.2%
The Danielle Christine Bassani Trust Anthony Orphonos and Donald Codignatto, Trustees 4 Keenan Drive Garden City, NY 11530	466,000 (3)	8.1%	12.1%
The Mitchell Children's Trust Richard Kirshenbaum and Seymour Zises, trustees c/o Seymour Zises Family Management Corporation 477 Madison Avenue New York, NY 10022	387,343 (4)	6.8%	10.2%
Executive Officers and Directors:			
Mark A. Smith P.O. Box 566 Crestone, Colorado 81131	371,194 (5)	6.9%	10.8%
Jere Northrop 1961 Tonawanda Creek Road Amherst, NY 14228	152,820 (6)	2.9%	4.4%
Jon Northrop 1922 W. Sanibel Court Littleton, Colorado 80120	149,162 (7)	2.8%	4.4%
All executive officers and directors as group (3 persons)	673,176	12.7%	19.2%

* Less than 1%

(1) Centerpoint Corporation is currently majority-owned by the Company. Under Colorado law, the common shares held by Centerpoint Corporation are not entitled to vote. These shares of common stock may be distributed to the

39

shareholders of Centerpoint Corporation at a future date. The shares, if distributed, distributed to Bion will be cancelled immediately following distribution.

(2) Includes 45,719 shares held directly by Dominic Bassani; 4,500 shares held by his wife; 3,000 shares held by his adult stepson who lives with him

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

(of which he disclaims beneficial ownership); 26,367 shares which represents 50% of the shares held by D2CO, of which he is 50% owner; 1,500 bridge warrants which represents 50% of the bridge warrants held by D2CO; 25,000 SV-DB warrants held by his wife; and 200,000 options.

(3) Represents SV-DB warrants held by the trust.

(4) Represents SV-DM warrants held by the trust.

(5) Includes 52,500 options held directly by Mark Smith, 3,416 shares held directly by Mark Smith, 42,518 shares of common stock held jointly with his wife, 5,240 shares of common stock held by his wife, 59,684 shares of common stock held by Mark A. Smith Roth IRA 50,905 shares of common stock held by Kelly Smith Roth IRA and 156,931 shares of common stock held by LoTayLingKyur Foundation which is controlled by Mark Smith. Does not include any shares which Mr. Smith may receive pursuant to deferred compensation arrangements. Does not include convertible debt issued by Bion Dairy Corporation that under certain circumstances may become convertible into Bion's common stock. Mr. Smith disclaims beneficial ownership on 80,588 shares of common stock held by Dublin Holding, Ltd. for which Mr. Smith is the authorized agent.

(6) Includes 67,401 shares held by Jere Northrop's wife; 20,121 shares held by a family trust; and options to purchase 42,500 shares held by Mr. Northrop. Does not include shares owned by an adult child of Jere Northrop, 12,608 shares owned by the Jere and Lynn Northrop Family Foundation, and 7,906 shares owned by the Jere Northrop Family trust, for each of which Mr. Northrop disclaims beneficial ownership.

(7) Includes 109,698 shares held directly; 20,464 shares owned by Jon Northrop's wife and options to purchase 19,000 shares held by Mr. Northrop. Does not include shares owned by the adult children of Jon Northrop for each of which he disclaims beneficial ownership.

Item 12. Certain Relationships and Related Transactions

TRANSACTIONS SINCE THE FILING OF OUR ANNUAL REPORT ON FORM 10-KSB FOR THE YEAR ENDED JUNE 30, 2003:

During February 2003 Bion entered into an agreement with Centerpoint (which agreement was amended April 23, 2003) which agreement was ratified by the shareholders of Centerpoint on August 25, 2003. This agreement, upon ratification by Centerpoint's shareholders and completion of a related agreement (executed May 29, 2003) with OAM, S.p.A., the former parent of Centerpoint, on August 27, 2003, amended certain contractual provisions which had prevented the raising of funds by Bion thereby creating the financial/management crisis which has afflicted Bion over the past year. For details, see "Item 1. Description of Business - Acquisition of Centerpoint/Transactions with Centerpoint and Recent Developments - Centerpoint Shareholders' Meeting/Removal of Contractual Problems" above and our Current Reports on Form 8-K dated August 25, 2003, June 9, 2003 and April 12, 2003 and the exhibits thereto.

During August 2003 Bion Dairy Corporation ("Dairy"), our wholly-owned subsidiary, completed the initial closing of secured convertible notes. As of September 30, 2003, the largest purchaser (\$600,000 in exchange for \$600,000 of advances (see below) made to Bion during 2003) was an entity owned by Dominic Bassani, General Manager of Dairy and a consultant to Bion and Dairy.

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

In addition, Mark A. Smith, our President and a director, purchased \$65,000 of such notes and an entity affiliated with David Mitchell, our former C.E.O., Chairman and a director, purchased (in exchange for \$65,000 of prior advances (see below) to Bion during 2003) \$65,000 of such notes. For details see "Item 1, Description of Business - Recent Developments, Bion Dairy Corporation Financing" above and our Current Report on Form 8-K dated August 25, 2003 and the exhibits thereto.

From January 2003 through August 2003, Dominic Bassani made advances to Bion (primarily through Bright Capital, Ltd. and D2, LLC) which totaled in excess of \$600,000. From late March 2003 (when most management personnel resigned and the contract with D2, LLC under which he had been providing consulting services to Bion terminated) through present, Mr Bassani has provided ongoing consulting services to Bion. Mr. Bassani will provide services to Bion and Dairy through March 31, 2005 for the sum of \$300,000 per year in deferred compensation (to be converted into Bion common stock at a price no greater than \$3.00 per share and the grant of 200,000 options to purchase Bion common stock at a price of \$3.00 per share until August 31, 2008. Additionally, pursuant to prior existing arrangements, adjustments were made to outstanding Class SV (650,000 were increased to 800,000 ; exercise price reduced to \$3.00; term extended to July 31, 2013 now owned by family members of Mr. Bassani (and/or trust for such family members). Various agreements related to such advances, services and adjustments have been executed by Bion. See our Current Reports on Form 8-K dated March 25, 2003, April 12, 2003, June 9, 2003 and August 25, 2003 and the exhibits thereto for further details. The agreements with Mr. Bassani are "interim" agreements which were assembled under time and financial constraints. We are presently in negotiations with Mr. Bassani regarding more formal and comprehensive agreements (anticipated to be executed during the current fiscal year) which will include extensions to the term of the agreement, specific incentives to Mr. Bassani when and if we reach certain benchmarks/goals and other matters.

Mark A. Smith, our President and a director, has agreed to serve in such positions on a consulting basis through March 31, 2003 in consideration of \$150,000 in deferred compensation (to be converted into Bion common stock at a price no greater than \$3.00 per share) and the grant (effective August 31, 2003) of 50,000 options to purchase Bion common stock at \$3.00 per share until August 31, 2003. See our Current Report on Form 8-K dated June 9, 2003 and the exhibits thereto for further details.

The management agreement between us and D2, LLC/David Mitchell was terminated effective as of March 25, 2003. The voting and shareholder agreements to which D2 was a party were also terminated as of that same date. The Trust Under Deferred Compensation Plan for D2CO, LLC (the "Trust") will remain in existence until mutually agreed otherwise and, unless otherwise agreed in writing, the "payable" balance of \$487,500 principal (plus accrued interest) owed by us to the Trust will be converted into shares of our Common Stock upon the earlier to occur of (a) a \$5 million or greater equity financing(s) by us, in which case the amount payable will be converted into shares of our Common Stock at the equity price of the financing (or, in the event that the \$5 million in equity financing is obtained in a series of more than one financing, the price of the equity financing which pushed the aggregate total of the financings above \$5 million), or (b) March 31, 2005, at the then current market price of our Common Stock.

41

Until late March 2003 consulting fees accrued for the services of D2, LLC (which provided the services of David Mitchell, our former Chairman, and Mr. Bassani). For details, see our Current Report on Form 8-K dated March 25, 2003 and the exhibits thereto. All 91,439 shares of Bion common stock held in

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

the Trust were distributed pursuant to the instructions of D2, LLC (45,720 to David Mitchell and 45,719 to Dominic Bassani) effective May 8, 2003. Effective August 31, 2003, pursuant to prior agreements and in consideration of services provided by David Mitchell to Bion, 387,543 outstanding Class SV warrants (now owned by family members of Mr. Mitchell or trusts for such persons) were adjusted to lower the exercise price to \$5.00 per share and extend the term until August 31, 2008. Below, find some details concerning compensation paid to the Trust (in shares and/or notes. The shares have been distributed as described above. The notes will be converted as described above.

As to other transactions related to David Mitchell/D2, LLC during the period leading up to the agreements in the above paragraph:

- (a) The Company issued to D2: 15,322 and 23,421 shares of common stock for management fees during the three and six months ended December 31, 2001, respectively. The management fees were valued at \$125,000 and \$250,000 during the three and six months ended December 31, 2001, respectively. These shares are among the shares distributed from the Trust as described above.
- (b) The Company and D2 orally agreed during January 2002, that in the event the average price per common share is below \$7.50 for any quarter in which consulting fees are to be paid to the Trust, Bion will issue a convertible note in lieu of the stock payment. The agreement was to remain in place during the "Adjustment Period" noted in the Centerpoint and OAM Agreements which has been eliminated recently (see our Current Report on Form 8-K dated August 25, 2003). The convertible note is recorded as deferred compensation upon consolidation of the Trust.
- (c) On July 1, 2002, D2 returned to the Company 2,874 shares of the Company's common stock that were issued as part of the consulting fee to D2 paid to the Trust. The shares were subsequently cancelled.
- (d) On September 30, 2002, the Company issued a convertible note for the D2 management fee to be paid to the Trust for the three months ended September 30, 2002. The convertible note was issued for the amount of the management fee of \$150,000 and pays interest at 6% per annum, payable in cash or in shares of the Company's common stock. The convertible note is convertible into shares of common stock in whole or in part at the time of the Company's next equity financing, at the price of the next equity financing. The convertible note is recorded as deferred compensation upon consolidation of the Trust.
- (e) On December 31, 2002, the Company issued a convertible note for the D2 management fee to be paid to the Trust for the three months ended December 31, 2002. The convertible note was issued for the amount of the management fee of \$150,000 and pays interest at 6% per annum, payable in cash or in shares of the Company's common stock. The convertible note is convertible into shares of common stock in whole or in part at the time of the Company's next equity financing, at the price of the next equity financing. The

convertible note is recorded as deferred compensation upon consolidation of the Trust.

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

On June 30, 2001, Bion and D2CO, LLC ("D2") agreed that the payments owed to D2 under an existing management agreement be paid to the Trust. On July 31, 2001, Bion and Sam Spitz (the "Trustee") entered into the Trust. Under the Trust agreement, the Company contributed assets to the Trust at such times as specified in the management agreement with D2. Such assets are subject to claims of the Company's creditors in the event of the Company's insolvency, have no preferred claim on, or any beneficial ownership interest in, any assets of the Trust unless and until such assets are distributed. Any rights created under the management agreement with D2 and the Trust shall be unsecured contractual rights of D2 against the Company. Payments of all amounts in the Trust are to be made to D2 on January 2, 2011, as stated in the Trust agreement, unless agreed otherwise.

The Company accounts for the Trust under the provisions of Emerging Issues Task Force ("EITF") 97-14 "Accounting for Deferred Compensation Arrangement Where Amounts are Earned and Held in a Rabbi Trust and Invested" which requires the Company to consolidate into its financial statements the net assets of the Trust. The value of the Company's common stock held by the Trust is classified in shareholders' equity and is accounted for in a manner similar to treasury stock. The deferred compensation obligation has been classified as a liability and is adjusted, with the corresponding charge or credit to compensation expense, to reflect changes in fair value of the common stock held by the Trust. As of June 30, 2003, \$487,500 is owed to the Trust (not including accrued interest of \$9,550). At March 31, 2003 the Trust held 91,439 shares of common stock of the Company (distributed effective May 8, 2003, net of return and cancellation of 2,874 shares as described above) having a fair value of \$59,435, for a total of \$549,185 in deferred compensation (including \$2250 of accrued interest). At June 30, 2003, the Trust is owed \$497,050 (including interest), all of which will convert into Bion common stock as set forth above.

Jon Northrop, a director of Bion, has been granted (effective August 31, 2003) an option to purchase 10,000 shares of Bion's common stock at a price of \$3.00 until August 31, 2008.

Jere Northrop, director and Technology Director of Bion, has been granted (effective August 31, 2003) an option to purchase 40,000 shares of Bion's common stock at a price of \$3.00 per share until August 31, 2008. In addition, Jere Northrop is receiving \$2500 per month of deferred compensation (to be converted into Bion common stock at a price no greater than \$3.00 per share) to compensate for additional duties he has taken on due to Bion's reduced technical personnel resulting from our ongoing financial crisis.

Our executive offices are located at 18 E. 50th Street, 10th Floor, New York, New York 10022 under a lease which, as renegotiated during fiscal 2003, expires on December 31, 2003. Bion currently pays no rent and occupies a small portion of the leased space at no monthly cost pursuant to agreements between and among the landlord (an unaffiliated party), Bion, and entities connected with David Mitchell (our former C.E.O. and Director) and Salvatore Zizza (our former Secretary and Director). We amended our New York City office lease effective March 1, 2003. Under this amendment the expiration date was changed to December 31, 2003, from the previous expiration date of December 31, 2010. The amendment calls for the drawdown of the letter of credit provided to the landlord for the full amount of \$120,561 to be used to pay arrearages and future rent. In addition, two of our new subtenants, Mitchell &

Co. and Zizza & Co., which are controlled by David Mitchell and Salvatore Zizza, respectively, are former officers and directors of Bion, and have

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

personally guaranteed the lease with the landlord. It is possible that we will not incur additional cash outflows in connection with this lease as a result of the drawdown of the letter of credit, the subrental income and the personal guarantees. See our Current Report dated March 25, 2003 and the exhibits thereto. However, Bion may have certain liabilities at the end of the lease term which cannot be fully determined at this time but which we estimate will be less than \$20,000. The lease/sublease agreements cover approximately 5,700 square feet.

We have no additional offices at this time but may have liability in connection with prior office leases related to space we have vacated including without limitation: a) space at 8899 Main Street, Williamsville, New York 14221 under a lease that expires on November 30, 2004 and provides for annual base rents of approximately \$18,600 and covers approximately 1,800 square feet; and b) space at 138 Uzzle Industrial Drive, Clayton, North Carolina 27520 under a lease that expired June 30, 2003 and provides for annual base rents of approximately \$15,000 and covers approximately 4 acres and an office building of approximately 2,350 square feet. Except as described above, all leases and rental agreements are with non-affiliated parties.

We do not own any of these facilities, nor are we obligated under any mortgages for the properties. We believe that, under our current operations, the facilities are adequate, but, if our second generation NMS testing is successful and we obtain additional financing, we will need additional office and other space.

TRANSACTIONS DISCLOSED IN OUR FORM 10-KSB FOR THE YEAR ENDED JUNE 30, 2002:

----- Transactions with David Mitchell and Related Entities -----

Management Agreement with D2 -----

In December 1999, we entered into a three year Management Agreement with D2CO., LLC ("D2") of which David Mitchell, the former Chairman, CEO and President of the Company, is sole member, pursuant to which D2 agreed to provide us specific management and consulting services (including the services of Dominic Bassani). The agreement called for compensation to D2 for such services in the amounts of:

- * \$240,000 per year payable in our common stock or cash; and
- * 250,000 warrants exercisable at \$25.00 expiring on December 31, 2004.

On August 10, 2000, we amended the Management Agreement with D2 under which we:

- * extended the agreement for D2's services for an additional year; and
- * issued 150,000 additional warrants (100,000 exercisable at \$35.00 per share and 50,000 exercisable at \$60.00 per share, both exercisable from January 1, 2002 until August 10, 2005).

In December 2000, the Company made additional amendments to the D2 Management Agreement by:

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

- * extending the term of the agreement by 18 months;
- * canceling all of the warrants issued under the Management Agreement as amended; and
- * increasing the annual base consideration to \$500,000 in calendar year 2001, to \$600,000 in calendar year 2002 and \$750,000; and calendar year 2003.

Effective January 1, 2001, the Company orally agreed to the following:

- * to make the payments due under the Management Agreement to the Trust Under Deferred Compensation Plan for D2CO, LLC (the "Trust") for the benefit of D2.

The payments to the Trust for the six months ended June 30, 2001 totaling \$250,000 were made in the form of 2000 and 2001 convertible bridge notes (the "CV Notes").

Effective July 1, 2001, compensation to D2 is paid to the Trust in the form of common stock on a quarterly basis.

We receive consulting services from Bright Capital, which provides the services of consultant Dominic Bassani. Bright Capital is compensated directly by D2 from the fees paid by Bion to D2.

On January 15, 2002, as a result of the transaction with Centerpoint:

- * all the D2 and the Trust CV Notes were converted into 37,022 shares and 36,064 shares of the Company's common stock, respectively.

Warrant Purchase Agreement

In December 1999, we entered into a Warrant Purchase Agreement pursuant to which:

- * D2 purchased 250,000 warrants, exercisable at \$17.50 expiring on December 31, 2004, for \$1,000,000 (\$500,000 in cash and \$500,000 in a non-recourse promissory note to us that was secured by the subject warrants).

In December 2000, we entered into an agreement with D2 pursuant to which:

- * We canceled the warrants issued under the Warrant Purchase Agreement; and
- * We agreed to repay the purchase price of the warrants issued under the Warrant Purchase Agreement with \$500,000 cash and cancellation of the existing \$500,000 non-recourse promissory note receivable and accrued interest

Southview

During the period January 8 through March 31, 2001, Southview, Inc. ("Southview"), a corporation wholly owned by Mr. Mitchell:

- * loaned the Company \$871,000 earning 8% interest per annum of which

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

\$371,000 was repaid in April 2001.

On February 16, 2001, under an agreement effective January 8, 2001, Southview purchased:

- * warrants to purchase 650,000 shares of the Company's common stock for the sum of \$500,000, exercisable until February 16, 2006.

Half of these warrants were exercisable at \$10.00 and half of these warrants were exercisable at varying prices between \$10.00 and \$20.00 per share, depending on the market price of the Company's common stock. The warrants were subsequently assigned to Atlantic Partners, LLC ("Atlantic"), an affiliate of David Mitchell.

On September 6, 2001, the Board of Directors affirmed an agreement dated August 1, 2001 entered into between the Company, D2, Southview and Atlantic in which, among other things, the Company agreed to amend the Southview warrants so that:

- * upon the conversion of the Company's outstanding CV Notes into the Company's common stock, the outstanding Southview warrants will be adjusted ("Adjusted Warrants") so that the Adjusted Warrants equal 20% of the "fully-diluted" outstanding shares; and

As partial consideration for Bion agreeing to the adjustment to the Southview warrants, Southview agreed to:

- * extend the term of the outstanding promissory note due July 31, 2001, with a balance of \$521,040 including accrued interest, so that such promissory note could be repaid from the proceeds of a new financing.

On January 15, 2002, as a result of the transaction with Centerpoint:

- * the Southview warrants were adjusted to equal 20% or, 1,037,343 shares of the "fully-diluted" outstanding shares of the Company and the exercise was adjusted to \$7.50; and
- * In addition, the Company repaid the Southview promissory note, which had a value of \$718,485 including interest and additional advances.

In the event of a subsequent equity financing below \$7.50, additional warrants would be issued on the Southview warrants currently outstanding to increase these warrants to reflect 20% of the fully diluted shares outstanding as of January 15, 2002, after giving effect to all subsequent financing adjustments. These warrants would also have their exercise price lowered to the price per share of the subsequent equity financing. See "Item 1. Private Placement."

On April 13, 2000, we completed a private placement offering in which D2 participated under the same terms as unaffiliated third parties. D2 purchased four units evidencing \$100,000 convertible notes and 3,000 warrants to purchase common stock exercisable at \$23.75 per share until December 31, 2004.

On January 15, 2002, as a result of the transaction with Centerpoint, D2's convertible note was converted into 15,712 shares of the Company's common stock under the amended terms of the notes.

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Shareholder Agreement/Stock Voting Agreement

On December 23, 1999, D2, Mark A. Smith, Jere Northrop, LoTayLingKyur, Inc., and Dublin Holding, Ltd. entered into a Shareholders' Agreement, as amended, which, among other things, restricts the transfer, sale, conveyance, exchange, pledge, or otherwise disposition of any shares of the Company except in connection with a sale of all or substantially all of the outstanding stock of the Company or a merger of the Company. Under the agreement, certain transfers are permitted under certain conditions.

On August 1, 2001, the Company, D2 and Dublin Holdings, Ltd., LoTayLingKyur, Inc., Mark Smith, Kelly Smith, LoTayLingKyur Foundation, Kelly Smith Rollover IRA, and Mark Smith Rollover IRA (collectively "the Smith shares"), entered into a voting agreement where among other things, the Smith shares shall not be transferred in a private non-market transfer which reduces the number of shares for which D2 is Proxy to less than 2/3 of the initial shares for which D2 is Proxy unless the transferee is willing to appoint D2 as Proxy for the transferred portion of the shares .

Transactions with Mark A. Smith and Related Entities

During the period beginning July 1, 2000, we entered into the following transactions with Mark A. Smith (our former Chairman and a former Director) and/or entities affiliated with him: LoTayLingKyur, Inc. ("LTLK"), LTLK Defined Benefit Plan, LoTayLingKyur Foundation, and Dublin Holding Ltd. (collectively "First Parties"), including the following:

Commencing August 3, 2000, and at various other effective dates through the month of August 2000, the First Parties (and related holders of our Class X Warrants and Class Z Warrants):

- * exchanged, in aggregate, 16,520 Class X Warrants and 542,544 Class Z Warrants for 86,340 restricted shares of our common stock. This exchange occurred pursuant to an agreement we had with the warrant holders dated December 20, 1999. Mr. Smith, (and affiliates and extended family members of Mr. Smith) participated in this warrant exchange agreement.

On August 1, 2001 Mark Smith, Dublin Holding, Ltd., LoTayLingKyur, Inc., LoTayLingKyur Foundation, Mark Smith Rollover IRA, Kelly Smith and Kelly Smith Rollover IRS which all owned shares of the Company's common stock (the "Smith Shares"), entered into a voting agreement that gives D2:

- * the power to vote all of the Smith Shares as to most matters. Mr. Smith will still have the right to vote the Smith Shares with respect to a sale of substantially all of our assets or a merger. The voting agreement is purely contractual and is not a formal voting trust.

In addition, Mark Smith, Dublin Holding, Ltd., LoTayLingKyur, Inc., LoTayLingKyur Foundation, Mark Smith Rollover IRA, Kelly Smith and Kelly Smith Rollover IRS entered into a separate agreement with the Company which imposed certain restrictions on the sale and transfer of the Smith Shares and amended the respective terms of convertible promissory notes payable to Dublin Holding, Ltd, the Mark A. Smith Rollover IRA and the Kelly Smith Rollover IRA to provide that these notes:

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

- * would be automatically and fully converted (with all principal and accrued interest calculated as if they had been held to maturity) into shares of the Company's common stock upon the conversion of the CV Notes at a conversion rate equal to the lesser of (i) \$18.00 per share or (ii) the conversion price of the CV Notes.

On January 15, 2002, as a result of the transaction with Centerpoint, these notes were converted into 588,852 shares of the Company's stock at \$7.50 per share.

Transactions with Salvatore J. Zizza

Beginning August 10, 2000, Salvatore J. Zizza, who served as a Director from December 1999 to February 2003, agreed to serve as our governmental affairs liaison and provide additional consulting services through September 1, 2002 for which he received no additional compensation. We granted Mr. Zizza options to purchase 7,500 shares of our common stock at a price of \$22.50 per share, exercisable until December 31, 2003, and issued him 10,000 Class J-2 warrants to purchase common stock at a price of \$23.75 per share. In addition, we agreed to provide Mr. Zizza with office space in our New York City office at no cost to him.

On January 15, 2002, we adjusted the price of the options to \$11.00 and cancelled the 10,000 Class J-2 warrants and issued Mr. Zizza options to purchase 10,000 shares of our common stock at a price of \$11.00 per share exercisable until December 31, 2004.

On June 25, 2002, Mr Zizza agreed to devote more time as our governmental affairs liaison. On July 1, 2002 we issued Mr. Zizza additional options to purchase 10,000 shares of our common stock at a price of \$7.50 per share vesting on July 1, 2003, exercisable until July 1, 2005.

Private Placements

On April 13, 2000, we completed a private placement offering in which Mr. Zizza participated under the same terms as unaffiliated third parties. Mr. Zizza purchased two units evidencing \$50,000 convertible debt and 1,500 warrants to purchase common stock exercisable at \$23.75 per share until December 31, 2004.

On June 8, 2001, we completed private placement offering in which Mr. Zizza participated under the same terms as unaffiliated third parties. Mr. Zizza purchased a \$98,552 convertible note and 2,955 warrants to purchase common stock exercisable at \$15.00 per share until December 31, 2005.

On January 15, 2002, as a result of the transaction with Centerpoint, Mr. Zizza's convertible notes, including accrued interest, were converted to 21,846 shares of the Company's common stock under the amended terms of the notes.

Transactions with Andrew G. Gould

Andrew G. Gould served on our Board of Directors from August 10, 2000 to February 14, 2003. In addition to his duties as a director, Mr. Gould, through Arthur P. Gould & Co., Inc., a company that he owns, contracted to provide us with an average of approximately ten hours per month of technology

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

consulting services through August 31, 2002, at no cost to us. We granted Mr. Gould options to purchase 7,500 shares of our common stock at a price of \$22.50 per share, exercisable until December 31, 2003. The exercise price of these options was adjusted on January 15, 2002 to \$11.00 per share.

On June 8, 2001, we completed private placement offering in which Mr. Gould participated under the same terms as unaffiliated third parties. Mr. Gould purchased a \$7,882 convertible note and 237 warrants to purchase common stock exercisable at \$15.00 per share until December 31, 2005.

On January 15, 2002, as a result of the transaction with Centerpoint, Mr. Gould's convertible note was converted to 1,114 shares of the Company's common stock under the amended terms of the note.

Other Transactions with Related Parties

Effective August 23, 2000, Jon Northrop, who was then a Director and President, and Jere Northrop, Director and Senior Technology Officer and their extended families, agreed to exchange, in aggregate:

- * 47,155 Class X Warrants and 85,570 Class Z Warrants for 26,984 restricted shares of our common stock. This exchange occurred pursuant to the terms of agreements dated December 20, 1999.

Effective August 29, 2001, we amended agreements with eight holders of outstanding promissory notes (Jon Northrop, Jere Northrop, Northrop Family Trust, M. Duane Stutzman, Harley Northrop, Edward Hennig, William Crossetta and Craig Scott), pursuant to which each note holder agreed to:

- * extend the maturity date to April 30, 2002;
- * cancel some of the outstanding options owned by the note holder; and
- * change the terms of the note so that outstanding principal and interest shall be completely converted to shares of the Company's common stock upon the earlier of April 29, 2002 or the conversion of the Company's outstanding CV Notes which conversion shall take place at the lower of \$22.50 per share, or the conversion price of the CV Notes.

On January 15, 2002, as a result of the transaction with Centerpoint, all of these promissory notes were automatically converted to 249,056 shares of the Company's common stock, respectively.

Effective on September 6, 2001 we entered into a severance agreement with Jon Northrop and as a result, we no longer have any employees in Denver and substantially all of our business operations are conducted out of our office in New York City. Mr. Northrop received monthly payments of \$10,000 in cash or common stock through August 2002.

Howard Chase joined our Board of Directors on January 21, 2002. In addition to his duties as a director, Mr. Chase, through Hollandbrook Group LLC (Hollandbrook), Inc. will provide us consulting services. Bion will pay Hollandbrook \$1,000 per month and issued to Hollandbrook \$9,000 in Bion common stock at a price per share of \$15.00.

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Transactions with Centerpoint

On January 15, 2002, Bion issued 1,900,000 shares of its restricted common stock, valued at \$7.50 per share, to Centerpoint, in exchange for \$8,500,000 in cash and the assignment of certain claims and other rights owned by Centerpoint for total consideration of \$14,250,000. Additional shares may be issued to Centerpoint if the Company raises equity at a price less than \$7.50 per share until the cumulative investment in the Company, from unaffiliated third parties, from the date of this transaction, equals \$5 million. The number of additional shares to be issued is determined by calculating the additional number of shares Centerpoint and OAM would have received if the transactions were consummated at the price per share of the subsequent equity financing. David Mitchell was a director of Centerpoint prior to the transaction with Bion and currently serves as Chairman and Chief Executive Officer of Centerpoint.

Option and Warrant Issuance

Directors and officers were issued options and warrants as disclosed in Item 10 Executive Compensation in this Form 10-KSB, above.

PART IV

ITEM 13. Exhibits and Reports on Form 8-K.

The following documents are filed as exhibits to this Form 10-KSB, including those exhibits incorporated in this Form 10-KSB by reference to a prior filing of Bion under the Securities Act or the Exchange Act as indicated in parenthesis:

Exhibit No.	Description
3.1	Articles of Incorporation previously filed and incorporated herein by reference.
3.2	Bylaws previously filed and incorporated by reference.
10.1	Management Agreement and Management Compensation Warrant dated December 23, 1999, between Bion Environmental Technologies, Inc. and D2CO, LLC. Incorporated by reference to Exhibit 10.1 to our Form 8-K dated December 11, 1999.
10.2	Warrant Purchase Agreement dated December, 1999, between Bion Environmental Technologies, Inc. and D2CO, LLC.; Promissory Note dated December 23, 1999; Warrant between Bion Environmental Technologies, Inc. and D2CO, LLC.; and Pledge Agreement dated December 23, 1999, between Bion Environmental Technologies, Inc. and D2CO, LLC. Incorporated by reference to Exhibit 10.2 to our Form 8-K dated December 11, 1999.
10.3	Shareholders' Agreement dated December 23, 1999, among D2CO, LLC, Mark A. Smith, Jere Northrop, Jon Northrop, LoTayLingKyur, Inc., LTLK Defined Benefit Plan, and Dublin Holding, Ltd. Incorporated by reference to Exhibit 10.3 to our Form 8-K dated December 11, 1999.

- 10.4 Agreement dated December 15, 1999, between Bion Environmental Technologies, Inc. and First Parties. Incorporated by reference to Exhibit 10.4 to our Form 8-K dated December 11, 1999.
- 10.5 Agreement dated December 11, 1999, between Bion Environmental Technologies, Inc. and Jon Northrop. Incorporated by reference to Exhibit 10.5 to our Form 8-K dated December 11, 1999.
- 10.6 Agreement dated December 14, 1999, between Bion Environmental Technologies, Inc. and Jere Northrop. Incorporated by reference to Exhibit 10.6 to our Form 8-K dated December 11, 1999.
- 10.7 Agreement dated December 13, 1999, between Bion Environmental Technologies, Inc. and Northrop Family Trust. Incorporated by reference to Exhibit 10.7 to our Form 8-K dated December 11, 1999.
- 10.8 Agreement dated December 11, 1999, between Bion Environmental Technologies, Inc. and M. Duane Stutzman. Incorporated by reference to Exhibit 10.8 to our Form 8-K dated December 11, 1999.
- 10.9 Agreement dated December 14, 1999, between Bion Environmental Technologies, Inc. and Harley E. Northrop. Incorporated by reference to Exhibit 10.9 to our Form 8-K dated December 11, 1999.
- 10.10 Agreement dated December 11, 1999, between Bion Environmental Technologies, Inc. and Edward A. Hennig. Incorporated by reference to Exhibit 10.10 to our Form 8-K dated December 11, 1999.
- 10.11 Agreement dated December 14, 1999, between Bion Environmental Technologies, Inc. and William J. Crossetta, Jr. Incorporated by reference to 10.11 to our Form 8-K dated December 11, 1999.
- 10.12 Agreement dated December 11, 1999, between Bion Environmental Technologies, Inc. and S. Craig Scott. Incorporated by reference to Exhibit 10.12 to our Form 8-K dated December 11, 1999.
- 10.13 Agreement dated August 10, 2000 between Bion Environmental Technologies, Inc. and D2CO, LLC. Incorporated by reference to Exhibit 99.2 to our Form 8-K dated August 3, 2000.
- 10.14 Agreement dated August 16, 2000 between Bion Environmental Technologies, Inc. and Salvatore Zizza. Incorporated by reference to Exhibit 99.3 to our Form 8-K dated August 3, 2000.
- 10.15 Agreement dated August 17, 2000 between Bion Environmental Technologies, Inc. and James W. Morris & Associates, Inc. Incorporated by reference to Exhibit 99.4 to our Form 8-K dated August 3, 2000.

- 10.16 Agreement dated August 6, 2000 among Bion Environmental Technologies, Inc., Dream Maker Dairy and Chris Northrop. Incorporated by reference to Exhibit 99.7 to our Form 8-K dated August 3, 2000.
- 10.17 2000 Incentive Plan. Incorporated by reference to Exhibit 99.5 to our Form 8-K dated August 10, 2000.
- 10.18 Amendment to Management Agreement with D2CO, LLC. Incorporated by reference to Exhibit 99.1 to our Form 8-K dated December 1, 2000.
- 10.19 Agreement dated February 7, 2001 between Bion Technologies, Inc. and Southview, Inc. Incorporated by reference to Exhibit 99.2 to our Form 8-K dated December 1, 2000.
- 10.20 Agreement dated October 31, 2000 between Bion Environmental Technologies, Inc. and George Bloom. Incorporated by reference to Exhibit 99.3 to our Form 8-K dated December 1, 2000.
- 10.21 Note and Warrant Purchase Agreement. Incorporated by reference to Exhibit 10.1 to our Form 8-K dated April 26, 2001.
- 10.22 Convertible Bridge Note. Incorporated by reference to Exhibit 10.2 to our Form 8-K dated April 26, 2001.
- 10.23 Bridge Warrant. Incorporated by reference to Exhibit 10.3 to our Form 8-K dated April 26, 2001.
- 10.24 Severance Agreement of Jon Northrop. Incorporated by reference to Exhibit 10.1 to our Form 8-K dated September 6, 2001.
- 10.25 Severance Agreement of Edward Hennig. Incorporated by reference to Exhibit 10.2 to our Form 8-K dated September 6, 2001.
- 10.26 Agreement of Harley E. Northrop. Incorporated by reference to Exhibit 10.3 to our Form 8-K dated September 6, 2001.
- 10.27 Agreement of Jere Northrop. Incorporated by reference to Exhibit 10.4 to our Form 8-K dated September 6, 2001.
- 10.28 Agreement of William J. Crossetta, Jr. Incorporated by reference to Exhibit 10.5 to our Form 8-K dated September 6, 2001.
- 10.29 Agreement of S. Craig Scott. Incorporated by reference to Exhibit 10.6 to our Form 8-K dated September 6, 2001.
- 10.30 Agreement of Northrop Family Trust. Incorporated by reference to Exhibit 10.7 to our Form 8-K dated September 6, 2001.
- 10.31 Agreement of M. Duane Stutzman. Incorporated by reference to Exhibit 10.8 to our Form 8-K dated September 6, 2001.

- 10.32 Stock Voting Agreement dated August 1, 2001. Incorporated by reference to Exhibit 10.9 to our Form 8-K dated September 6, 2001.
- 10.33 Mark Smith and Related Entities Agreement dated August 1, 2001. Incorporated by reference to Exhibit 10.10 to our Form 8-K dated September 6, 2001.
- 10.34 D2 Agreement dated August 1, 2001. Incorporated by reference to Exhibit 10.11 to our Form 8-K dated September 6, 2001.
- 10.35 2001 Incentive Plan. Incorporated by reference to Exhibit 10.12 to our Form 8-K dated September 6, 2001.
- 10.36 Letter Agreement with Howard Chase. Incorporated by reference to Exhibit 10.36 to our Form 10-KSB for the year ended June 30, 2002.
- 10.37 Non-Binding Agreement re Dairy Parks LLC. Incorporated by reference to Exhibit 10.37 to our Form 10-KSB for the year ended June 30, 2002.
- 10.38 Agreement between Bion Environmental Technologies, Inc. and Centerpoint Corporation canceling provisions of the Subscription Agreement by and between Bion Environmental Technologies, Inc. and Centerpoint Corporation. Incorporated by reference to Exhibit 10.1 to our Form 8-K dated February 7, 2003.
- 10.39 Promissory Note and Security Agreement between Bion Environmental Technologies, Inc. and Bright Capital, LLC. Incorporated by reference to Exhibit 10.1 to our Form 8-K dated March 25, 2003.
- 10.40 First Amendment to Lease between Bion Environmental Technologies, Inc. and Pan Am Equities Corp. Incorporated by reference to Exhibit 10.2 to our Form 8-K dated March 25, 2003.
- 10.41 Agreement between Bion Environmental Technologies, Inc. and Bergen Cove. Incorporated by reference to Exhibit 10.3 to our Form 8-K dated March 25, 2003.
- 10.42 Agreement between Bion Environmental Technologies, Inc. and David Mitchell dated April 7, 2003. Incorporated by reference to Exhibit 10.4 to our Form 8-K dated March 25, 2003.
- 10.43 Letter Agreement with Bright Capital, Ltd. Incorporated by reference to Exhibit 99.1 to our Form 8-K dated April 12, 2003.
- 10.44 Agreement with OAM, S.p.A. Incorporated by reference to Exhibit 99.2 to our Form 8-K dated April 12, 2003.
- 10.45 Amended Agreement with Centerpoint Corporation.

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Incorporated by reference to Exhibit 99.3 to our Form 8-K dated April 12, 2003.

53

- 10.46 Financing Documents for Bion Dairy Corporation. Incorporated by reference to Exhibit 10.1 to our Form 8-K dated August 25, 2003.
- 10.47 Form of Class SV/DB Warrant. Filed herewith electronically.
- 10.48 Form of Class SV/DM Warrant. Filed herewith electronically.
- 10.49 2003 Incentive Plan. Filed herewith electronically.
- 21 Subsidiaries of the Registrant. Filed herewith electronically.
- 31.1 Certification of Chief Executive Officer and Interim Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. Filed herewith electronically.
- 32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350. Filed herewith electronically.

Reports on Form 8-K

The following Report on Form 8-K was filed during the quarter ended June 30, 2003:

We filed a Form 8-K dated April 12, 2003 reporting information under items 5 and 7 of that form.

Item 14. Principal Accountant Fees and Services

As result of our inability to pay our auditors, BDO Seidman LLP, for their audit of our financial statements for the year ended June 30, 2002, we have not yet engaged them to audit our financial statements for the year ended June 30, 2003. For the fiscal year ended June 30, 2003, we were billed \$10,000 by BDO Seidman LLP in connection with their review of our Form 10-QSB for the quarter ended September 30, 2003 and \$15,290 for their review of a registration statement and amendments to prior Forms 10-KSB and 10-QSB.

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Index to Consolidated Financial Statements and Schedule

THIS REPORT INCLUDES FINANCIAL STATEMENTS AND THE NOTES THERETO WHICH HAVE NOT BEEN REVIEWED OR AUDITED BY INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS. AS A RESULT, THE FINANCIAL STATEMENTS DO NOT MEET THE REQUIREMENTS OF FORM 10-KSB.

	Page
Consolidated balance sheet as of June 30, 2003 (Unaudited)	F-2
Consolidated statements of operations for the years ended June 30, 2003 (Unaudited) and 2002	F-3
Consolidated statements of changes in stockholders' equity for the years ended June 30, 2003 (Unaudited) and 2002	F-4
Consolidated statements of cash flows for the years ended June 30, 2003 (Unaudited) and 2002	F-5
Notes to consolidated financial statements (Unaudited)	F-6

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

F-1

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES
 Consolidated Balance Sheet
 As of June 30, 2003 (Unaudited)

	June 30, 2003

ASSETS	
Current assets:	
Cash and cash equivalents	\$ 9,386
Accounts receivable, net of allowance for doubtful accounts of \$5,935	7,945
Inventory	
Prepaid expenses and other current assets	42,988

Total current assets	60,319
Property and equipment, net	215,683
Claims receivable	600,000
Other assets	31,873

Total assets	\$ 907,875
	=====
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Accounts payable	\$ 854,957
Accrued expenses	330,676
Capital lease obligation	1,021
Deferred compensation / due to trust	497,050
Advances from affiliates	593,800

Total current liabilities	2,277,504
Capital lease obligation - less current portion	-

Total liabilities	2,277,504
Minority interest	390,526
Commitments and contingencies	
Stockholders' equity:	
Preferred stock, \$.01 par value, 10,000 shares authorized, -0- shares issued and outstanding	
Common stock, no par value, 100,000,000 shares authorized, 4,202,491 shares issued and outstanding (does not include 1,095,730 shares held	

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

by Centerpoint which when distributed will be cancelled)

Additional paid in capital	58,347,239
Accumulated deficit	(60,107,394)

 Total stockholders' equity	 (1,760,155)
	=====
 Total liabilities and stockholders' equity	 \$ 907,875
	=====

See notes to consolidated financial statements

F-2

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES Consolidated Statements of Operations

	Years Ended June 30,	
	2003	2002
	-----	-----
	(Unaudited)	
Revenue:		
Soil	\$ 116,029	\$ 69,382
	-----	-----
	116,029	69,382
Cost of soil	762,681	546,117
	-----	-----
Gross loss	(646,652)	(476,735)
Expenses:		
General and administrative (excluding non cash charges for services and compensation)	2,343,385	2,498,400
Research and development	559,759	735,622
Non cash charges for compensation	-	4,967,562
	-----	-----
	2,903,144	8,201,584
	-----	-----
Operating loss	(3,549,796)	(8,678,319)
Other income and expenses:		
Interest expense (including non-cash interest charges)	(9,846)	(8,611,903)
Interest income	13,940	36,011
Other expenses, net	36,875	74,855
	-----	-----
	40,969	(8,501,037)

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Net loss before minority interest	(3,508,827)	(17,179,356)
Minority interest	50,567	85,457
	-----	-----
Net loss	\$ (3,458,260)	\$ (17,093,899)
	=====	=====
Basic and diluted loss per common share:		
Net loss	\$ (0.82)	\$ (7.18)
	=====	=====
Weighted-average number of common shares outstanding,		
basic and diluted loss per share	4,205,993	2,380,651
	=====	=====

See notes to consolidated financial statements

F-3

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Consolidated Statement of Stockholders' Equity

	Common Stock Shares	Additional Paid-In Capital	Accumulated Deficit	Total Stockholders' Deficit
	-----	-----	-----	-----
Balance, June 30, 2001	1,306,348	\$30,218,339	\$ (39,380,101)	\$ (9,161,762)
Issuance of stock options	9,118	120,000		120,000
Issuance of stock for notes conversion	1,905,979	14,369,520		14,369,520
Issuance of stock for services	85,950	864,934		864,934
Issuance of options and warrants for consulting services		329,283		329,283
Non-cash variable options adjusted		(3,469)		(3,469)
Modification of terms of bridge warrants		297,000		297,000
Issuance of warrants as an inducement to convert debt		3,709,713		3,709,713
Beneficial conversion feature on change of terms of debt		5,547,000		5,547,000
Write-off of debt discount				

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

on conversion of debt		(1,566,511)		(1,566,511)
Acquisition of Centerpoint	904,270	5,517,659		5,517,659
Net loss			(17,093,899)	(17,093,899)
Balance - June 30, 2002	4,211,665	\$59,403,468	\$ (56,474,000)	\$ 2,929,468
Unaudited:				
Non-cash variable options adjusted		(30,993)		(30,993)
Adjustment to value of claim receivable				(739,154)
Elimination of shares due to trust	(94,313)	(142,108)	(397,004)	(539,112)
Distribution of shares to trust	94,439		58,973	58,973
Return of shares	(6,300)	(143,974)	162,897	18,923
Net Loss			(3,458,260)	(3,458,260)
Balance - June 30, 2003	4,202,491	58,347,239	(60,107,394)	(1,760,155)

F-4

BION ENVIRONMENTAL TECHNOLOGIES, INC AND SUBSIDIARIES
Consolidated Statements of Cash Flows

	Years Ended June	
	2003	2002
	(Unaudited)	(Unaudited)
Cash flows from operating activities:		
Net loss	\$ (3,458,260)	\$ (17,093,899)
Adjustments to reconcile net loss to net cash used in operating activities:		
Minority interest in net loss of subsidiary	(50,567)	
Depreciation and amortization	137,001	
Amortization of debt discount		
Accretion of notes payable for interest expense		
Beneficial conversion feature amortized to interest expense		
Compensation charge from variable options		
Issuance of warrants as an inducement to convert debt		
Non-cash charges for equity instruments issued for compensation and services		
Loss on disposal of assets	109,278	
Amounts owed to trust (including interest of \$9,550)	497,050	
Reduction of note receivable for consulting services		
Changes in:		
Accounts receivable	(9,350)	

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Note receivable	(55,969)	
Inventory	(67,640)	
Prepaid expenses and other current assets	(105,011)	
Claims receivable		
Deposits and other	(124,973)	
Accounts payable	531,020	
Accrued liabilities	275,524	
	-----	-----
Net cash used in operating activities	(2,321,897)	(
	-----	-----
Cash flows from investing activities:		
Proceeds from issuance of common stock for acquisition		
Payment for purchase of acquisition, net of cash acquired		
Proceeds from sale of assets	44,554	
Purchase of property and equipment	(119,060)	
	-----	-----
Net cash provided by (used in) investing activities	(74,506)	
	-----	-----
Cash flows from financing activities:		
Proceeds from advances from affiliates	593,800	
Proceeds from exercise of options and warrants		
Payment of loan		
Payments of capital lease obligations	(1,582)	
	-----	-----
Net cash (used in) provided by financing activities	592,218	
	-----	-----
Net increase (decrease) in cash and cash equivalents	(1,804,185)	
	-----	-----
Cash and cash equivalents, beginning of period	1,813,571	
	-----	-----
Cash and cash equivalents, end of period	\$ 9,386	\$
	=====	=====

See notes to consolidated financial statements

F-5

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

PRELIMINARY NOTE:

THE FINANCIAL STATEMENTS AS OF JUNE 30, 2003 AND FOR THE YEAR THEN ENDED HAVE NOT BEEN AUDITED. THE FINANCIAL STATEMENTS FOR THE YEAR ENDED JUNE 30, 2002 ARE FROM FINANCIAL STATEMENTS PREVIOUSLY AUDITED BY BDO SEIDMAN LLP. BDO SEIDMAN LLP HAS NOT REISSUED THEIR REPORT AS TO SUCH FINANCIAL STATEMENTS AND HAVE NOT OTHERWISE BEEN INVOLVED IN THE PREPARATION OF THESE FINANCIAL STATEMENTS.

1. ORGANIZATION AND NATURE OF BUSINESS

Bion Environmental Technologies, Inc. ("Bion" or the "Company") was incorporated in 1987 in the State of Colorado.

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

The Company is in the process of developing and testing a second generation of its technology to provide waste management solutions to the agricultural industry, focusing on livestock waste from confined animal feeding operations, such as large dairy and hog farms. In the past the Company has engaged in two main areas of activity by utilizing the first generation of its technology (which the Company discontinued marketing during calendar year 2001) (which areas the Company intends to re-enter during the current fiscal year pending results of field testing its second generation NMS technology during fiscal year 2004):

- 1) WASTE STREAM REMEDIATION. The removal of pollutants (primarily nitrogen and phosphorus) which pollute soil and water and reduction of emissions of gases to the atmosphere which result in acid rain, smog, ground-level ozone or produce "greenhouse warming" effects). We intend to pursue this area of activity primarily through licensing our second generation technology: a) to retrofit existing confined animal feeding operations installations (with emphasis on large dairy farms utilizing anaerobic lagoons for the next 12 months) and b) for use in newly constructed dairy farms; and
- 2) BIONSOIL SALES. The production and sale of organic BionSoil fertilizer products made from the waste solids produced by use of our technology.

In addition, the Company intends to pursue the "Dairy Park Opportunity," which reflects what the Company believes is the potential for the Bion technology to allow very large dairy farms to vertically integrate (with pasteurization, cream separation, milk bottling, and/or cheese plants, etc.) and pursue site integration (with ethanol plants, methane production, organic farming, etc.) on relatively small plots of land. The consolidated financial statements have been prepared assuming the Company will continue as a going concern. The Company incurred losses totaling \$17,093,899 during the year ended June 30, 2002 (including non-cash interest expense and other non-cash expenses of \$8,607,023 and \$4,971,610, respectively) and has a history of losses which has resulted in an accumulated deficit of \$56,474,000 at June 30, 2002.

Effective July 8, 2002, the Company completed a 1 for 10 reverse stock split (the "stock split"). The stock split has been retroactively reflected in the Company's consolidated balance sheet and consolidated statement of operations, adjusted in the consolidated statements of changes in stockholders equity and notes to consolidated financial statements.

F-6

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

1. ORGANIZATION AND NATURE OF BUSINESS (Continued)

The consolidated financial statements have been prepared assuming the Company will continue as a going concern. The Company incurred losses totaling \$3,458,200 during the year ended June 30, 2003 and has a history of losses which has resulted in an accumulated deficit of \$60,107,394 at June 30, 2003.

During the year ended June 30, 2002, through the Company's transactions with Centerpoint Corporation and OAM S.p.A. the Company obtained \$4,800,000 in cash (See Note 3). The Company continues to explore sources of additional financing to satisfy its current operating requirements.

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

The Company has been suffering from severe financial difficulties since approximately late January of 2003. These financial difficulties resulted in the resignation of nearly all of the Company's officers and directors during February and March of 2003, and the termination of most of our employees. The Company has retained a core technical staff, but has drastically curtailed its business activities to include only those activities that are directly needed to complete development and testing of the Company's second generation technology.

The Company's financial difficulties resulted primarily from its inability to raise additional funds due to contractual anti-dilution provisions that were contained in the agreements related to the financing transactions that were completed in January of 2002 which prevented any reasonable financing from being completed. When the Company became aware of the negative implications of these anti-dilution provisions while attempting to structure a planned financing (which financing attempts ultimately failed in January of 2003), the Company attempted to either find alternative financing methods which could be reasonably completed and/or negotiate an amendment to such provisions. After months of negotiations, agreements related to amending such provisions were entered into during the spring of 2003 and the provisions were finally amended effective August 27, 2003.

Although the Company was able to complete a small financing through one of its subsidiaries during August of 2003 which will allow it to continue limited work on its second generation technology, the Company's operations have been severely damaged during the past year. In order to continue with business activities, the Company has had to structure interim financing on extremely dilutive terms. The Company still faces a severe working capital shortage and since it has no revenues will need to obtain additional capital to satisfy its existing creditors. There is no assurance that the Company will be able to obtain the funds that it needs to stay in business or to successfully develop its business.

There is substantial doubt about the Company's ability to continue as a going concern. The accompanying consolidated financial statements do not include any adjustments relating to the recoverability or classification of asset carrying amounts or the amounts and classification of liabilities that may result should the Company be unable to continue as a going concern.

The Company has a stockholders' deficit of \$1,760,155 accumulated deficit of \$60,107,394 limited current revenues and substantial current operating losses. Our operations are not currently profitable; therefore, readers are further cautioned that our continued existence is uncertain if we are not successful in obtaining outside funding in an amount sufficient for us to meet our operating expenses at our current level.

F-7

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

2. SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its wholly- and majority-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Revenue recognition:

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Revenue from the sale of BionSoil products and associated fees are recognized when shipped, as the Company has no continuing obligations.

Revenues from fixed-price system development and construction projects are recognized on the percentage-of-completion method. For contracts accounted for under the percentage-of-completion method, the amount of revenue recognized is the percentage of the total contract price that the cost expended to date bears to the anticipated final total cost based upon current estimates of the cost to complete the contract. Contract cost includes all labor and benefits, materials unique to or installed in the project, subcontract costs and allocations of indirect costs. General and administrative costs are charged to expense. Provisions for estimated losses on uncompleted contracts are provided when determined, regardless of the completion percentage. As contracts can extend over one or more accounting periods, revisions in costs and earnings estimated during the course of the work are reflected during the accounting period in which the facts that require such revisions become known. Project managers make assumptions concerning cost estimates for labor hours, consultant hours and other project costs. Due to uncertainties inherent in the estimation process and potential changes in customer needs as projects progress, it is at least reasonably possible that completion costs for some uncompleted projects may be further revised in the near term, and that such revisions may be material.

F-8

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Depreciation and amortization:

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the related assets, generally three to seven years. Leasehold improvements are amortized using the straight-line method over the shorter of the term of the lease or the estimated useful life of the asset.

Income taxes:

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Deferred income taxes are determined by applying enacted statutory rates in effect at the balance sheet date to the differences between the tax bases of assets and liabilities and their reported amounts in the consolidated financial statements. A valuation allowance is provided based on the weight of available evidence, if it is considered more likely than not that some portion, or all, of the deferred tax assets will not be realized.

Cash and cash equivalents:

The Company considers cash and all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Impairment of long-lived assets:

Long-lived assets and certain intangibles are evaluated for impairment when events or changes in circumstances indicate that the carrying value of the assets may not be recoverable through the estimated undiscounted future cash flows resulting from the use of these assets. When any such impairment exists, the related assets will be written down to fair value.

Inventory:

Inventories are stated at the lower of cost or market, principally determined by the FIFO method. Inventories include the cost of raw materials, supplies, labor and overhead.

Loss per share of common stock:

Basic earnings per share includes no dilution and is computed by dividing income or loss available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution of securities that could share in the earnings of an entity, similar to fully diluted earnings per share. In loss periods, dilutive common equivalent shares are excluded, as the effect would be anti-dilutive. Therefore, basic and diluted earnings per share are the same for all periods presented.

F-9

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

For the years ended June 30, 2003 and 2002, stock options exercisable into 51,503 and 214,523 shares of common stock, respectively, and stock warrants exercisable into 1,393,393 and 1,393,393 shares of common stock, respectively, were not included in the computation of diluted earnings per share because their effect was anti-dilutive.

Use of estimates:

The preparation of financial statements in conformity with accounting

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. Actual results could differ from those estimates and assumptions.

Fair value of financial instruments:

The estimated fair value of financial instruments has been determined using available market information or other appropriate valuation methodologies, including the Black Scholes model. However, considerable judgment is required in interpreting market data to develop estimates of fair value. Consequently, the estimates are not necessarily indicative of the amounts that could be realized or would be paid in a current market exchange. The carrying amounts reported on the consolidated balance sheets approximate their respective fair values.

Stock-based compensation:

The Company accounts for its stock-based compensation arrangements with its employees in accordance with the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and complies with the disclosure provisions of SFAS 123, "Accounting for Stock-Based Compensation." SFAS 123 established a fair-value-based method of accounting for stock-based compensation plans. Stock-based awards to nonemployees are accounted for at fair value in accordance with the provisions of SFAS 123.

Patents:

Patents are recorded at cost less accumulated amortization, which is calculated on a straight-line basis over a period of the estimated economic life or legal life of 17 years. Amortization expense for the years ended June 30, 2003 and 2002 was \$3,232 each year.

Reclassifications:

Certain prior-year amounts have been reclassified to conform to their 2002 presentation.

F-10

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cumulative effects of accounting changes:

During the year ended June 30, 2001, the Company applied Emerging Issues Task Force Issue No. 00-27 ("EITF 00-27"), "Application of EITF Issue No. 98-5, Accounting for Convertible Securities with Beneficial Conversion Features of Contingently Adjustable Conversion Ratios, to Certain Convertible Instruments", which is effective for all such instruments. This issue clarifies the accounting for instruments with beneficial conversion features or contingently adjustable conversion ratios. The Company modified the

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

previous calculation of the beneficial conversion features associated with previously issued convertible bridge notes. Based on further clarification, the beneficial conversion feature should be calculated by allocating the proceeds received in the financing to the convertible instruments and to any detachable warrants issued in the transactions, and measuring the intrinsic value based on the effective conversion price based on the allocated proceeds. The previous calculation was based on a comparison of the stated conversion price in the terms of the instrument to the fair value of the issuer's stock at the commitment date.

As a result of the issuance of EITF 00-27, effective October 1, 2000, the Company recorded an additional warrant discount on the 2000 convertible bridge notes of \$1,050,000 due to the beneficial conversion feature calculated on the intrinsic value of the allocated proceeds received in the financing. Since the notes automatically convert into common stock one year from the date of issuance, the Company has recorded \$481,250 as a cumulative effect of change in accounting principle. The remaining discount of \$568,750 has been amortized to interest expense over the remaining conversion period.

Recent accounting pronouncements

In July 2002, the FASB issued SFAS No. 146, Accounting for Restructuring Costs. SFAS No. 146 applies to costs associated with an exit activity (including restructuring) or with a disposal of long-lived assets. Those activities can include eliminating or reducing product lines, terminating employees and contracts, and relocating plant facilities or personnel. Under SFAS No. 146, a company will record a liability for a cost associated with an exit or disposal activity when that liability is incurred and can be measured at fair value. SFAS No. 146 will require a company to disclose information about its exit and disposal activities, the related costs, and changes in those costs in the notes to the interim and annual financial statements that include the period in which an exit activity is initiated and in any subsequent period until the activity is completed. SFAS No. 146 is effective prospectively for exit or disposal activities initiated after December 31, 2002 with earlier adoption encouraged. Under SFAS No. 146, a company may not restate its previously issued financial statements and the new Statement grandfathered the accounting for liabilities that a company had previously recorded under Emerging Issues task Force Issue 94-3. The adoption of SFAS No. 146 will not have an effect on our financial condition or the results of operations.

F-11

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." SFAS No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. The provisions of SFAS No. 144 are effective for fiscal years beginning after December 15, 2001. The Company is required to adopt SFAS No. 144 by the first quarter of fiscal 2003. The Company is currently evaluating the potential impact of SFAS No. 144 on its results of operations and financial position.

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations", and SFAS No. 142, "Goodwill and Other Intangible Assets". SFAS No. 141 requires the use of the purchase method of accounting and prohibits the use of pooling-of-interests method of accounting for business combinations initiated after June 30, 2001. SFAS No. 141 also requires that we recognize acquired intangible assets apart from goodwill if the acquired intangible assets meet certain criteria. SFAS No. 141 applies to all business combinations initiated after June 30, 2001 and for purchase business combinations completed on or after July 1, 2001. It also requires, upon adoption of SFAS No. 142, that we reclassify the carrying amounts of intangible assets and goodwill based on the criteria in SFAS No. 141. The adoption of SFAS No. 141 did not have an effect on our financial condition or the results of operations.

SFAS No. 142 requires, among other things, that companies no longer amortize goodwill, but instead test goodwill for impairment at least annually. In addition, SFAS No. 142 requires that we identify reporting units for the purposes of assessing potential future impairments of goodwill, reassess the useful lives of other existing recognized intangible assets, and cease amortization of intangible assets with an indefinite useful life. An intangible asset with an indefinite useful life should be tested for impairment in accordance with the guidance in SFAS No. 142. SFAS No. 142 is required to be applied in fiscal years beginning after December 15, 2001 to all goodwill and other intangibles assets recognized at that date, regardless of when those assets were initially recognized. The adoption of SFAS No. 141 and 142 did not have an effect on our financial condition or results of operations. The adoption of SFAS No. 142 will not have an effect on our financial condition or the results of operations.

3. ACQUISITION OF CENTERPOINT CORPORATION/SUBSEQUENT TRANSACTIONS WITH CENTERPOINT

ACQUISITION:

On January 15, 2002, Bion issued 1,900,000 shares of its restricted common stock, valued at \$7.50 per share, to Centerpoint Corporation, a publicly held Delaware corporation ("Centerpoint"), in exchange for \$8,500,000 in cash and the assignment of claims related to Centerpoint's transaction with Aprilia and other rights owned by Centerpoint for total consideration of \$14,250,000.

F-12

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

3. ACQUISITION OF CENTERPOINT CORPORATION (Continued)

Immediately upon consummation of the transaction with Centerpoint, Bion purchased a 57.7% majority interest in Centerpoint from its Italian parent, OAM, S.p.A. ("OAM") by issuing 100,000 shares of its common stock to OAM, a warrant to purchase an additional 100,000 shares of common stock valued at \$380,000 using the Black-Scholes pricing model, \$3,700,000 of cash, assignment of a loan receivable valued at \$3,263,000 and its rights acquired under claims receivable acquired from Centerpoint valued at \$2,487,000. The combination has been accounted for using the purchase method of accounting.

Additional shares may be issued to Centerpoint and OAM if the Company issues,

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

sells or transfers any of its equity securities or securities convertible into or exchangeable for equity securities at a price less than \$7.50 per share until the cumulative investment in the Company, from unaffiliated third parties, from the date of this transaction, equals \$5 million. The number of additional shares to be issued would be determined by calculating the additional number of shares Centerpoint and OAM would have received if the transactions were consummated at the price per share of the subsequent equity financing.

On January 15, 2002, the Company recorded a minority interest of \$526,550, which represents 42.3% of the net assets of Centerpoint at that time. The Company has included the results of Centerpoint's operations in its financial statements for the period commencing January 15, 2002, the date of the combination, through June 30, 2002. The Company recorded a minority interest of \$85,457 representing the minority shareholders interest in the net loss of Centerpoint for the period ended June 30, 2002.

As a result of these two transactions, the Company obtained \$4,800,000 in cash and ownership of a majority of issued and outstanding shares of Centerpoint. On August 12, 2002, the Company filed a registration statement to allow Centerpoint to distribute to its stockholders the 1.9 million shares of Common Stock of Bion that the Company issued to Centerpoint in connection with the transaction. The Company expects the distribution to occur during the second half of calendar 2002. When that distribution occurs, approximately 1.1 million shares of common stock of Bion will be distributed back to the Company and cancelled. After the Company cancels these shares of common stock, the two transactions will have resulted in a net increase of approximately 900,000 of issued and outstanding shares of common stock of Bion, which includes 100,000 shares issued by the Company directly to OAM as partial consideration for the Company obtaining control of Centerpoint.

The Centerpoint transaction triggered the conversion of \$14,256,779 of notes payable including interest into 1,900,911 shares of our common stock. In addition, warrants to purchase 213,263 shares of our common stock had their exercise price decreased to \$7.50 and \$6.00. As described above, if the Company raises equity at a price less than \$7.50 per share, the Company may need to issue additional shares to the note holders as if the notes were converted into shares of the Company's common stock at the price per share of

F-13

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

3. ACQUISITION OF CENTERPOINT CORPORATION (Continued)

the subsequent equity financing. In addition, the exercise prices for 17,596 warrants may be decreased to the price per share of the subsequent equity financing and the exercise prices for 195,174 warrants may be decreased to 80% of the price per share of the subsequent equity financing. Also, in the event of a subsequent equity financing below \$7.50, additional warrants will be issued on 1,037,343 warrants currently outstanding to increase these warrants to reflect 20% of the fully diluted shares outstanding as of January 15, 2002, after giving effect to the above adjustments. These warrants will also have their exercise price lowered to the price per share of the subsequent equity financing.

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Centerpoint had owned the Moto Guzzi motorcycle business, which it sold in August 2000. Since that time it had been seeking an investment opportunity for the cash it received from the sale. Other than seeking an investment opportunity, Centerpoint has been inactive since the time of the sale of Moto Guzzi. After giving effect to the January 15, 2002 transactions, Centerpoint's primary asset is 1,900,000 shares of Bion's common stock. Centerpoint currently has only minimal cash, no other significant assets other than the Bion shares and no business operations. Centerpoint does continue to hold 35% of the rights to a litigation claim and an escrow account. The claim was initially reflected on the balance sheet at \$1,339,154 and the escrow account was not valued.

Effective June 30, 2003 Bion management based on its own evaluation of the relevant facts and circumstances (collectibility, cost of litigation, timelines for receipt, currency fluctuation, etc.) reduced the value of the 35% of the Claims owned by Centerpoint to \$600,000 (a reduction of \$739,154).

TRANSACTIONS (POST-ACQUISITION):

In March 2002, the Company and Centerpoint entered in an agreement effective January 15, 2002 whereby Centerpoint agreed to pay the Company \$12,000 a month and issued a warrant to purchase 1,000,000 shares of Centerpoint's common stock at \$3.00 per share exercisable until March 14, 2007 for management services, support staff and office space. In addition, the Company agreed to advance to Centerpoint funds needed to cure its delinquencies with the SEC, distribute the Company's common shares to Centerpoint shareholders, to locate and acquire new business opportunities and for on-going expenses. The Company had no obligation to make any advances in excess of \$500,000. All funds due the Company are evidenced by a convertible revolving promissory note, which bears interest at 1% per month, payable with accrued interest on March 15, 2003. This date may be extended by agreement between the Company and Centerpoint. The Company shall have the right to convert, at any time, all or a portion of the amount due under the promissory note in shares of Centerpoint's common stock at a conversion price of \$3.00 per share. As of June 30, 2002 the Company had advanced Centerpoint \$186,257.

F-14

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

3. ACQUISITION OF CENTERPOINT CORPORATION (Continued)

During March 2003, the Company and Centerpoint entered into an agreement (amended on April 23, 2003) which forgave sums due from Centerpoint to Bion (approximately \$450,000 at that time) and cancelled the warrants issued by Centerpoint to Bion in consideration of amending the terms of the January 2002 agreement between Bion and Centerpoint to remove the adjustment provisions (and other related) described above. This agreement was ratified by the shareholders of Centerpoint on August 25, 2003. Such ratification enabled Bion to complete an agreement with OAM, S.p.A. on August 27, 2003 which removed the balance of the adjustment provisions.

4. PROPERTY AND EQUIPMENT

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Property and equipment consists of the following as of June 30, 2003:

	Estimated Useful Lives (Years)	

Furniture and equipment	5-7	\$ 331,647
Computer equipment	3-5	60,032
Leasehold improvements	11	30,174

		421,854
Less accumulated depreciation and amortization		206,171

		\$ 215,683
		=====

Depreciation and amortization expense related to property and equipment was \$72,199 and 137,001 for the years ended June 30, 2002 and 2003, respectively. At June 30, 2003, property and equipment acquired under capital leases had all been fully depreciated.

5. CLAIMS RECEIVABLE

Aprilia claim:

In June 2001, Aprilia's legal counsel sent a letter to Centerpoint which alleged that it had various claims under the Share Purchase Agreement aggregating approximately Lit. 9,600 million (approximately US\$4,658,000). In July 2001, Centerpoint's Italian counsel sent a letter to Aprilia's counsel contesting all of the alleged claims.

F-15

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

5. CLAIMS RECEIVABLE (Continued)

On July 13, 2001, Aprilia requested that IMI, the escrow agent, pay them Lit. 7,611 million, (approximately US\$ 3,693,000) in respect of the alleged claims. On July 26, 2001, in spite of being aware of Centerpoint contesting of the alleged claims and its intention to seek arbitration, IMI advised Centerpoint that it had paid the requested funds from the escrow account to Aprilia.

IMI claim:

At the September 7, 2000 closing of the sale of the subsidiaries, in accordance with an invoice previously submitted to them by IMI, but without the prior approval, knowledge or consent of the Company, IMI was paid

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Lit.11,401 million (approximately US\$5,532,000), in respect of fees and expenses claimed by IMI to be due it under its engagement letter with TRG and OAM.

On February 11, 2002, Centerpoint brought a suit against IMI seeking reimbursement of Lit. 8,766 million (approximately US\$4,253,000) of the amount paid to IMI at the closing.

The above claims were valued at \$3,826,154 arrived through an internal allocation made by Bion management based on its own evaluation of the relevant facts and circumstances and its review of a fairness opinion that was provided by an investment banking firm with regard to the transaction as a whole. The rights to 65% of these claims were ultimately assigned to OAM. The rights to 35% of the claims remained with Centerpoint and are included in the consolidated financial statements of the Company. See Note 3 - Acquisition of Centerpoint.

Effective June 30, 2003 Bion management, based on its own evaluation of the relevant facts and circumstances (including without limitation, collectibility, cost of litigation, timelines for receipt, currency fluctuation, etc.) reduced the value of the 35% of the claims owned by Centerpoint to \$600,000 (a reduction of \$739,154).

6. STOCKHOLDERS' EQUITY

Reverse stock split:

Effective July 8, 2002, the Company completed a one-for-ten reverse stock split of its outstanding shares of common stock. The accompanying consolidated financial statements have been retroactively adjusted to reflect the reverse stock split.

F-16

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

6. STOCKHOLDERS' EQUITY (Continued)

Common stock:

Holder of common stock are entitled to one vote per share on all matters to be voted on by common stockholders. In the event of liquidation, dissolution or winding up of the Company, the holders of common stock are entitled to share in all assets remaining after liabilities have been paid in full or set aside. Common stock has no preemptive, redemption or conversion rights. The rights of holders of common stock are subject to, and may be adversely affected by, the rights of the holders of any other series of preferred stock the Company may designate in the future.

During the year ended June 30, 2003, the Company issued a net of 87,539 shares

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

of its common stock, including 91,349 shares which the Trust distributed on May 8, 2003, and returns of 3,900 shares including 3,000 shares from Stanley F. Freedman, legal counsel to the Company, and 900 shares from Hollilandbrook.

During the year ended June 30, 2003, the Company issued 14,690 shares of its common stock, valued at \$136,906, for services and 6,250 shares of Centerpoint's common stock valued at \$9,377. The Company also issued 13,012 shares of its common stock, valued at \$168,650, to employees as compensation.

Warrants:

As of September 30, 2003, the Company had the following common stock warrants (1,543,353 in aggregate) outstanding:

	Number of Shares -----	Exercise Price -----	Expiration Date -----
Class D2C-W	2,455	\$ 25.00	June 30, 2004
Class J-1	3,000	\$ 20.00	December 31, 2004
Class J-1A	119,850 (a)	\$ 6.00	December 31, 2004
Class J-1AA	17,596 (b)	\$ 7.50	December 31, 2004
Class J-1B	30,047 (a)	\$ 6.00	December 31, 2005
Class J-1C	45,770 (a)	\$ 6.00	December 31, 2005
Class J-1D	30,832 (c)	\$ 15.00	December 31, 2004
Class J-2	6,500	\$ 15.00	December 31, 2004
Class SV/DM	387,343	\$ 5.00	July 31, 2008
Class O	100,000	\$ 9.00	January 15, 2006
Class SV/DB	800,000	\$ 3.00	July 31, 2013

(a) Redeemable by the Company at \$0.05 per warrant if the bid price for our common stock is above \$14.00.

F-17

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

6. STOCKHOLDERS' EQUITY (Continued)

b) Redeemable by the Company at \$0.05 per warrant if the bid price for our common stock is above \$15.00.

(c) Issued for services valued at \$109,543. Redeemable by the Company at \$0.05 per warrant if the bid price for our common stock is above \$35.00.

(d) The exercise price is deemed to be the conversion price of the CV Notes. The exercise price may be lowered if the Company issues shares of its common stock for consideration that is below \$7.50 up until the time the Company raises \$5,000,000 in proceeds. See Note 3.

(e) In the event of (d) above, additional warrants will be issued to reflect 20% of "fully diluted" outstanding shares of the Company. See Note 9.

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

During the year ended June 30, 2001, in connection with the Company's private placement of its convertible notes payable, the Company issued 75,817 warrants with a value of \$737,809. This value was obtained using the Black Scholes model of pricing, and has been charged to stockholders' deficit, and is reflected as a discount on the convertible notes. Increases in value totaling \$297,000 and \$213,172 have been made to the warrants issued during the years ended June 30, 2002 and June 30, 2001, respectively, due to various changes in terms of these warrants.

During the year ended June 30, 2001, holders of 63,466 Class X warrants and 632,389 Class Z warrants exchanged their warrants for 114,531 shares of restricted common stock. For the year ended June 30, 2001, the Company recorded \$2,179,182 as additional expense related to the beneficial value of the consideration received over the value of warrants surrendered.

Stock options:

The 1994 Incentive Plan (the "1994 Plan") provides for incentive stock options to be granted to employees. Options to purchase up to 238,055 shares of the Company's common stock (or 20% of the Company's outstanding stock which ever is greater) may be granted under the Plan. Terms of exercise and expiration of options granted under the 1994 Plan may be established at the discretion of an administrative committee appointed to administer the Plan, or by the Board of Directors if no committee is appointed, but no option may be exercisable for more than ten years. As of June 30, 2003, options to purchase 18,500 shares of the Company's common stock are outstanding under the 1994 Plan.

F-18

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

6. STOCKHOLDERS' EQUITY (Continued)

The 1996 Non-employee Director Stock Plan ("the Director Plan") provides for each non-employee director to receive annually, an option to purchase 500 shares of the Company's common stock at an exercise price of 50% of the average market price of the Company's common stock for the preceding twelve months. The options were ultimately issued with an exercise price equal to the market value of the Company's common stock at its issuance date, and therefore no compensation had been recorded. No option may be exercisable for more than five years. Options to purchase up to 10,000 shares of the Company's common stock may be granted under the Director Plan. As of June 30, 2003, options to purchase 18,500 shares of the Company's common stock are outstanding under the Director Plan.

The 2000 Incentive Plan (the "2000 Plan") provides for incentive stock options to be granted to selected employees and directors of the Company, and selected non-employee advisors to the Company. Options to purchase up to 100,000 shares

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

of the Company's common stock may be granted under the 2000 Plan. Terms of exercise and expiration of options granted under the 2000 Plan may be established at the discretion of an administrative committee appointed to administer the 2000 Plan, but no option may be exercisable for more than five years. As of June 30, 2003, options to purchase 3,891 shares of the Company's common stock are outstanding under the 2000 Plan.

The 2001 Incentive Plan (the "2001 Plan") provides for incentive stock options to be granted to selected employees and directors of the Company, and selected non-employee advisors to the Company. Options to purchase up to 150,000 shares of the Company's common stock may be granted under the 2001 Plan. Terms of exercise and expiration of options granted under the 2001 Plan may be established at the discretion of an administrative committee appointed to administer the 2001 Plan, but no option may be exercisable for more than ten years. As of June 30, 2003, options to purchase 10,612 shares of the Company's common stock are outstanding under the 2001 Plan.

The 2002 Incentive Plan (the "2002 Plan") provides for incentive stock options to be granted to selected employees and directors of the Company, and selected non-employee advisors to the Company. Options to purchase up to 300,000 shares of the Company's common stock may be granted under the 2002 Plan. Terms of exercise and expiration of options granted under the 2002 Plan may be established at the discretion of an administrative committee appointed to administer the 2002 Plan, but no option may be exercisable for more than ten years. As of June 30, 2003, there were no options outstanding under the 2002 Plan. However, as of the date of this report, 110,000 options are outstanding under the 2002 Plan.

F-19

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

6. STOCKHOLDERS' EQUITY (Continued)

The 2003 Incentive Plan (the "2003 Plan") provides for incentive stock options to be granted to selected employees and directors of the Company, and selected non-employee advisors to the Company. Options to purchase up to 750,000 shares of the Company's common stock may be granted under the 2003 Plan. Terms of exercise and expiration of options granted under the 2003 Plan may be established at the discretion of an administrative committee appointed to administer the 2003 Plan, but no option may be exercisable for more than ten years. As of June 30, 2003, there were no options outstanding under the 2002 Plan. However, as of September 30, 2003, 431,333 options were outstanding under the 2003 Plan.

During the year ended June 30, 2003, the Company granted options to purchase 30,000 shares of common stock, of which options to purchase 10,000 shares expired during the year.

During the year ended June 30, 2002, the Company granted options to purchase 18,500 shares of common stock to members of the advisory board. The fair value of the options, in the amount of \$78,000, is being amortized as non-cash compensation expense through July 2003. Non-cash charges for these options

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

amounted to \$47,921 during the year ended June 30, 2002. The Company also issued options to consultants to purchase 21,618 shares of common stock. The fair value of the options, in the amount of \$98,000, is being amortized as non-cash compensation expense through July 2004. Non-cash charges for these options amounted to \$68,741 during the year ended June 30, 2002.

In January 2002, the Company reduced the exercise price to \$11.00 for 63,693 outstanding options. These options will be accounted for as variable from the date of the modification to the date the options are exercised, forfeited or expires unexercised. Variable accounting requires the Company to take a non-cash charge to earnings for the difference between the exercise price and the fair market value of the stock multiplied by the number of vested options on the date each price requirement is met. As of June 30, 2002, the fair market value of the Company's common stock was lower than the reduced exercise price of these options, thus no charges against operations were incurred.

During the year ended June 30, 2001, the Company granted options to purchase 24,000 shares of common stock to consultants. The fair value of the options, in the amount of \$162,000, was amortized as non-cash compensation expense through June 2002. Non-cash charges for these options amounted to \$66,209 during the year ended June 30, 2002.

F-20

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

6. STOCKHOLDERS' EQUITY (Continued)

The Company applies APB Opinion 25 and related interpretations in accounting for equity instruments issued to employees. Accordingly, no compensation cost has been recognized for its employee stock option grants other than non-cash charges for the vesting of price-vested options. Had the compensation cost for the Company's stock options grants been determined based on the fair value at the grant dates for awards consistent with the method of SFAS 123, the Company's net loss attributable to common stockholders and basic and diluted loss per common share would have changed to the pro forma amounts indicated below for the year ended June 30, 2002:

	For the Year ended June 30, ----- 2002 -----
Pro forma net loss:	
As reported	\$ (17,093,899)
Pro forma effect of SFAS No. 123	(541,995)

Pro forma after giving effect to SFAS No. 123	\$ (17,635,894)

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Basic and diluted loss per common share:	
As reported	\$ (7.18)
Pro forma effect of SFAS No. 123	(0.23)
Pro forma after giving effect to SFAS No. 123	\$ (7.41)

THE ABOVE TABLE HAS NOT BEEN UPDATED FOR THE YEAR ENDED JUNE 30, 2003 AS ONLY 30,000 OPTIONS WERE GRANTED DURING THE YEAR AND 10,000 OF THEM EXPIRED. MANAGEMENT HAS CONCLUDED THAT THE AGGREGATE AFFECT ON OUR FINANCIAL STATEMENTS IS RELATIVELY SMALL AND DOES NOT MATERIALLY AFFECT THE ABILITY OF INVESTORS TO EVALUATE THE COMPANY.

The weighted-average fair value at date of grant for options granted during the years ended June 30, 2002 was \$4.20 per share. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model using the following weighted-average assumptions:

	Year ended June 30,

	2002

Risk-free interest rate	3.24%
Expected lives in years	2.7
Expected volatility	60%
Expected dividend yield	0%

Because of its financial difficulties, the Company has been unable to prepare the information required by SFAS 123 for the year ended June 30, 2003.

F-21

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

6. STOCKHOLDERS' EQUITY (Continued)

The following table summarizes the Company's stock options at June 30, 2003 and 2002, as well as changes during the years then ended:

	Years ended June 30,			
	-----		-----	
	2003		2002	
	-----		-----	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
	-----	-----	-----	-----
Options outstanding at beginning of year	214,523	\$ 14.17	190,541	\$ 18.39
Granted	30,000	\$ 7.50	95,419	\$ 4.62
Forfeited	193,020	\$ 16.44	(62,319)	\$ 26.79

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Exercised	0	\$ 0	(9,118)	\$ 2.08
	-----		-----	
Options outstanding at end of year	51,503	\$ 12.81	214,523	\$ 14.17
	=====		=====	
Options exercisable at end of year	51,503	\$ 12.81	159,069	\$ 15.10
	=====		=====	

The following table presents information relating to stock options outstanding as of June 30, 2003:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Shares	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
\$ 0 - \$ 7.50	20,000	4.1	\$ 7.50	20,000	\$ 7.50
\$ 9.50 - \$ 11.00	9,000	1.1	\$ 10.83	9,000	\$ 10.83
\$ 12.20 - \$ 15.00	4,891	1.3	\$ 15.00	4,891	\$ 15.00
\$ 15.40 - \$ 17.00	6,500	1.5	\$ 16.02	6,500	\$ 16.02
\$ 20.00 - \$ 29.10	11,112	1.0	\$ 21.14	11,112	\$ 21.14
	51,503	2.29	\$ 12.81	51,503	\$ 12.81
	=====			=====	

The Company had 746,552 options reserved for future issuance under all of the incentive plans as of June 30, 2003.

F-22

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

7. INCOME TAXES

DUE TO OUR CURRENT FINANCIAL PROBLEMS, WE HAVE NOT PREPARED INCOME TAX INFORMATION FOR THE YEAR ENDED JUNE 30, 2003. WE ARE PROVIDING INFORMATION FOR THE YEAR ENDED JUNE 30, 2002 BELOW.

The provision for income taxes consisted of the following:

For the year ended June 30,
2002

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Deferred benefit:	
Federal	\$ 1,185,000
State	209,000

	1,394,000
Increase in valuation allowance	(1,394,000)

	\$ -
	=====

A reconciliation of the effective tax and the statutory U.S. federal income tax is as follows:

	For the year ended June 30, 2002

Expected tax (benefit)	\$ (4,139,000)
Increase (decrease) in taxes resulting from:	
Permanent differences	3,475,000
State and local income tax (benefit), net of federal effect	(730,000)
Increase in valuation allowance	1,394,000

Taxes on income	\$ -
	=====

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets, liabilities and the valuation allowance at June 30, 2002 are as follows:

F-23

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

7. INCOME TAXES (Continued)

	June 30, 2002

Deferred tax assets:	
Accounts receivable allowance	\$ 1,000
Accrued expenses	4,000
14,000	
Depreciation and amortization	7,000
-	
Compensation expense for common stock options and warrants not allowed for income tax purposes	1,961,000
1,954,000	

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Federal, state and local net operating loss carryforwards	13,961,000

Net deferred tax asset before valuation allowance	15,934,000

Valuation allowance	(15,934,000)

Net deferred tax asset	\$ -
	=====

The Company provided a valuation allowance of 100% of its net deferred tax asset due to the uncertainty of generating future profits that would allow for the realization of such deferred tax asset.

The Company has a net operating loss carryforward for tax purposes of approximately \$32,580,000 as of June 30, 2002. This carryforward expires from 2004 to 2022.

The utilization of the loss carryforwards may be limited under Section 382 of the Internal Revenue Code.

The net operating loss carryforward includes net operating losses from Centerpoint of approximately \$3,258,000 which expire between 2019 and 2021. In addition to these operating losses, Centerpoint has a capital loss carry-forward of \$14,370,000 which can be carried forward to 2005. The utilization of the loss carryforwards should be limited under Section 382 of the Internal Revenue Code. The above loss carryforwards are carried at no value on Centerpoint's books as management believes that it more likely than not that these carryforwards will not be utilized.

8. COMMITMENTS AND CONTINGENCIES

Employment and director agreements:

At June 30, 2003 the Company was not a party to any employment/consultant agreements (as all employees had been terminated effective February 15, 2003. Those employees/consultants who continued working for the Company subsequent thereto have done so without agreements.

For termination of agreements with D2, LLC/David Mitchell, see Note 9 below.

F-24

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

8. COMMITMENTS AND CONTINGENCIES (Continued)

Subsequent to June 30, 2003 certain agreements have been executed. See Note 9 below.

Obligations under operating leases:

Our executive offices are located at 18 E. 50th Street, 10th Floor, New York, New York 10022 under a lease which, as renegotiated during fiscal 2003, expires on December 31, 2003. Bion currently pays no rent and occupies a small portion of the leased space at no monthly cost pursuant to agreements

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

between and among the landlord (an unaffiliated party), Bion, and entities connected with David Mitchell (our former C.E.O. and Director) and Salvatore Zizza (our former Secretary and Director). We amended our New York City office lease effective March 1, 2003. Under this amendment the expiration date was changed to December 31, 2003, from the previous expiration date of December 31, 2010. The amendment calls for the drawdown of the letter of credit provided to the landlord for the full amount of \$120,561 to be used to pay arrearages and future rent. In addition, two of our new subtenants, Mitchell & Co. and Zizza & Co., which are controlled by David Mitchell and Salvatore Zizza, respectively, are former officers and directors of Bion, and have personally guaranteed the lease with the landlord. It is possible that we will not incur additional cash outflows in connection with this lease as a result of the drawdown of the letter of credit, the subrental income and the personal guarantees. See our Current Report dated March 25, 2003 and the exhibits thereto. However, Bion may have certain liabilities at the end of the lease term which cannot be fully determined at this time but which we estimate will be less than \$20,000. The lease and sublease agreements cover approximately 5,700 square feet.

We have no additional offices at this time but may have liability in connection with prior office leases related to space we have vacated including without limitation: a) space at 8899 Main Street, Williamsville, New York 14221 under a lease that expires on November 30, 2004 and provides for annual base rents of approximately \$18,600 and covers approximately 1,800 square feet; and b) space at 138 Uzzle Industrial Drive, Clayton, North Carolina 27520 under a lease that expired June 30, 2003 and provides for annual base rents of approximately \$15,000 and covers approximately 4 acres and an office building of approximately 2,350 square feet. Except as described above, all leases and rental agreements are with non-affiliated parties.

F-25

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

8. COMMITMENTS AND CONTINGENCIES (Continued)

Obligations under capital leases:

The Company has various non-cancelable capital leases for computers and equipment. At June 30, 2003, minimum future lease payments under non-cancelable capital leases were as follows:

2003	\$ 1,021
------	----------

Licensing agreement:

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

On January 31, 2002, the Company entered into a licensing agreement with BioBalance A/S. This agreement allows the Company to license the BioBlance technology for use in the field of agricultural applications for treating/converting animal waste into soil-like products with a content of nutrients and organic matter. The agreement exclusively covers the United States and its territories. This licensing agreement is for ten years and can be cancelled by the Company with 120 days notice. At June 30, 20023 future minimum licensing commitments are as follows:

2003	\$	20,833
2004		60,417
2005		85,417
2006		100,000
2007		100,000
Thereafter		1,508,333

	\$	1,875,000
		=====

Claims Contingency:

On September 30, 2003, Morrison Cohen Singer & Weinstein, LLP ("MCSW") filed a complaint in the Supreme Court of the State of New York, County of New York, against us alleging that we owe MCSW approximately \$114,000 for legal services provided. We have not yet filed an answer in that proceeding. Because we have already recorded a liability for these legal services, we do not believe that this lawsuit will have a material adverse effect on our financial condition.

F-26

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

8. COMMITMENTS AND CONTINGENCIES (Continued)

On July 22, 2002, Thomas Keith Barefoot ("Barefoot"), doing business as Quin Deca Farm ("Quin Deca"), an unaffiliated party, filed a complaint against the Company in the Superior Court of the County of Harnett in the State of North Carolina regarding the Company's first generation Bion NMS System on Quin Deca Farm and the harvesting of BionSoil. The complaint includes breach of contract claims asserting that the Company abandoned the NMS system on Quin Deca Farm and the failure of the Company to harvest BionSoil. The second claim is for fraud regarding misrepresentation of the state of the technology of the first generation NMS. The third claim is for unfair and deceptive trade practices for misrepresentation of the state of the technology of the NMS

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

System. The fourth claim is for negligent misrepresentation made by Bion in connection with the work it performed and its suitability for the intended purpose. The fifth claim is for equity/specific performance in that Bion left Quin Deca with an economically and technically deficient waste management system that cannot continue to be used without adequate and alternative methods of waste removal. Quin Deca is seeking \$830,000 in damages plus punitive damages and to have its damages trebled, reasonable attorney fees and principles of equity requiring Bion to install its second generation Bion NMS system. We have filed an answer and counterclaims. The action has been removed to the U.S. District Court for the Eastern District of North Carolina which court recently ruled that most of the substantive claims should be arbitrated. The Company does not believe that the claims against it have merit and, assuming that we have the funds to properly defend this action, we that the ultimate resolution of this litigation will not have a material adverse effect on the Company, its operations or its financial condition.

On May 6, 2002, Arab Commerce Bank Ltd. ("ACB"), an unaffiliated party, filed a complaint against the Company in the Supreme Court of the State of New York regarding \$100,000 of the Company's convertible bridge notes ("Notes") that were issued to ACB in March of 2000. The complaint includes breach of contract claim asserting that the Company owes ACB \$265,400 plus interest or \$121,028 including interest based on ACB's interpretation of the terms of the Notes and subsequent amendments. Effective June 30, 2001, the Company issued ACB 5,034 shares of common stock on conversion in full payment of the Notes based on the Company's interpretation of the Notes, as amended. The Company has filed an answer to the complaint denying the allegations. The Company does not believe that the ultimate resolution of this litigation will have a material adverse effect on the Company, its operations or its financial condition.

Letter of Credit:

The Company has provided a letter of credit for \$120,561, which serves as a security deposit on a lease agreement. The amount has been recorded as restricted cash and is included in other assets on the Company's consolidated balance sheet.

F-27

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

9. RELATED PARTY TRANSACTIONS AND SUBSEQUENT EVENTS

(A) Since filing of Annual Report on Form 10-KSB for the year ended June 30, 2002:

During February 2003 Bion entered into an agreement with Centerpont (which agreement was amended April 23, 2003) which agreement was ratified by the shareholders of Centerpoint on August 25, 2003. This agreement, upon ratification by Centerpoint's shareholders and completion of a related agreement (executed May 29, 2003) with OAM, S.p.A., the former parent of Centerpoint, on August 27, 2003, amended certain contractual provisions which

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

had prevented the raising of funds by Bion thereby creating the financial/management crisis which has afflicted Bion over the past year. For details, see "Item 1. Description of Business---Acquisition of Centerpoint/Transactions with Centerpoint and Recent Developments - Centerpoint Shareholders' Meeting/Removal of Contractual Problems" above and our Current Reports on Form 8-K dated August 25, 2003, June 9, 2003 and April 12, 2003 and the exhibits thereto.

During August 2003 Bion Dairy Corporation ('Dairy'), our wholly-owned subsidiary, completed the initial closing of secured convertible notes. As of September 30, 2003, the largest purchaser (\$600,000 in exchange for \$600,000 of advances (see below) made to Bion during 2003) was an entity owned by Dominic Bassani, General Manager of Dairy and a consultant to Bion and Dairy. In addition, Mark A. Smith, our President and a director, purchased \$65,000 of such notes and an entity affiliated with David Mitchell, our former C.E.O., Chairman and a director, purchased (in exchange for \$65,000 of prior advances (see below) to Bion during 2003) \$65,000 of such notes. For details see "Item 1. Description of Business -Recent Developments, Bion Dairy Corporation Financing" above and our Current Report on Form 8-K dated August 25,2003 and the exhibits thereto.

F-28

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

9. RELATED PARTY TRANSACTIONS AND SUBSEQUENT EVENTS (Continued)

From January 2003 through August 2003, Dominic Bassani made advances to Bion (primarily through Bright Capital, Ltd. and D2, LLC) which totaled in excess of \$600,000. From late March 2003 (when most management personnel resigned and the contract with D2, LLC under which he had been providing consulting services to Bion terminated) through present, Mr Bassani has provided ongoing consulting services to Bion. Mr. Bassani will provide services to Bion and Dairy through March 31,2005 for the sum of \$300,000 per year in deferred compensation (to be converted into Bion common stock at a price no greater than \$3.00 per share and the grant of 200,000 options to purchase Bion common stock at a price of \$3.00 per share until August 31,2008. Additionally, pursuant to prior existing arrangements, adjustments were made to Class SV

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

(650,000 increased to 800,000 ; exercise price reduced to \$3.00; term extended to August 31,2008) now owned by family members of Mr. Bassani (and/or trust for such family members). Various agreements related to such advances, services and adjustments have been executed by Bion. See our Current Reports on Form 8-K dated March 25, 2003, April 12, 2003, June 9, 2003 and August 25, 2003 and the exhibits thereto for further details.

Mark A. Smith, our President and a director, has agreed to serve in such positions on a consulting basis through March 31,2003 in consideration of \$150,000 in deferred compensation (to be converted into Bion common stock at a price no greater than \$3.00 per share) and the grant (effective August 31, 2003) of 50,000 options to purchase Bion common stock at \$3.00 per share until August 31, 2003. See our Current Report on Form 8-K dated June 9, 2003 and the exhibits thereto for further details.

The management agreement between us and D2, LLC/David Mitchell was terminated effective as of March 25, 2003. The voting and shareholder agreements to which D2 was a party were also terminated as of that same date. The Trust Under Deferred Compensation Plan for D2CO, LLC (the "Trust") will remain in existence until mutually agreed otherwise and, unless otherwise agreed in writing, the "payable" balance of \$487,500 principal (plus accrued interest) owed by us to the Trust will be converted into shares of our Common Stock upon the earlier to occur of (a) a \$5 million or greater equity financing(s) by us, in which case the amount payable will be converted into shares of our Common Stock at the equity price of the financing (or, in the event that the \$5 million in equity financing is obtained in a series of more than one financing, the price of the equity financing which pushed the aggregate total of the financings above \$5 million), or (b) March 31, 2005, at the then current market price of our Common Stock.

F-29

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

9. RELATED PARTY TRANSACTIONS AND SUBSEQUENT EVENTS (Continued)

Until late March 2003 consulting fees accrued for the services of D2, LLC (which provided the services of David Mitchell, our former Chairman, and, indirectly, Mr. Bassani). For details, see our Current Report on Form 8-K dated March 25, 2003 and the exhibits thereto. All 94,439 shares of Bion common stock held in the Trust were distributed pursuant to the instructions of D2, LLC (to David Mitchell and Dominic Bassani). Effective August 31, 2003, pursuant to prior agreements and in consideration of services provided by David Mitchell to Bion, 387,343 outstanding Class SV warrants (now owned by a trust for his children) were adjusted to lower the exercise price to \$5.00 per share and extend the term until August 31, 2008. Below are some details concerning compensation paid to the Trust in shares and/or notes. The shares have been distributed as described above. The notes will be converted as described above.

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

As to other transactions related to David Mitchell/D2, LLC during the period leading up to the agreements in the above paragraph:

(1) The Company issued to D2: 15,322 and 23,421 shares of common stock for management fees during the three and six months ended December 31, 2001, respectively. The management fees were valued at \$125,000 and \$250,000 during the three and six months ended December 31, 2001, respectively. These shares are among the shares distributed from the Trust (as defined below) as described above.

(2) The Company and D2 orally agreed during January 2002, that in the event the average price per common share is below \$7.50 for any quarter in which consulting fees are to be paid to the Trust, Bion will issue a convertible note in lieu of the stock payment. The agreement is to remain in place during the "Adjustment Period" noted in the Centerpoint and OAM Agreements. The convertible note is recorded as deferred compensation upon consolidation of the Trust.

(3) On July 1, 2002, D2 returned to the Company 2,874 shares of the Company's common stock that were issued as part of the consulting fee to D2 paid to the Trust Under Deferred Compensation Plan for D2Co, LLC (the "Trust") for the Benefit of D2. The shares were subsequently cancelled.

(4) On September 30, 2002, the Company issued a convertible note for the D2 management fee to be paid to the Trust for the three months ended September 30, 2002. The convertible note was issued for the amount of the management fee of \$150,000 and pays interest at 6% per annum, payable in cash or in shares of the Company's common stock. The convertible note is convertible into shares of common stock in whole or in part at the time of the Company's next equity financing, at the price of the next equity financing. The convertible note is recorded as deferred compensation upon consolidation of the Trust.

F-30

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

9. RELATED PARTY TRANSACTIONS AND SUBSEQUENT EVENTS (Continued)

(5) On December 31, 2002, the Company issued a convertible note for the D2 management fee to be paid to the Trust for the three months ended December 31, 2002. The convertible note was issued for the amount of the management fee of \$150,000 and pays interest at 6% per annum, payable in cash or in shares of the Company's common stock. The convertible note is convertible into shares of common stock in whole or in part at the time of the Company's next equity financing, at the price of the next equity financing. The convertible note is recorded as deferred compensation upon consolidation of the Trust.

On June 30, 2001, Bion and D2CO, LLC ("D2") agreed that the payments owed to D2 under an existing management agreement be paid to the Trust. On July 31, 2001, Bion and Sam Spitz (the "Trustee") entered into the Trust. Under the Trust agreement, the Company contributed assets to the Trust at such times as specified in the management agreement with D2. Such assets are subject to claims of the Company's creditors in the event of the Company's insolvency,

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

have no preferred claim on, or any beneficial ownership interest in, any assets of the Trust unless and until such assets are distributed. Any rights created under the management agreement with D2 and the Trust shall be unsecured contractual rights of D2 against the Company. Payments of all amounts in the Trust are to be made to D2 on January 2, 2011, as stated in the Trust agreement, unless agreed otherwise.

The Company accounts for the Trust under the provisions of Emerging Issues Task Force ("EITF") 97-14 "Accounting for Deferred Compensation Arrangement Where Amounts are Earned and Held in a Rabbi Trust and Invested" which requires the Company to consolidate into its financial statements the net assets of the Trust. The value of the Company's common stock held by the Trust is classified in shareholders' equity and is accounted for in a manner similar to treasury stock. The deferred compensation obligation has been classified as a liability and is adjusted, with the corresponding charge or credit to compensation expense, to reflect changes in fair value of the common stock held by the Trust. As of June 30, 2003, \$487,500 is owed to the Trust (not including accrued interest of \$9,550). At March 31, 2003 the Trust held 91,439 shares of common stock of the Company (now distributed after return and cancellation of 2874 shares as described above) having a fair value of \$59,435, for a total of \$549,185 in deferred compensation (including \$2250 of accrued interest). At June 30, 2003, the Trust is owed \$497,050 (including interest), all of which will convert into Bion common stock as set forth above.

Jon Northrop, a director of Bion, has been granted (effective August 31, 2003) an option to purchase 10,000 shares of Bion's common stock at a price of \$3.00 until August 31, 2008.

F-31

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

9. RELATED PARTY TRANSACTIONS AND SUBSEQUENT EVENTS (Continued)

Jere Northrop, director and Technology Director of Bion, has been granted (effective August 31, 2003) an option to purchase 40,000 shares of Bion's common stock at a price of \$3.00 per share until August 31, 2008. In addition, Jere Northrop is receiving \$2,500 per month of deferred compensation (to be converted into Bion common stock at \$3.00 per share) to compensate for additional duties he has taken on due to Bion's reduced technical personnel resulting from our ongoing financial crisis.

Our executive offices are located at 18 E. 50th Street, 10th Floor, New York, New York 10022 under a lease which, as renegotiated during fiscal 2003, expires on December 31, 2003. Bion currently pays no rent and occupies a small portion of the leased space at no monthly cost pursuant to agreements between and among the landlord (an unaffiliated party), Bion, and entities connected with David Mitchell (our former C.E.O. and Director) and Salvatore

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Zizza (our former Secretary and Director). We amended our New York City office lease effective March 1, 2003. Under this amendment the expiration date was changed to December 31, 2003, from the previous expiration date of December 31, 2010. The amendment calls for the drawdown of the letter of credit provided to the landlord for the full amount of \$120,561 to be used to pay arrearages and future rent. In addition, two of our new subtenants, Mitchell & Co. and Zizza & Co., which are controlled by David Mitchell and Salvatore Zizza, respectively, are former officers and directors of Bion, and have personally guaranteed the lease with the landlord. It is possible that we will not incur additional cash outflows in connection with this lease as a result of the drawdown of the letter of credit, the subrental income and the personal guarantees. See our Current Report dated March 25, 2003 and the exhibits thereto. However, Bion may have certain liabilities at the end of the lease term which cannot be fully determined at this time but which we estimate will be less than \$20,000. The lease/sublease agreements cover approximately 5,700 square feet.

We have no additional offices at this time but may have liability in connection with prior office leases related to space we have vacated including without limitation: a) space at 8899 Main Street, Williamsville, New York 14221 under a lease that expires on November 30, 2004 and provides for annual base rents of approximately \$18,600 and covers approximately 1,800 square feet; and b) space at 138 Uzzle Industrial Drive, Clayton, North Carolina 27520 under a lease that expired June 30, 2003 and provides for annual base rents of approximately \$15,000 and covers approximately 4 acres and an office building of approximately 2,350 square feet. Except as described above, all leases and rental agreements are with non-affiliated parties.

We do not own any of these facilities, nor are we obligated under any mortgages for the properties. We believe that, under our current operations, the facilities are adequate, but, if our second generation NMS testing is successful and we obtain additional financing, we will need additional office and other space.

F-32

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

9. RELATED PARTY TRANSACTIONS (Continued)

(B) Transactions disclosed in our Annual Report on Form 10-KSB for the year ended June 30, 2002:

Transactions with David Mitchell and Related Entities

Management Agreement with D2

In December 1999, the Company entered into a three year Management Agreement with D2 Co., LLC ("D2") of which David Mitchell, Chairman, CEO and President of the Company, is sole member, pursuant to which D2 agreed to provide the Company specific management and consulting services. The agreement called for compensation to D2 for such services in the amounts of:

* \$240,000 per year payable in common stock or cash; and

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

- * 250,000 warrants exercisable at \$25.00 expiring on December 31, 2004.

On August 10, 2000, the Company amended the Management Agreement with D2 under which the Company:

- * Extended the agreement for D2's services for an additional year; and
- * issued 150,000 additional warrants (100,000 exercisable at \$35.00 per share and 50,000 exercisable at \$60.00 per share, both exercisable from January 1, 2002 until August 10, 2005).

In December 2000, the Company made additional amendments to the D2 Management Agreement by:

- * extending the term of the agreement by 18 months;
- * canceling all of the warrants issued under the Management Agreement as amended; and
- * increasing the annual base consideration to \$500,000 in calendar year 2001, to \$600,000 in calendar year 2002 and \$750,000; and calendar year 2003.

Effective January 1, 2001, the Company orally agreed to the following:

- * to make the payments due under the Management Agreement to the Trust Under Deferred Compensation Plan for D2CO, LLC (the "Trust") for the benefit of D2.

The payments to the Trust for the six months ended June 30, 2001 totaling \$250,000 were made in the form of 2000 and 2001 convertible bridge notes (the "CV Notes").

F-33

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

9. RELATED PARTY TRANSACTIONS (Continued)

Effective July 1, 2001 through June 30, 2002, compensation to D2 was paid to the Trust in the form of common stock on a quarterly basis. Thereafter, notes were issued to the Trust. As of March 27, 2003, the date on which the agreements with D2 terminated (upon the resignation of David J. Mitchell), the sum of \$487,500 was owed to by Bion to the Trust. The Trust and D2 have agreed, unless otherwise agreed in writing, that the "payable" balance of \$475,000 owed by us to the Trust will be converted into shares of our common stock upon the earlier to occur of (a) a \$5 million or greater equity financing(s) by us, in which case the amount payable will be converted into shares of our common stock at the equity price of the financing (or, in the event that the \$5 million in equity financing is obtained in a series of more than one financing, the price of the equity financing which pushed the aggregate total of the financings above \$5 million), or (b) March 31, 2005, at

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

the then current market price of our common stock. See our Current Report on Form 8K dated March 25, 2003 and the exhibits thereto.

We receive consulting services from Bright Capital, which provides the services of consultant Dominic Bassani. Bright Capital is compensated directly by D2 from the fees paid by Bion to D2.

On January 15, 2002, as a result of the transaction with Centerpoint:

- * all the D2 and the Trust CV Notes were converted into 37,022 shares and 36,064 shares of the Company's common stock, respectively.

See Note 3.

Warrant Purchase Agreement

In December 1999, we entered into a Warrant Purchase Agreement pursuant to which:

- * D2 purchased 250,000 warrants, exercisable at \$17.50 expiring on December 31, 2004, for \$1,000,000 (\$500,000 in cash and \$500,000 in a non-recourse promissory note to us that was secured by the subject warrants).

F-34

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

9. RELATED PARTY TRANSACTIONS (Continued)

In December 2000, we entered into an agreement with D2 pursuant to which:

- * We canceled the warrants issued under the Warrant Purchase Agreement; and
- * We agreed to repay the purchase price of the warrants issued under the Warrant Purchase Agreement with \$500,000 cash and cancellation of the existing \$500,000 non-recourse promissory note receivable and accrued interest

Southview

During the period January 8 through March 31, 2001, Southview, Inc. ("Southview"), a corporation wholly owned by Mr. Mitchell:

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

- * loaned the Company \$871,000 earning 8% interest per annum of which \$371,000 was repaid in April 2001.

On February 16, 2001, under an agreement effective January 8, 2001, Southview purchased:

- * warrants to purchase 650,000 shares of the Company's common stock for the sum of \$500,000, exercisable until February 16, 2006.

Half of these warrants were exercisable at \$10.00 and half of these warrants were exercisable at varying prices between \$10.00 and \$20.00 per share, depending on the market price of the Company's common stock. The warrants were subsequently assigned to Atlantic Partners, LLC ("Atlantic"), an affiliate of David Mitchell.

On September 6, 2001, the Board of Directors affirmed an agreement dated August 1, 2001 entered into between the Company, D2, Southview and Atlantic in which the Company agreed to amend the Southview warrants so that:

- * upon the conversion of the Company's outstanding CV Notes into the Company's common stock, the outstanding Southview warrants will be adjusted ("Adjusted Warrants") so that the Adjusted Warrants equal 20% of the "fully-diluted" outstanding shares; and

As partial consideration for Bion agreeing to the adjustment to the Southview warrants, Southview agreed:

- * to extend the term of the outstanding promissory note due July 31, 2001, with a balance of \$521,040 including accrued interest, so that such promissory note could be repaid from the proceeds of a new financing.

F-35

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

9. RELATED PARTY TRANSACTIONS (Continued)

On January 15, 2002, as a result of the transaction with Centerpoint:

- * the Southview warrants were adjusted to equal 20% or, 1,037,343 shares of the "fully-diluted" outstanding shares of the Company and the exercise was adjusted to \$7.50 resulting in a benefit of \$3,709,713 calculated using the Black-Scholes pricing model; and
- * In addition, the Company repaid the Southview promissory note, which had a value of \$718,485 including interest and additional advances.

Private Placement

On April 13, 2000, we completed a private placement offering in which D2 participated under the same terms as unaffiliated third parties. D2 purchased four units evidencing \$100,000 convertible notes and 3,000 warrants to purchase common stock exercisable at \$23.75 per share until December 31, 2004.

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

On January 15, 2002, as a result of the transaction with Centerpoint, D2's convertible note was converted into 15,712 shares of the Company's common stock under the amended terms of the notes.

See Note 3.

Shareholder Agreement/Stock Voting Agreement

On December 23, 1999, D2, Mark A. Smith, Jere Northrop, LoTayLingKyur, Inc., and Dublin Holding, Ltd. entered into a Shareholders' Agreement, as amended, which, among other things, restricts the transfer, sale, conveyance, exchange, pledge, or otherwise disposition of any shares of the Company except in connection with a sale of all or substantially all of the outstanding stock of the Company or a merger of the Company. Under the agreement, certain transfers are permitted under certain conditions.

On August 1, 2001, the Company, D2 and Dublin Holdings, Ltd., LoTayLingKyur, Inc., Mark Smith, Kelly Smith, LoTayLingKyur Foundation, Kelly Smith Rollover IRA, and Mark Smith Rollover IRA (collectively "the Smith shares"), entered into a voting agreement where among other things, the Smith shares shall not be transferred in a private non-market transfer which reduces the number of shares for which D2 is Proxy to less than 2/3 of the initial shares for which D2 is Proxy unless the transferee is willing to appoint D2 as Proxy for the transferred portion of the shares .

Transactions with Mark A. Smith and Related Entities

During the period beginning July 1, 2000, we entered into the following transactions with Mark A. Smith and/or entities affiliated with him: LoTayLingKyur, Inc. ("LTLK"), LTLK Defined Benefit Plan, LoTayLingKyur Foundation, and Dublin Holding Ltd. (collectively "First Parties"), including the following:

F-36

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

9. RELATED PARTY TRANSACTIONS (Continued)

Commencing August 3, 2000, and at various other effective dates through the month of August 2000, the First Parties (and certain related holders of our Class X Warrants and Class Z Warrants):

- * exchanged, in aggregate, 16,520 Class X Warrants and 542,544 Class Z Warrants for 86,340 restricted shares of our common stock. This exchange occurred pursuant to an agreement we had with the warrant holders dated December 20, 1999. Mr. Smith, (and affiliates and extended family members of Mr. Smith) participated in this warrant exchange agreement.

On August 1, 2001 Mark Smith, Dublin Holding, Ltd., LoTayLingKyur, Inc., LoTayLingKyur Foundation, Mark Smith Rollover IRA, Kelly Smith and Kelly Smith Rollover IRS which all owned shares of the Company's common stock (the "Smith Shares"), entered into a voting agreement that gives D2:

- * the power to vote all of the Smith Shares as to most matters. Mr.

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Smith will still have the right to vote the Smith Shares with respect to a sale of substantially all of our assets or a merger. The voting agreement is purely contractual and is not a formal voting trust.

In addition, Mr. Smith and certain related entities entered into a separate agreement with the Company which imposed certain restrictions on the sale and transfer of the Smith Shares and amended the respective terms of convertible promissory notes payable to Dublin Holding, Ltd, the Mark A. Smith Rollover IRA and the Kelly Smith Rollover IRA to provide that these notes:

- * would be automatically and fully converted (with all principal and accrued interest calculated as if they had been held to maturity) into shares of the Company's common stock upon the conversion of the CV Notes at a conversion rate equal to the lesser of (i) \$18.00 per share or (ii) the conversion price of the CV Notes.

On January 15, 2002, as a result of the transaction with Centerpoint, these notes were converted into 588,852 shares of the Company's stock at \$7.50 per share.

See Note 3.

Transactions with Salvatore J. Zizza

Beginning August 10, 2000, Salvatore J. Zizza, who served as a Director from December 1999 to February 2003, agreed to serve as our governmental affairs liaison and provide additional consulting services through September 1, 2002 for which he received no additional compensation. We granted Mr. Zizza options to purchase 7,500 shares of our common stock at a price of \$22.50 per share, exercisable until December 31, 2003, and issued him 10,000 Class J-2 warrants to purchase common stock at a price of \$23.75 per share. In addition, we agreed to provide Mr. Zizza with office space in our New York City office at no cost to him.

F-37

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

9. RELATED PARTY TRANSACTIONS (Continued)

On January 15, 2002, we adjusted the price of the options to \$11.00 and cancelled the 10,000 Class J-2 warrants and issued Mr. Zizza options to purchase 10,000 shares of our common stock at a price of \$11.00 per share exercisable until December 31, 2004.

On June 25, 2002, Mr Zizza agreed to devote more time as our governmental affairs liaison. On July 1, 2002 we issued Mr. Zizza additional options to purchase 10,000 shares of our common stock at a price of \$7.50 per share vesting on July 1, 2003, exercisable until July 1, 2005.

Private Placements

On April 13, 2000, we completed a private placement offering in which Mr. Zizza participated under the same terms as unaffiliated third parties. Mr. Zizza purchased two units evidencing \$50,000 convertible debt and 1,500

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

warrants to purchase common stock exercisable at \$23.75 per share until December 31, 2004.

On June 8, 2001, we completed private placement offering in which Mr. Zizza participated under the same terms as unaffiliated third parties. Mr. Zizza purchased a \$98,552 convertible note and 2,955 warrants to purchase common stock exercisable at \$15.00 per share until December 31, 2005.

On January 15, 2002, as a result of the transaction with Centerpoint, Mr. Zizza's convertible notes, including accrued interest, were converted to 21,846 shares of the Company's common stock under the amended terms of the notes.

Transactions with Andrew G. Gould

Andrew G. Gould served on our Board of Directors from August 10, 2000 to February 14, 2003. In addition to his duties as a director, Mr. Gould, through Arthur P. Gould & Co., Inc., a company that he owns, contracted to provide us with an average of approximately ten hours per month of technology consulting services through August 31, 2002, at no cost to us. We granted Mr. Gould options to purchase 7,500 shares of our common stock at a price of \$22.50 per share, exercisable until December 31, 2003. The exercise price of these options was adjusted on January 15, 2002 to \$11.00 per share.

F-38

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

9. RELATED PARTY TRANSACTIONS (Continued)

On June 8, 2001, we completed private placement offering in which Mr. Gould participated under the same terms as unaffiliated third parties. Mr. Gould purchased a \$7,882 convertible note and 237 warrants to purchase common stock exercisable at \$15.00 per share until December 31, 2005.

On January 15, 2002, as a result of the transaction with Centerpoint, Mr. Gould's convertible note was converted to 1,114 shares of the Company's common stock under the amended terms of the note. See Note 3.

Other Transactions with Northrops and Other Related Parties

Effective August 23, 2000, certain holders of our Class X Warrants and Class Z Warrants, including without limitation, Jon Northrop, who was then a Director and President, and Jere Northrop, Director and Senior Technology Officer (and their extended families), agreed to exchange, in aggregate:

- * 47,155 Class X Warrants and 85,570 Class Z Warrants for 26,984 restricted shares of our common stock. This exchange occurred pursuant to the terms of agreements dated December 20, 1999.

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Effective August 29, 2001, we amended agreements with eight holders of outstanding promissory notes (Jon Northrop, Jere Northrop, Northrop Family Trust, M. Duane Stutzman, Harley Northrop, Edward Hennig, William Crossetta and Craig Scott), pursuant to which each note holder agreed to:

- * extend the maturity date to April 30, 2002;
- * cancel certain outstanding options owned by the note holder; and
- * change the terms of the note so that outstanding principal and interest shall be completely converted to shares of the Company's common stock upon the earlier of April 29, 2002 or the conversion of the Company's outstanding CV Notes which conversion shall take place at the lower of \$22.50 per share, or the conversion price of the CV Notes.

On January 15, 2002, as a result of the transaction with Centerpoint, all of these promissory notes were automatically converted to 249,056 shares of the Company's common stock, respectively.

See Note 3.

F-39

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

9. RELATED PARTY TRANSACTIONS (Continued)

Effective on September 6, 2001 we entered into a severance agreement with Jon Northrop and as a result, we no longer have any employees in Denver and substantially all of our business operations are conducted out of our office in New York City. Mr. Northrop received monthly payments of \$10,000 in cash or common stock through August 2002.

Howard Chase joined our Board of Directors on January 21, 2002. In addition to his duties as a director, Mr. Chase, through Hollandbrook Group LLC (Hollandbrook), Inc. provided us consulting services. Bion paid Hollandbrook \$1,000 per month and issued to Hollandbrook \$9,000 in Bion common stock at a price per share of \$15.00. On February 14, 2003, Mr. Chase resigned from our Board of Directors and, subsequent thereto, Hollandbrook returned the 900 shares of Bion common stock that had been issued to it.

Transactions with Centerpoint

On January 15, 2002, Bion issued 1,900,000 shares of its restricted common stock, valued at \$7.50 per share, to Centerpoint, in exchange for \$8,500,000 in cash and the assignment of certain claims and other rights owned by Centerpoint for total consideration of \$14,250,000.

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

David Mitchell was a director of Centerpoint prior to the transaction with Bion and remained a director of Centerpoint until mid 2002.

The Company's equity and notes payable transactions with stockholders and other related parties are included in Note 10.

10. CONVERSION OF NOTES PAYABLE

In September 2001, a CV Note in the amount of \$112,740 was converted into 5,033 shares of the Company's common stock.

On January 15, 2002, the transactions involving Centerpoint caused the automatic conversion of our CV Notes in accordance with their terms. The CV Notes, in the aggregate amount of \$7,972,536, were converted into 1,063,038 common shares, at a conversion price of \$7.50 per share, of the Company's common stock. The conversion included 111,758 common shares issued to D2, the Trust, and Salvatore Zizza and Andrew Gould, former directors of the Company. The conversion price was contractually set to be equal to the value per share used to issue shares to Centerpoint in the Centerpoint transaction. See Note 3.

The transactions involving Centerpoint also caused the automatic conversion of promissory notes in accordance with their terms. The promissory notes, in the aggregate amount of \$6,284,244, were converted into 837,908 common shares, at

F-40

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

10. CONVERSION OF NOTES PAYABLE (Continued)

a conversion price of \$7.50 per share, of the Company's common stock. The conversion included common shares issued to Jere Northrop, our Chief Technical Officer and a director of the Company, and Mark Smith and affiliates of Mark A. Smith, President and Jon Northrop, director of the Company. The conversion price was contractually set to be equal to the value per share used to issue shares to Centerpoint in the Centerpoint transaction. See Note 3.

The Company incurred interest expense in the amount of \$1,208,598 and amortized debt discount in the amount of \$1,554,425 on the CV Notes and promissory notes during the year ended June 30, 2002.

In January 2002, the Company incurred interest expense in the amount of \$5,547,000 for the beneficial conversion of the CV Notes and promissory notes.

11. BUSINESS SEGMENT INFORMATION

The Company has in the past operated in three business segments. The Company has effectively re-entered the "development stage" over the past 18 months as it has ceased sales and operation of its first generation NMS systems and

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

BionSoil derived from them as it completes development and testing of its second generation NMS systems. The business segments it operated in are as follows:

Systems: The Company designed, marketed, installed and managed waste, wastewater and storm water systems, primarily in the livestock agricultural and food processing industries.

Soil: The Company produced and marketed BionSoil products such as organic fertilizers, potting soils and soil amendments which were produced from the nutrient rich Bion Solids harvested from agricultural systems installed on large dairy and hog farms.

Other: Contains the operating results of Centerpoint in which the Company's owns 57.2%. Centerpoint currently does not have any business operations other than general and administrative.

The Company's reportable operating segments have been determined in accordance with the Company's internal management structure, which in the past has been organized based on operating activities. The accounting policies of the operating segments are the same as those described in the summary of accounting policies. The Company evaluates performance based upon several factors, of which the primary financial measure is segment operating income.

The following table summarizes information about operations and long-lived assets as of and for the years ended June 30, 2003 and 2002:

F-41

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

11. BUSINESS SEGMENT INFORMATION (Continued)

	Systems -----	Soil -----	Other -----	Total -----
Year Ended - June 30, 2003				
Revenues	\$ - =====	\$ 116,029 =====	\$ - =====	\$ 116, =====
Operating loss	\$ (2,989,540)	\$ (900,224)	\$ 339,968	\$ (3,549,
Other income/(expense), net	\$ 244,298	3,820	\$ (207,149)	\$ 40,
Minority interest	\$ -	\$ -	\$ 50,567	\$ 50,
Net Loss	\$ (2,745,242) =====	\$ (896,404) =====	\$ 183,386 =====	\$ (3,458, =====
Supplemental segment information:				
Amortization and depreciation	\$ 37,883	\$ 99,118	\$ -	\$ 137,

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

As of June 30, 2003

Property and Equipment, net	\$ 165,803	\$ 49,880	\$ -	\$ 215,
Total Assets	\$ 203,580	\$ 58,183	\$ 646,113	\$ 907,

Year Ended - June 30, 2002

Revenues	\$ -	\$ 69,382	\$ -	\$ 69,
Operating loss	\$ (4,672,777)	\$ (3,903,022)	\$ (102,520)	\$ (8,678,
Other income/(expense), net	\$ (4,193,612)	(4,208,301)	\$ (99,124)	\$ (8,501,
Minority interest	\$ -	\$ -	\$ 85,457	\$ 85,
Net Loss	\$ (8,866,389)	\$ (8,111,323)	\$ (116,187)	\$ (17,093,

Supplemental segment information:

Amortization and depreciation	\$ 32,860	\$ 23,877	\$ -	\$ 72,
-------------------------------	-----------	-----------	------	--------

As of June 30, 2002

Property and Equipment, net	\$ 68,070	\$ 86,355	\$ -	\$ 154,
Total Assets	\$ 1,837,339	\$ 1,858,162	\$ 57,398	\$ 3,752,

12. CONCENTRATIONS OF CREDIT RISK

The Company's financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable.

The Company's cash and cash equivalents are in demand deposit accounts placed with federally insured financial institutions and selected brokerage accounts. Such deposit accounts at times may exceed federally insured limits. The Company has not experienced any losses on such accounts.

F-42

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

12. CONCENTRATIONS OF CREDIT RISK (Continued)

Concentrations of credit risk with respect to trade accounts receivable are generally limited since customers are dispersed across geographic areas. The Company reviews a customer's credit history before extending credit and establishes an allowance for doubtful accounts based upon the credit risk of specific customers, historical trends and other information. Generally, the Company does not require collateral from its customers.

13. SUPPLEMENTAL NON-CASH DISCLOSURES TO STATEMENT OF CASH FLOWS

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

The Company had the following non-cash financing activities during 2002 (no such activities took place during 2003):

	Year ended June 30, 2002 -----
Warrants issued in private placement	\$ -
Convertible bridge notes payable converted to common stock	7,325,354
Note payable, related parties-current converted to common stock	1,867,872
Note payable, related parties-long-term converted to common stock	3,609,783
Cancellation of note receivable for sale of warrants	-
Beneficial conversion feature on convertible bridge notes	-
Note receivable received for sale of common stock, and reassigned for purchase of Centerpoint stock	3,263,000
Claims receivable received for sale of common stock, then reassigned for purchase of Centerpoint stock	2,487,000

13. SUBSEQUENT EVENT

Bion Dairy Corporation Financing

On August 25, 2003 Bion Dairy Corporation ("Dairy"), of which we own all 4,000,000 shares of its common stock outstanding, closed an initial stage of financing totaling \$1,117,500 (including \$600,000 of prior advances from Bright Capital, Ltd. ("Brightcap") and \$65,000 of prior advances from affiliates of David Mitchell, our former CEO) of secured convertible debt ("Notes"). Through September 30, 2003 an additional \$65,000 of the Notes were sold to Mark A. Smith our president, for a total issuance of \$1,182,500. Up to a total of \$2,065,00 of such Notes may be issued. The largest holder of these Notes is Chris-Dan, LLC, which is owned by Dominic Bassani, General Manager of Dairy and a consultant to Bion. The Notes are secured by: a) all of the intellectual property of Bion (and its subsidiaries) (which previously secured outstanding obligations to Bright Capital, Ltd. which is owned by Mr. Bassani), b) all of the outstanding shares of Dairy, and c) all of the shares of Centerpoint owned by Bion. The Notes are convertible into the common stock of Dairy at a price of \$1.00 (principal and accrued interest on the Notes)

F-43

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to consolidated financial statements (Unaudited)

13. SUBSEQUENT EVENT (Continued)

under various conditions specified in the financing documentation, one or more of which conditions precedent to conversion may never be met. Under additional specified conditions (which also have no assurance of being met), the Notes (or Dairy common stock received pursuant to the conversion thereof) may in the future be exchanged for shares of the common stock of Bion. If conversion of the Notes into the common stock of Dairy takes place, all of Bion's business opportunity in the dairy industry world-wide will be conducted through Dairy, and the board of directors of Dairy will consist of three

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

members, two of which will be designated by the majority of the shareholders of Dairy and only one will be designated by Bion. The financing restricts the use of its proceeds and, unless Dairy and/or Bion raise substantial additional funds, there will be no substantial funds available for Bion to pay its creditors and carry out its business. See Exhibit 10.1 to our Current Report on Form 8-K dated August 25,2003 for further details.

F-44

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: October 13, 2003

BION ENVIRONMENTAL TECHNOLOGIES, INC.

By: /s/ Mark A. Smith

Mark A. Smith
President and Interim Chief
Financial Officer

Edgar Filing: BION ENVIRONMENTAL TECHNOLOGIES INC - Form 10KSB

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature -----	Title -----	Date -----
/s/ Mark A. Smith ----- Mark A. Smith	Director President, Interim Chief Financial Officer and Director	October 13, 2003
/s/ Jon Northrop ----- Jon Northrop	Director	October 13, 2003
----- Jere Northrop	Director	October __, 2003