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PROFILE TECHNOLOGIES INC
Form 10KSB
October 14, 2003

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

Commission File Number
0-21151

PROFILE TECHNOLOGIES, INC.
(Name of small business issuer in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

91-1418002
(I.R.S. Employer
Identification Number)

2 Park Avenue, Suite 201
MANHASSET, NY
(Address of Principal
Executive Offices)

11030
(Zip Code)

Issuer's telephone number: (516) 365-1909

Securities registered under Section 12(b) of the Act: None

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

Common Stock, \$.001 Par Value

Title of Class

Check whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes No

Check if there is no disclosure of delinquent filers pursuant to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of registrant'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.

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State issuer's revenues for the most recent fiscal year. \$350,919.

The aggregate market value of the voting stock held by non-affiliates of the registrant was \$1,708,653, computed by reference to the price at which the common stock last sold or the average bid and ask price as reported by the NASDAQ Over the Counter Bulletin Board on October 9, 2003.

There were 5,461,659 shares of common stock, \$.001 par value, outstanding as of October 9, 2003.

DOCUMENTS INCORPORATED BY REFERENCE:

Part III incorporates certain information by reference from the Registrant's definitive proxy statement for its annual shareholder meeting to be held on December 15, 2003 to be filed pursuant to Regulation 14A.

Transitional Small Business Format (check one): Yes No

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Preliminary Note Regarding Certain Risks and Forward-Looking Statements

This Annual Report on Form 10-KSB contains "forward-looking statements." These forward-looking statements can generally be identified as such because the context of the statement will include words such as the Company "believes," "anticipates," "expects" or words of similar import. Similarly, statements that describe the Company's projected future results, future plans, objectives or goals or future conditions or events are also forward-looking statements. Actual results are inherently difficult to predict. Any such forward-looking statements are subject to the risks and uncertainties that could cause actual results of operations, financial condition, acquisitions, financing transactions,

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operations, expenditures, expansion and other events to differ materially from those expressed or implied in such forward-looking statements. Any such forward-looking statements would be subject to a number of assumptions regarding, among other things, future economic, competitive and market conditions generally. Such assumptions would be based on facts and conditions as they exist at the time such statements are made as well as predictions as to future facts and conditions, the accurate prediction of which may be difficult and involve the assessment of events beyond the Company's control.

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

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PART I

Item 1. Description of Business.

Introduction

Since its formation in 1988, Profile Technologies, Inc., a Delaware corporation (the "Company"), has been engaged in the business of researching and developing a high speed scanning process, which is nondestructive and noninvasive, to test remotely buried, encased and insulated pipelines for corrosion. The Company's electromagnetic wave inspection process, referred to as the Company's "Inspection EMW(SM)" or "EMW," is a patented process of analyzing the waveforms of electrical impulses in a way that extracts point-to-point information along a segment of pipeline to illustrate the integrity of the entire pipeline. This process involves sending electrical pulses along the pipe being tested from two directions toward a varying intersecting point between the two pulser locations. One or more of the modified pulses is analyzed to determine whether an anomaly exists at the intersecting location.

The EMW process is designed to detect external corrosion of pipelines which occurs under pipe insulation and on buried pipes, without the need for taking the lines out of service, physically removing the insulation or digging up pipes, and then visually inspecting the outside of the pipe for corrosion. The Company often can inspect the pipelines by using various access points to the pipelines that already exist for other reasons. Where such access is not already available, the Company's technology permits the inspection of pipelines with a minimal amount of disturbance to the coating or insulation on the pipeline. In addition, the Company's technology permits an inspection of the entire pipeline, as opposed to other technologies which only conduct inspections at points selected for the testing. Such "spot inspections" are not necessarily accurate in indicating the overall condition of a pipe segment.

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The most common forms of pipeline corrosion under insulation are localized corrosion of carbon steel and chloride stress corrosion cracking of stainless steel. Refineries, chemical plants, utilities, natural gas transmission companies and the petroleum industry have millions of miles of pipeline, and much of this pipeline is exposed to harsh and severe environments. As a result, there is an on-going effort by these industries to ensure that the quality of the pipe meets standards established by regulatory bodies and the industry to protect operating personnel and the environment.

In the summer of 1998, the Company completed its first commercial contract on the North Slope of Alaska, testing approximately 100 road and caribou crossings on British Petroleum pipelines under a contract with ASCG Inspection, Inc.

In the summer of 1999, the Company followed up its initial Alaska work under a contract with another large multi-national oil company to test approximately 250 below grade pipes. During the summer of 2000, the Company expanded its Alaska efforts by testing a total of 372 below-ground pipes. In 2001, the Company tested 441 lines in Alaska. In 2002, the Company inspected 364 lines.

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Based on estimates provided by its customers, the Company originally planned to inspect between 400 and 500 below-grade lines in Alaska in 2003. The Company now anticipates that it will inspect 250 below-grade pipes this year, based on its final work scopes and the fact that in excess of 40 lines could not be tested for various physical reasons. Once its below-grade work is completed, the Company will begin a program of testing above-grade, insulated pipes for one of its Alaska customers in an effort to be included in that customer's 2004 above-grade inspection budget. The Company's out-of-pocket costs of this qualification testing, estimated to take approximately five days, will be reimbursed. Although the Company is confident it can provide greater value to its customer than companies offering competing inspection technologies for above-grade work, there can be no assurance that the Company will be able to secure any contracts to perform above-grade, insulated pipe inspections during 2003 or at any time in the future. Nevertheless, because above-grade work can continue as late as December, the Company will continue to seek such work on a commercial basis for 2003.

In January 2002, the Company retained Dr. Charles Frost, President of Pulse Power Physics, Inc., to assist in the improvement of the Company's hardware, software and its testing and data interpretation methods. These improvements, which are ongoing, are described in some detail in Management's Discussion and Analysis in Item 6 below.

The Company's data interpretation process has been largely automated, and the Company hopes to be able to complete this automation in the near future. The Company's business model and strategy is heavily dependent on its ability to automate the data interpretation process and fully implement its technology. If the Company is unable to automate the data interpretation process and fully implement its technology, the Company may not be able to secure additional fee-for-service contracts or implement a licensing and joint venture business model. As a result, such failure may have a material adverse effect on the business and financial condition of the Company.

Pipeline Corrosion

Corrosion of pipelines can impose significant financial and regulatory

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burdens on companies as well as result in serious safety issues. Federal, state, local and industry jurisdictions regulate corrosion protection. The U.S. Department of Labor, operating through the Occupational Safety and Health Administration, has jurisdiction over numerous plants and facilities containing corrosion protected pipelines that, if breached, could cause serious bodily injury or death to on-site workers. The U.S. Department of Transportation has jurisdiction over intrastate natural gas and hazardous liquids pipelines. Counterpart state agencies have jurisdiction over interstate natural gas and hazardous liquids pipelines. In addition, the American Petroleum Institute has promulgated a comprehensive Piping Inspection Code which requires that extensive corrosion testing be completed by all members (which includes the vast majority of the petroleum and petrochemical industries). As a result of extensive regulation and testing requirements, the industry is required to engage in extensive testing for corrosion.

In 1993, the American Petroleum Institute imposed even stricter testing standards regarding the problem of corrosion under the insulation on pipelines. When pipeline is uninsulated and above ground, external corrosion can be identified visually. The petroleum and other related industries, however,

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insulate much of their piping to conserve energy and to prevent injury to personnel from high temperature levels on the pipelines. As soon as piping is insulated, a very complex situation is created. Corrosion can occur underneath the insulation due to moisture or corrosive products that find their way through broken or poorly sealed insulation. This corrosion under insulated pipelines is very difficult and costly to locate. In the past, testing for this problem had been completed on a limited sample basis and relied upon inspection processes that were very cumbersome and costly.

Two prevalent testing methods used to detect corrosion under insulated pipelines are X-ray and eddy current methods, which are methods of detecting defects in pipe by analyzing visual images and decay. After physically stripping away coating for visual inspection, depth gauges, ultrasonics and X-ray are then used to determine the severity of corrosion on questionable pipe. However, the stripping of insulation to determine corrosion is a costly testing method for the industry because it often involves the assembly of scaffolding for testing otherwise inaccessible above ground pipe (particularly in refineries and petrochemical plants) or an actual dig-up on below ground pipe. The Company's technology enables it to test above-grade insulated pipe segments in a refinery setting using "cherry pickers" instead of costly scaffolding.

Corrosion under insulated pipelines presents a very complicated testing problem because corrosion cannot be easily identified by statistical sampling. If, for example, a segment of pipe has a small insulation part removed every ten feet and is visually inspected using eddy current or x-ray techniques, there is no statistical basis to assume whether the external condition of the piping between the removed insulation parts is good or bad. The American Petroleum Institute testing standard adopted in 1993, in essence, mandates either stripping even larger amounts of coating or using an alternate system that will identify corrosion under the insulation without stripping the coating on suspected and unsuspected pipe. Because of the enormous cost involved in using the stripping and visual testing process, the Company believes that the industry will be receptive to an alternate testing system that is reliable and less costly.

The Company believes that its EMW process provides an alternate testing system that could be widely accepted by the industry. However, while the Company has obtained some commercial contracts and prospects for expanded commercial contracts in the future appear favorable, there can be no assurance that such

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acceptance will continue to grow or that competitors will not develop newer and better technologies in the future.

The Company's EMW Inspection Technology

The Company has developed two basic EMW inspection techniques, namely, Dual Pulse or Pulse Propagation Analyzer and Single-Pulse or Calibration Mark Z. For above-grade piping, the Company uses the Single-Pulse technique to determine the condition of a given pipe segment. For direct buried pipe, the Company intends to use both methods. However, the Company must obtain additional funding in order to design, fabricate and test new hardware and software for this application before the Company can resume marketing in the direct buried pipe inspection area.

The Company's two basic techniques provide an assessment of the overall integrity of the pipe in question and the location and classification of electromagnetic anomalies which, in most instances, are related to external corrosion.

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The Single-Pulse Technique

The Single-Pulse Technique process requires fixing the source location on one end of the pipe segment in question and stepping the receiver generally at an equal incremental distances from the source across the segment. From the characteristics of the electromagnetic waves as a result of wave propagation, attenuation, and dispersion, the Company determines whether electromagnetic anomalies exist, as in the case of the Dual-Pulse techniques.

The Company believes that its single pulse technology has two significant competitive advantages in the inspection of encased and insulated pipes. First, its technology can inspect certain pipelines that are inaccessible to other testing methods. Second, the Company's technology requires only minimal access to the surface of any given pipe and, therefore, has a much lower of site preparation than competing technologies.

The Dual-Pulse Technique

The Dual Pulse Technique process extracts corrosion related information from segments of both accessible and inaccessible pipelines underneath the entire insulation barrier by analyzing the intersection of two electrical current pulses traveling in opposite directions along the pipeline. This corrosion related information is extracted without the need for removing the insulation protecting the pipeline. Through laboratory and field testing, the Company established that the electrical response, the CTF, of two intersecting pulses traveling along the pipeline is uniquely defined with location specific information that relates to the integrity of the pipeline at the point of intersection.

The Dual Pulse process was developed to evaluate the condition and integrity of pipelines. Electro-magnetic pulses are applied at both ends of the pipe segment being tested. Under computer control, the timing of the pulses is controlled so that the intersection point of the two pulses moves sequentially from one end of the pipe to the other end. A unique CTF is obtained for each intersection point of the pipeline segment being tested on some predetermined interval, such as, in one foot-intervals. When this data is geophysically displayed, it provides a visual display of data related to the physical condition of the pipe at each point of intersection. Information can also be

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derived using the EMW process to determine the condition of the coating and the effectiveness of the existing corrosion protection system that is being used to protect each point of intersection. Where there are indications of problems, closer interval inspection can be performed and/or one of the other location specific processes used in the industry may be utilized before the insulation is removed to inspect the pipe condition.

As simple as these concepts may appear, the Company believes that the EMW process is not intuitively obvious. The petroleum industry has spent large sums trying to solve the problem of finding corrosion under insulation. Correlating pipeline corrosion information using the Company's technology requires a combination of state-of-the-art instrumentation plus an understanding of the physical phenomena that are being measured. Although the principles of the EMW process are simple to explain, management believes that the EMW measurement and analysis are at the leading edge of inspection technology, particularly given the recent technological improvements described in Management's Discussion and Analysis set forth in Item 6 below. The Company will continue its research and development efforts of new applications for the Company's technology and to develop new products for the petroleum industry and other industries.

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Sales and Marketing

The Company's sales and marketing strategy includes positioning the Company's EMW inspection as the method of choice to detect pipeline corrosion where the pipelines are either inaccessible to other inspection tools or much more costly to inspect with tools other than the Company's EMW inspection. These facilities are found commonly in refinery and chemical plants (such as insulated, overhead pipes), natural gas distribution systems (such as pipes buried in city streets), and natural gas transmission systems (such as road, bridge and stream crossings and concrete-encased pipes). The Company intends to emphasize the reliability of its testing method, the flexibility of the method's application and its cost effectiveness.

The Company relies upon several employees, including the Chief Executive Officer, the Chief Operating Officer, the Vice President--Field Operations and a part-time employee, for the Company's sales functions. The Company has historically concentrated its marketing efforts on the integrated oil company market in Alaska. In fiscal 2003, 100% of the Company's revenues were attributable to work performed in Alaska.

However, due to the improvements in its technology described in Management's Discussion and Analysis set forth in Item 6 below, the Company believes that it is in a position to pursue aggressively opportunities to inspect above-grade, insulated pipe and below-grade, encased pipes, not only in Alaska, but in the lower-48 U.S. states and Canada as well. Exploitation of these opportunities may, in some cases, entail partnering with other inspection companies. Although the Company anticipates that it will continue to perform inspection services in Alaska and obtain additional contracts throughout the rest of the United States and Canada, there can be no assurance that the Company will be able to secure revenue from these potential contracts.

The Company believes that the natural gas distribution and transmission industry also presents a significant opportunity for marketing the Company's technology. There are millions of miles of metal pipelines, including older pipe beneath paved city streets, that are difficult to inspect. New government laws and regulations may require that many more of these pipelines be tested in compressed time frames, particularly in so-called "high consequence areas" (e.g., populated areas). Before resuming an aggressive pursuit of this market segment, the Company plans to first retool its buried-pipe equipment and

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techniques as described in Management's Discussion and Analysis set forth in Item 6 below.

Patents, Intellectual Property and Licensing

The Company pursues a policy of generally obtaining patent protection both in the United States and abroad for patentable subject matter in its proprietary technology. As of June 30, 2003, the Company had ten issued U.S. patents, six issued foreign patents, seven U.S. patent applications pending, and ten foreign patents pending.

The Company's success depends in large part upon its ability to protect its processes and technologies under United States and international patent laws and other intellectual property laws. U.S. patents have a term of 17 years from date of issuance or, for more recently filed patent applications, 20 years from the filing of such applications, and patents in most foreign countries have a term of 20 years from the proprietary filing date of the patent application. The

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Company's first U.S. patent was issued in 1990; three patents were issued in 1993; one patent was issued in 1998; two patents were issued in 2000; two patents were issued in 2001; and one patent was issued in 2002. In addition, the Company filed one provisional patent application in May, 2003, which is still pending. There can be no assurance that the United States Patent and Trademark Office will grant to the Company the patents requested. If the Company is unable to obtain approval for all such patent applications, the Company's operations and financial condition may be adversely affected.

The Company believes that it owns and has the right to use or license all proprietary technology necessary to license and market its EMW(SM) process under development. The Company is not aware of the issuance of any patents or the filing of any patent applications which relate to processes or products which utilize the Company's proprietary technology in a manner which could be similar to or competitive with the Company's products or processes. The Company has no knowledge that it is infringing on any existing patent such that it would be prevented from marketing or licensing products or services currently being developed by the Company.

The Company may decide for business reasons to retain a patentable invention as a trade secret. In such event or if patent protection is not available, the Company must rely upon trade secrets, internal knowledge and continuing technological innovation to develop and maintain its competitive position. The Company's employees and consultants have access to the Company's proprietary information and have signed confidentiality agreements. However, even inadvertent disclosure of such trade secrets without a promise of confidentiality could destroy trade secret protection. There can be no assurance that inadvertent disclosures might not occur. If the Company's proprietary information is disclosed to competitors, it may have a material adverse effect on the Company's business.

Competition

Although a number of inspection technologies have been developed to aid in ascertaining the condition of piping throughout the pipeline corrosion control industry, information needed to determine the integrity of these critical systems is often difficult and costly to acquire. The Company has numerous indirect competitors, but the Company believes that its inspection services have significant competitive advantages over other services provided by competitors.

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There are several competitors offering established inspection techniques that compete with the Company's EMW inspection technology, including infrared scanning, radiography, Incotest and ultrasound. The three manufacturers who offer guided wave ultrasonics constitute the Company's most direct competitors. Unlike the EMW technology, guided wave ultrasonics use a special class of ultrasonic waves which provide volumetric inspection of piping to detect both internal and external corrosion of pipeline. However, this method typically requires more pipe preparation than the Company's EMW process, and the waves are attenuated by some common pipe conditions that do not affect EMW.

The Company's EMW process can be distinguished from the products and services offered by other competitors. Although widely used in the pipeline corrosion industry, infrared scanning does not reliably locate corrosion on insulated pipes and does not detect any level of corrosion on below-grade piping. In addition, although radiography and radioscopy are widely used in the industry in which the Company competes, this technology can only be used in the particular location tested. Likewise, the "Incotest" technology is a relatively new inspection method which calculates the average wall thickness of an area of pipeline.

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The Company's EMW inspection service is designed to help pipeline operators quickly and less expensively screen buried, insulated, or hard to-access piping for external corrosion. Although its technology does not provide pipeline and plant operators with all the data they will require to manage and remediate corrosion, when used as a "front-end" screening tool in combination with one or more spot inspection tools, it can dramatically lower the cost of acquiring all of the data necessary to manage corrosion risks to their piping systems. There can be no assurances, however, that the Company's competitors will not develop newer, more efficient and less costly technologies.

Employees

The Company presently has nine employees, two of which are part-time.

If the Company is not successful in implementing a licensing and joint venture business model and continues to implement a fee-for-service model, then the Company anticipates it will need to secure additional commercial contracts to make the Company financially viable, and the Company will be required to hire and train additional field crews. The number of crews employed by the Company at any given time is dependent upon the Company's level of business activity. In addition, the Company will continue to retain independent consultants to render advice with respect to technical and scientific matters.

Executive Officers of the Company

In addition to Murphy Evans and Henry Gemino, who also serve as directors, the following constitute the executive officers of the Company:

| Name | Age | Positions Held and Principal Occupations During the Past 5 Years |
|-----------------|-----|--|
| ---- | --- | ----- |
| Philip L. Jones | 61 | Mr. Jones has served as the Chief Operating Officer for the Company during the past three years. Previous to his employment with the Company, he provided energy consulting services |

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to certain utility companies for a period of one year. Prior to that time, Mr. Jones held various executive positions with Consolidated Natural Gas Company before retiring in April 2000.

Joseph Galbraith 54 During the past six years, Mr. Galbraith has served as the Vice President - Field Operations for the Company.

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Customers

For the fiscal year ended June 30, 2003, the Company had two customers in Alaska that accounted for 100 percent of the Company's revenues. The loss of the Alaska customers or the Company's failure to broaden the base of customers in fiscal year 2004 could have a material adverse effect on the financial condition and ultimate profitability of the Company.

Supplier Relationships

The Company relies upon several relationships for the supply of equipment and services relating to the components of the Company's EMW technology inspection equipment. Criteria for choosing suppliers includes the quality and performance of the product for the intended purpose and pricing. The Company now purchases its pulse generators and other equipment from a single supplier. However, there are alternative suppliers for all of the elements required for the production of the EMW Inspection Equipment.

Government Regulation

Natural gas and hazardous liquids pipelines are extensively regulated. The Department of Transportation's Office of Pipeline Safety, and state public utility commissions applying federal regulations, monitor operator compliance with corrosion monitoring and other pipeline safety-related regulatory requirements. Recent pipeline safety incidents (a gasoline pipeline explosion in Washington and a natural gas transmission line explosion in New Mexico) have prompted renewed interest in pipeline safety in Congress. In December 2002, the President signed the Pipeline Safety Improvement Act. This legislation requires more active corrosion monitoring than is currently required and could generate significant interest in the Company's technology by natural gas transmission and hazardous liquids pipeline operators. In addition, there may be opportunities to demonstrate the technology, in light of this legislation, to industry and government pipeline safety advisory groups. However, this legislation and any promulgated regulations could impose legal obligations and liabilities on the Company or otherwise subject it to additional regulation. Any such regulations under the new legislation could mandate testing methods other than that provided by the Company's technology. As a result, any such regulation could have a material adverse effect on the Company.

Research and Development Expenditures

During the last six years, the Company has developed and improved its capability to detect EMW anomalies related to pipeline corrosion under insulation or on buried pipeline. Recently, using new hardware and software developed by consultants and the Company's personnel, the Company has extended its testing distances for encased buried pipe and above-grade insulated pipe.

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The Company is attempting to extend its corrosion detection range for buried pipe to distances greater than 300-feet as well by implementing certain technology improvements that are specifically related to buried conditions. There can be no assurances that the Company will be able to finance new hardware and software to test buried pipe, successfully fabricate and test it, or be able to widely market, license and/or support such technology.

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During the two most recent fiscal years ended June 30, 2003 and June 30, 2002, the Company spent \$173,795 and \$394,005, respectively, on research and development activities. This decrease was due to a reduction in the number of the Company's employees, and certain employees spending less time on research and development and more time on revenue generating contracts. The Company's field operation system for commercialization consists of all of the hardware and software for data acquisition, data processing, data analysis and interpretation.

The Company's research and development efforts are focused on continuing to improve the EMW system's efficiency, reliability and accuracy. During the next fiscal year, the Company anticipates that it will continue to incur significant research and development expenses to redevelop its buried-pipe product. Its current estimate for this project is approximately \$500,000.

If the Company is unable to raise sufficient funds from operations, or obtain additional debt or equity financing, the Company may not be able to generate the funds for the research and development necessary to improve the EMW technology. The Company's inability to generate sufficient cash and to invest in the required research and development expenditures could have a material adverse effect of the business and operations of the Company.

Item 2. Description of Property.

The Company's executive offices are located at 2 Park Avenue, Suite 201, Manhasset, NY 11030. The Company leases on a month-to-month basis approximately 500 square feet of office space from a non-affiliate. The rental payment is \$785.00 per month.

The Company's research and development facility is located in Ferndale, Washington. The Company leases 1,800 square feet of space from a non-affiliate at a monthly cost of approximately \$2,080 per month, pursuant to a lease that expires on January 31, 2004.

The Company does not own any real estate.

Item 3. Legal Proceedings.

None.

Item 4. Submission of Matter to Vote of Security Holders.

None.

PART II

Item 5. Market for Common Equity and Related Stockholder Matters

Market Information

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The Company's common stock traded on the NASDAQ SmallCap market from the date it began to be publicly traded in February, 1997 until August 10, 2001 under the symbol PRTK. On August 13, 2001, the Company's common stock was delisted from the NASDAQ Small Cap market and began trading on the Over the Counter Bulletin Board (the "OTCBB") under the same symbol. The Company's common stock continues to be traded on the OTCBB.

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The following table sets forth the high and low closing sale prices for the Company's common stock for the past two fiscal years as reported by NASDAQ and OTCBB. The quotations reflect inter-dealer prices, with retail mark-up, mark-down or commissions, and may not represent actual transactions.

| | Range of Sale Prices | |
|------------------|-------------------------|--------|
| | High | Low |
| Fiscal Year 2003 | | |
| First Quarter | \$0.55 | \$0.36 |
| Second Quarter | \$0.40 | \$0.20 |
| Third Quarter | \$0.50 | \$0.25 |
| Fourth Quarter | \$0.51 | \$0.15 |
| Fiscal Year 2002 | | |
| First Quarter | \$1.45 | \$0.25 |
| Second Quarter | \$1.45 | \$0.31 |
| Third Quarter | \$1.40 | \$0.65 |
| Fourth Quarter | \$1.15 | \$0.40 |

Holders

As of October 9, 2003, the Company had approximately 942 holders of record of the Company's common stock.

Dividends

The payment of dividends by the Company is within the discretion of its Board of Directors and depends in part upon the Company's earnings, capital requirements, debt covenants and financial condition. Since its inception, the Company has not paid any dividends on its common stock and does not anticipate paying such dividends in the foreseeable future. The Company intends to retain earnings, if any, to finance its operations.

Recent Sales of Unregistered Securities

On March 18, 2002, the Board of Directors approved an offering of 1,000,000 shares of the Company's common stock at a price of \$0.70 per share, with attached warrants (the "2002 Offering"). Each warrant entitles the holder to purchase one share of common stock at an exercise price of \$1.05 per share until April 4, 2007. The Company did not incur or pay any commissions with respect to offers and sales of securities under the 2002 Offering. The 2002 Offering terminated on December 31, 2002. As of December 31, 2002, the Company had raised a total of \$403,200 from the 2002 Offering. All of the investors were accredited investors. The 2002 Offering is exempt from registration under Section 4(2) of the Securities Act of 1933, as amended (the "Securities Act").

In April 2002, the Company issued a non-interest bearing bridge loan in the principal amount of \$15,000 (the "Gemino Loan") payable to Henry Gemino, the Chief Executive Officer, Chief Financial Officer and a director and stockholder of the Company. The terms of the Gemino Loan provided for payment at such time as the Company determined that it had sufficient working capital to repay the principal balance of the Gemino Loan and for the conversion into 21,428 equity units. Each equity unit was comprised of one share of the Company's common stock, with a detached 5-year warrant to purchase one additional share of the Company's common stock at an exercise price of \$1.05 per share. The Gemino Loan is exempt from registration under the Securities Act pursuant to Section 4(2) thereof. The Gemino Loan was converted into the 21,428 equity units in 2002.

In April 2002, the Company issued a non-interest bearing bridge loan in the principal amount of \$7,500 (the "Scott Loan") payable to G.L. Scott, the former Chairman of the Board of Directors and stockholder of the Company. The Scott Loan is payable at such time as the Company determines that it has sufficient working capital to repay the principal balance of the Scott Loan and is convertible into 10,714 equity units at any time prior to payment. Each equity unit is comprised of one share of the Company's common stock, with a detached 5-year warrant to purchase one additional share at an exercise price of \$1.05 per share. The Scott Loan is exempt from registration under the Securities Act pursuant to Section 4(2) thereof. On September 29, 2002, Mr. Scott died unexpectedly from a stroke before converting any part of this loan. As of September 26, 2003, Mr. Scott's estate had not converted any part of the Scott Loan into equity units.

On May 9, 2002, the Company entered into a \$150,000 bridge loan agreement with Murphy Evans, the President and a director and stockholder of the Company (the "Evans Loan"). The Company's Board of Directors approved the terms of the Evans Loan. The Evans Loan is exempt from registration under Section 4(2) of the Securities Act.

Mr. Evans had loaned the Company \$126,000, pursuant to the Evans Loan. Under the terms of the Evans Loan, once Mr. Evans loaned the Company \$125,000, the Company cancelled 150,000 warrants held by Mr. Evans, with exercise prices ranging from \$3.00 per share to \$7.50 per share, and issued to Mr. Evans 150,000 five-year warrants with an exercise price of \$1.05 per share. If the Company had raised \$400,000 pursuant to the 2002 Offering within 90 days of May 9, 2002, the entire loan amount would have been converted into the Company's common stock in accordance with the terms of the 2002 Offering. However, the Company raised only \$346,250, not \$400,000, under the 2002 Offering within 90 days of May 9, 2002. As a result, under the terms of the Evans Loan, the Company would have been obligated to commence making monthly loan payments to Mr. Evans in the amount of \$25,000 per month, with interest accruing at 6% per annum on the unpaid principal balance of the Evans Loan. On March 6, 2003, the Evans Loan was replaced and superseded by the Amended Evans Loan as described below. As of March 6, 2003, Mr. Evans made no demand for payment under the Evans Loan, and no repayments of the Evans Loan had been made by the Company.

During 2002, the Company also entered into certain non-interest bearing bridge loans in the aggregate amount of \$56,500 (the "Subsequent Evans Loan") payable to Murphy Evans, the President and a director and shareholder of the Company. The terms of the Subsequent Evans Loan provided for payment at such time as the Company determined it had sufficient working capital to repay the

principal balance of the Subsequent Evans Loan which was convertible into 81,428

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equity units at any time prior to payment. Each equity unit was comprised of one share of the Company's common stock, with a detached 5-year warrant to purchase one additional share at an exercise price of \$1.05 per share. The Subsequent Evans Loan is exempt from registration under Section 4(2) of the Securities Act. On March 6, 2003, the Subsequent Evans Loan was replaced and superseded by the Amended Evans Loan as described below. As of March 6, 2003, no repayments of the Subsequent Evans Loan had been made by the Company.

During fiscal year 2003, Murphy Evans also loaned \$194,650 to the Company (collectively, the "Non-Convertible Evans Loan"). This loan agreement provided for payment at such time as the Company determined it had sufficient working capital to repay the Non-Convertible Evans Loan. Interest was to accrue on the Non-Convertible Evans Loan at a rate of 5% per annum. The Non-Convertible Evans Loan is exempt from registration under Section 4(2) of the Securities Act. On March 6, 2003, the Non-Convertible Evans Loan was replaced and superseded by the Amended Evans Loan as described below. As of March 6, 2003, no repayments of the Evans Loan had been made by the Company.

On March 6, 2003, the Company's Board of Directors approved the Loan Amendment and Promissory Note (the "Amended Evans Loan") between the Company and Murphy Evans. The Amended Evans Loan amends and supersedes the indebtedness under the Evans Loan, Subsequent Evans Loan and Non-Convertible Evans Loan by aggregating the debt under all of these loans by Mr. Evans into one promissory note bearing interest on the aggregate principal balance at a rate of 5% per annum, payable on June 30 and December 31 of each year. The outstanding balance under the Amended Evans Loan is due and payable in full on December 31, 2003. The Amended Evans Loan superseded and replaced all of the terms under the Evans Loan, Subsequent Evans Loan and Non-Convertible Evans Loan, including the conversion feature under the Subsequent Evans Loan.

In addition, the terms of the Amended Evans Loan will apply to all future loans that may be made to the Company by Murphy Evans. Due to the necessity by the Company to obtain additional financing in the future to sustain the Company's operations, the Board of Directors approved the terms of the Amended Evans Loan. From March 6, 2003 through June 30, 2003, Murphy Evans loaned the company an additional \$172,315 under the Amended Evans Loan. The Amended Evans Loan is exempt from registration under Section 4(2) of the Securities Act. As of June 30, 2003, the outstanding principal balance of the Amended Evans Loan was equal to \$549,465. As of September 29, 2003, the Company has not made the interest payment due on June 30, 2003 under the Amended Evans Loan. As of September 29, 2003, Mr. Evans has not made any demand for payment, or exercised any of his remedies, under the Amended Evans Loan.

During the twelve months ended June 30, 2003, the Company entered into two non-interest bearing bridge loans in the respective principal amounts of \$40,000 and \$10,000 (the "Shareholder Loans") payable to two shareholders of the Company. The terms of the Shareholder Loans provide for payment at such time as the Company determines it has sufficient working capital to repay the principal balances of the Shareholder Loans. The Shareholder Loans are convertible into 57,142 and 14,286 equity units, respectively, at any time prior to payment. Each equity unit is comprised of one share of the Company's common stock, with a detached 5-year warrant to purchase one additional share at an exercise price of \$1.05 per share. The Shareholder Loans are exempt from registration under Section 4(2) of the Securities Act. As of September 26, 2003, neither shareholder had converted either Shareholder Loan into equity units.

On June 19, 2003, the Board of Directors approved a promissory note (the "2003 Gemino Note") in the principal amount of \$34,047 payable to Henry E. Gemino, the Chief Executive Officer, Chief Financial Officer and a director and

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stockholder of the Company. The 2003 Gemino Note bears interest at the rate of 5% per annum, payable on each June 30 and December 31 of each year. The 2003 Gemino Note evidences the Company's obligation to repay Mr. Gemino certain amounts advanced by Mr. Gemino to pay certain expenses of the Company. The outstanding balance under the 2003 Gemino Note is due and payable in full on December 31, 2003. The 2003 Gemino Note is exempt from registration under Section 4(2) of the Securities Act. As of June 30, 2003, the outstanding principal balance of the 2003 Gemino Note was equal to \$34,047. As of September 29, 2003, the Company has not made the interest payment due on June 30, 2003 under the 2003 Gemino Note. As of September 29, 2003, Mr. Gemino has not made any demand for payment, or exercised any of his remedies, under the 2003 Gemino Note.

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

Upon the purchase of, and for each \$0.50 of the Debenture's principal amount, the Company will issue to an investor a warrant (the "Warrant") to purchase one (1) share of the Company's common stock at an exercise price of \$0.75 per share. For example, if an investor executes a Debenture in the principal amount of \$100,000, the Company will issue to such investor 200,000 Warrants. The Warrants will be exercisable at any time prior to the 5th anniversary date of the redemption of the Debenture. The 2003 Offering is exempt from registration under Section 4(2) of the Securities Act. As of June 30, 2003, the Company had not received any funds from the 2003 Offering. As of September 26, 2003, the Company had raised \$25,000 from the 2003 Offering.

The Company currently requires additional cash to sustain existing operations and to meet current obligations (including those described in Item 6, Management's Discussion and Analysis) and the Company's ongoing capital requirements. The continuation of the Company's operations is dependent in the short term upon its ability to obtain additional financing and to secure additional contracts, and, in the long term, to generate sufficient cash flow to meet its obligations on a timely basis, to obtain additional financing as may be required, and ultimately to attain profitability.

Capital will be expended to support operations until the Company can generate sufficient cash flows from operations. In order for the Company to generate cash flows from operations, the Company must generate additional revenue generating contracts. Management is currently directing the Company's activities towards obtaining additional service contracts, which, if obtained, will necessitate the Company attracting, hiring, training and outfitting qualified technicians. If additional service contracts are obtained, it will also necessitate additional field test equipment purchases in order to provide the services. The Company's intention is to purchase such equipment for its field crews for the foreseeable future, until such time as the scope of operations may require alternate sources of financing equipment. The Company expects that if additional contracts are secured, and revenues increase, working capital requirements will increase. There can be no assurance that the Company's

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time frame, or at all. The Company will incur additional expenses as it hires and trains field crews and support personnel related to the successful receipt of commercial contracts. Additionally, the Company anticipates that cash will be used to meet capital expenditure requirements necessary to develop infrastructure to support future growth. There can be no assurance that the Company will be able to secure additional revenue generating contracts to provide sufficient cash.

Item 6. Management's Discussion and Analysis or Plan of Operation

Overview

In January 2002, the Company, through consultants and the Company's employees, began to implement its business strategy of improving its hardware, software and data acquisition procedures. In July 2002, the Company deployed this new hardware and software technology in Alaska. During the summer of 2002, the Company used the new technology to test over 300 lines. The Company's data interpretation process has been largely automated, and the Company hopes to be able to complete this automation in the near future. The Company's business model and strategy is heavily dependent on its ability to automate the data interpretation process and fully implement its new technology. If the Company is unable to automate the process and fully implement its technology, the Company may not be able to implement a licensing and joint venture business model and may not be able to secure additional contracts. As a result, such failure may have a material adverse effect on the business and financial condition of the Company.

Revenue

The Company derives revenue solely from the sale of the EMW inspection technology service. The Company relies upon several employees, including the Chief Executive Officer, the Chief Operating Officer and the Vice President--Field Operations, for the Company's sales functions. The Company relies solely upon the employees of the Company to conduct its sales activities.

In fiscal year 2003, all of the Company's sales were attributable to two customers. These customers, with projects located in Alaska, accounted for 100% of the Company's net sales in fiscal 2003. During the fiscal years ended June 30, 2003 and June 30, 2002, these customers individually accounted for 63% and 37%, and 37% and 51%, respectively, of the Company's revenue.

During 2003, the Company originally had planned to inspect between 400 and 500 below-grade lines in Alaska. However, based on the most recent estimates of work scope provided by its customers, the Company anticipates that it will inspect between 250 to 300 below-grade pipes this year. In addition, certain customers of the Company have requested that the Company begin a program of testing above-grade, insulated pipes after it completes the below-grade inspections. The Company cannot estimate the number of above-grade pipes that can be tested before the end of the calendar year primarily because of the unpredictability of the weather on the North Slope. Moreover, the Company has yet to receive a written work scope for such testing. As a result, there can be no assurance that the Company will be able to secure any contracts to perform above-grade, insulated pipe inspections during 2003 or at any time in the future.

Marketing

The Company's sales and marketing strategy includes positioning the

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Company's EMW technology as the method of choice to detect pipeline corrosion where the pipelines are either inaccessible to other inspection tools or much more costly to inspect with tools other than Profile's EMW inspection. Pending completion of designed improvements to its buried pipe inspection equipment and procedures, the Company intends to concentrate its marketing efforts on above-grade insulated pipe such as is common in refineries and chemical plants and on encased road and stream crossings.

The Company is seeking industry and other funding to redevelop its buried pipe product; however, there can be no assurance that such funding will be obtained. Until such funding is obtained and the necessary, new hardware and software is fabricated and tested, the Company will be unable to pursue the utility and other buried pipe market segments.

Critical Accounting Estimates and Policies

The discussion and analysis of financial condition and results of operations is based upon the Company's financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including contract revenue recognition and impairment of long-lived assets. The Company bases its estimates on historical experience and on various other assumptions that the Company believes to be reasonable under the circumstances, the results of which form its basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ materially from these estimates under different assumptions and conditions, and such variations may be adverse.

The Company recognizes revenue from service contracts using the percentage-of-completion method of contract accounting. Contract revenues earned are measured using either the percentage-of-contract costs incurred to date to total estimated contract costs or, when the contract is based on measurable units of completion, revenue is based on the completion of such units. Anticipated losses on contracts, if any, are charged to earnings as soon as such losses can be estimated. Changes in estimated profits on contracts are recognized during the period in which the change in estimate is known. The Company records claims for additional compensation on contracts upon revision of the contract to include the amount to be received for the additional work performed. Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools and repairs, and depreciation costs. Selling, general, and administrative costs are charged to expense as incurred. Service contracts generally extend no more than six months.

The Company reviews long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount which the carrying amount of the asset exceeds the fair value of the asset.

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

Revenues for the year ended June 30, 2003 were \$350,919, which represented a decrease of \$58,394, or 14% as compared to revenues of \$409,313 for the year ended June 30, 2002. This decrease was due to the inspection of fewer lines by the Company in Alaska. Revenues for the year ended June 30, 2003 were derived predominantly from work performed on the North Slope of Alaska.

Cost of revenue decreased 10% to \$321,212 for the year ended June 30, 2003 compared to \$356,910 for the year ended June 30, 2002. The Company believes that the decrease in the cost of revenue for the year ended June 30, 2003 was a result of a reduction in the number of the Company's employees available to work on customer projects and greater operational and production efficiencies in the Company's technology and business as compared to the year ended June 30, 2002.

Gross profit decreased to \$29,707 for the year ended June 30, 2003 from profit of \$52,403 for the year ended June 30, 2002. The decrease in gross profit for the year ended June 30, 2003 as compared to the previous year resulted primarily from fewer lines being inspected during fiscal year 2003.

Research and development expenses for the year ended June 30, 2003 decreased 56% to \$173,795 from \$394,005 for the year ended June 30, 2002, a decrease of \$220,210. The decrease in the Company's research and development expenses was due to lower salaries and a reduction in the number of the Company's employees. In addition, the Company substantially completed a major research and development project to improve the Company's hardware and software in the second half of the fiscal year 2002.

General and administrative expenses decreased 7.5% to \$941,893 for the year ended June 30, 2003, from \$1,018,124 for the year ended June 30, 2002. The decrease is primarily due to a reduction in discretionary expenditures, including a reduction in the number of the Company's employees and the closing of two of the Company's offices during the fiscal year ended June 30, 2002.

Loss from operations decreased 20.1% to \$1,085,981 for the year ended June 30, 2003 compared to \$1,359,726 for the year ended June 30, 2002. This decrease is due to a reduction in operating expenses as discussed above. As a result of the Company's cost structure, which includes a significant amount of fixed costs, fluctuations in revenue will significantly impact the Company's gross margin and loss from operations.

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Interest income decreased to \$6 for the year ended June 30, 2003 down from \$1,007 for the year ended June 30, 2002. This decrease was the result of declining cash and cash equivalent balances during the year as the Company used such resources to sustain its commercial operations and research and development activities. The Company included \$6,754 in other income for the year ended June 30, 2003 related to a gain on disposal of an asset.

Interest expense was \$25,374 for the fiscal year ended June 30, 2003 compared with \$4,862 for the fiscal year ended June 30, 2002. This increase in interest expense resulted from the issuance of notes payable by the Company to certain officers of the Company, as described in Item 5, Market for Common Equity and Related Stockholder Matters, Sales of Unregistered Securities, and

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from finance charges of \$2,175 incurred in the ordinary course of the Company's business.

Net loss decreased 19% to \$1,104,595 for the year ended June 30, 2003, compared to \$1,363,581 for the year ended June 30, 2002.

New Accounting Pronouncements

In June 2001, FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations. SFAS No. 143 requires the Company to record the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development, and/or normal use of the assets. The Company also records a corresponding asset that is depreciated over the life of the asset. Subsequent to the initial measurement of the asset retirement obligation, the obligation will be adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The Company was required to adopt SFAS No. 143 on January 1, 2003. The adoption of SFAS No. 143 did not have an effect on the Company's financial statements.

In April 2002, the FASB issued SFAS No. 145, Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections. SFAS No. 145 amends existing guidance on reporting gains and losses on the extinguishment of debt to prohibit the classification of the gain or loss as extraordinary, as the use of such extinguishments have become part of the risk management strategy of many companies. SFAS No. 145 also amends SFAS No. 13 to require sale-leaseback accounting for certain lease modifications that have economic effects similar to sale-leaseback transactions. The provisions of the Statement related to the rescission of Statement No. 4 is applied in fiscal years beginning after May 15, 2002. Earlier application of these provisions is encouraged. The provisions of the Statement related to Statement No. 13 were effective for transactions occurring after May 15, 2002, with early application encouraged. The adoption of SFAS No. 145 did not have an effect on the Company's financial statements.

In June 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity. The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31, 2002, with early application encouraged. The adoption of SFAS No. 146 did not have an effect on the Company's financial statements.

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In November 2002, the FASB issued Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others, an interpretation of FASB Statements No. 5, 57 and 107 and a rescission of FASB Interpretation No. 34. This Interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. The Interpretation also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. The initial recognition and measurement provisions of the Interpretation are applicable to guarantees issued or modified after December 31, 2002. The disclosure requirements are effective for financial statements of interim or annual periods ending after December 15, 2002. The adoption of FIN 45

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did not have an impact on the Company's financial statements.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of FASB Statement No. 123. This Statement amends FASB Statement No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of Statement No. 123 to require prominent disclosures in both annual and interim financial statements. Certain of the disclosure modifications are required for fiscal years ending after December 15, 2002 and are included in the notes to these consolidated financial statements.

Liquidity and Capital Resources

The Company has an accumulated deficit of \$9,293,538 at June 30, 2003 and had negative working capital of \$1,117,430 as of June 30, 2003. During the twelve months ended June 30, 2003, the Company used \$694,738 of cash in operating activities primarily as a result of net losses offset by depreciation, amortization and increased accrued liabilities. Net cash provided by investing activities was \$8,690 for the year ended June 30, 2003. The Company's cash and cash equivalents as of June 30, 2003 were \$0. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management recognizes that in order to meet the Company's capital requirements and continue to operate, additional financing will be necessary. Cash provided by financing activities was \$612,534 primarily from note payable to related parties.

The Company is evaluating alternative sources of financing, including seeking industry-partner investment through joint venture or other possible arrangements, to improve its cash position and is also undertaking efforts to raise capital from more conventional sources. Further, the Company is making on-going efforts to reduce its on-going expense requirements including payroll. If the Company is unable to raise additional capital or secure additional revenue contracts and generate positive cash flow, the Company will be unable to continue as a going concern. No adjustments have been made to the financial statements due to this uncertainty.

Capital will be expended to support operations until the Company can generate sufficient cash flows from operations. In order for the Company to generate cash flows from operations, the Company must generate additional revenue generating contracts. Management is currently directing the Company's activities towards obtaining additional service contracts, which, if obtained, will necessitate the Company attracting, hiring, training and outfitting qualified technicians. If additional service contracts are obtained, it will also necessitate additional field test equipment purchases in order to provide the services. The Company's intention is to purchase such equipment for its field crews for the foreseeable future, until such time as the scope of

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operations may require alternate sources of financing equipment. The Company expects that if additional contracts are secured, and revenues increase, working capital requirements will increase. There can be no assurance that the Company's process will gain widespread commercial acceptance within any particular time frame, or at all. The Company will incur additional expenses as it hires and trains field crews and support personnel related to the successful receipt of commercial contracts. Additionally, the Company anticipates that cash will be used to meet capital expenditure requirements necessary to develop infrastructure to support future growth. There can be no assurance that the Company will be able to secure additional revenue generating contracts to provide sufficient cash.

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The Company's contractual obligations consist of commitments under operating leases, deferred salary and fees, and repayment of loans payable to certain officers, directors and stockholders. Future minimum rental payments on the operating leases are less than \$11,874 for the remainder of the calendar year 2003, although the Company expects to continue to incur costs on leased properties, as the Company has extended such leases in the past or may use alternate facilities. On February 26, 2003, the Company extended its Ferndale, Washington office lease through January 31, 2004.

As of June 30, 2003, deferred salary and fees amounted to \$255,658, and the salaries and fees will continue to be deferred until the Company has sufficient resources to pay the amounts owed, or the employees, officers, or directors exchange such amounts as described below. On March 18, 2002, the Board of Directors approved a right under which any such employee, officer or director could exchange each dollar of his or her deferred salary or fees for an option to purchase two shares of the Company's common stock which may be exercised over a five-year term at an exercise price of \$1.00 per share. As of June 30, 2003, no conversions have occurred.

As of June 30, 2003, the Company had outstanding loans payable to certain officers, directors and stockholders with principal amounts, in the aggregate, equal to \$641,012. The terms of the loans are described below.

In April 2002, the Company issued a non-interest bearing bridge loan in the principal amount of \$15,000 (the "Gemino Loan") payable to Henry Gemino, the Chief Executive Officer, Chief Financial Officer and a director and stockholder of the Company. The terms of the Gemino Loan provided for payment at such time as the Company determined that it had sufficient working capital to repay the principal balance of the Gemino Loan and for the conversion into 21,428 equity units. Each equity unit was comprised of one share of the Company's common stock, with a detached 5-year warrant to purchase one additional share of the Company's common stock at an exercise price of \$1.05 per share. The Gemino Loan was converted into the 21,428 equity units in 2002.

In April 2002, the Company issued a non-interest bearing bridge loan in the principal amount of \$7,500 (the "Scott Loan") payable to G.L. Scott, the former Chairman of the Board of Directors and stockholder of the Company. The Scott Loan is payable at such time as the Company determines that it has sufficient working capital to repay the principal balance of the Scott Loan and is convertible into 10,714 equity units at any time prior to payment. Each equity unit is comprised of one share of the Company's common stock, with a detached 5-year warrant to purchase one additional share at an exercise price of \$1.05 per share. On September 29, 2002, Mr. Scott died unexpectedly from a stroke before converting any part of this loan. As of September 26, 2003, Mr. Scott's estate had not converted any part of the Scott Loan into equity units.

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On May 9, 2002, the Company entered into a \$150,000 bridge loan agreement with Murphy Evans, the President and a director and stockholder of the Company (the "Evans Loan"). The Company's Board of Directors approved the terms of the Evans Loan. Mr. Evans had loaned the Company \$126,000, pursuant to the Evans Loan. Under the terms of the Evans Loan, once Mr. Evans loaned the Company \$125,000, the Company cancelled 150,000 warrants held by Mr. Evans, with exercise prices ranging from \$3.00 per share to \$7.50 per share, and issued to Mr. Evans 150,000 five-year warrants with an exercise price of \$1.05 per share. If the Company had raised \$400,000 pursuant to the 2002 Offering within 90 days of May 9, 2002, the entire loan amount would have been converted into the Company's common stock in accordance with the terms of the 2002 Offering. However, the Company raised only \$346,250, not \$400,000, under the 2002 Offering

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within 90 days of May 9, 2002. As a result, under the terms of the Evans Loan, the Company would have been obligated to commence making monthly loan payments to Mr. Evans in the amount of \$25,000 per month, with interest accruing at 6% per annum on the unpaid principal balance of the Evans Loan. On March 6, 2003, the Evans Loan was replaced and superseded by the Amended Evans Loan as described below. As of March 6, 2003, Mr. Evans made no demand for payment under the Evans Loan, and no repayments of the Evans Loan had been made by the Company.

During 2002, the Company also entered into certain non-interest bearing bridge loans in the aggregate amount of \$56,500 (the "Subsequent Evans Loan") payable to Murphy Evans, the President and a director and shareholder of the Company. The terms of the Subsequent Evans Loan provided for payment at such time as the Company determined it had sufficient working capital to repay the principal balance of the Subsequent Evans Loan which was convertible into 81,428 equity units at any time prior to payment. Each equity unit was comprised of one share of the Company's common stock, with a detached 5-year warrant to purchase one additional share at an exercise price of \$1.05 per share. On March 6, 2003, the Subsequent Evans Loan was replaced and superseded by the Amended Evans Loan as described below. As of March 6, 2003, no repayments of the Subsequent Evans Loan had been made by the Company.

During fiscal year 2003, Murphy Evans also loaned \$194,650 to the Company (collectively, the "Non-Convertible Evans Loan"). This loan agreement provided for payment at such time as the Company determined it had sufficient working capital to repay the Non-Convertible Evans Loan. Interest was to accrue on the Non-Convertible Evans Loan at a rate of 5% per annum. On March 6, 2003, the Non-Convertible Evans Loan was replaced and superseded by the Amended Evans Loan as described below. As of March 6, 2003, no repayments of the Evans Loan had been made by the Company.

On March 6, 2003, the Company's Board of Directors approved the Loan Amendment and Promissory Note (the "Amended Evans Loan") between the Company and Murphy Evans. The Amended Evans Loan amends and supersedes the indebtedness under the Evans Loan, Subsequent Evans Loan and Non-Convertible Evans Loan by aggregating the debt under all of these loans by Mr. Evans into one promissory note bearing interest on the aggregate principal balance at a rate of 5% per annum, payable on June 30 and December 31 of each year. The outstanding balance under the Amended Evans Loan is due and payable in full on December 31, 2003. The Amended Evans Loan superseded and replaced all of the terms under the Evans Loan, Subsequent Evans Loan and Non-Convertible Evans Loan, including the conversion feature under the Subsequent Evans Loan.

In addition, the terms of the Amended Evans Loan will apply to all future loans that may be made to the Company by Murphy Evans. Due to the necessity by the Company to obtain additional financing in the future to sustain the Company's operations, the Board of Directors approved the terms of the Amended

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Evans Loan. During the twelve months ended June 30, 2003, Murphy Evans loaned the Company and additional \$172,315 under the Amended Evans Loan. As of June 30, 2003, the outstanding principal balance of the Amended Evans Loan was equal to \$549,465. As of September 26, 2003, the Company has not made the interest payment due on June 30, 2003, under the Amended Evans Loan. As of September 29, 2003, Mr. Evans has not made any demand for payment, or exercised any of his remedies, under the Amended Evans Loan.

During the twelve months ended June 30, 2003, the Company entered into two non-interest bearing bridge loans in the respective principal amounts of \$40,000 and \$10,000 (the "Shareholder Loans") payable to two shareholders of the

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Company. The terms of the Shareholder Loans provide for payment at such time as the Company determines it has sufficient working capital to repay the principal balances of the Shareholder Loans. The Shareholder Loans are convertible into 57,142 and 14,286 equity units, respectively, at any time prior to payment. Each equity unit is comprised of one share of the Company's common stock, with a detached 5-year warrant to purchase one additional share at an exercise price of \$1.05 per share. As of September 30, 2003, neither shareholder had converted either Shareholder Loan into equity units.

On June 19, 2003, the Board of Directors approved a promissory note (the "2003 Gemino Note") in the principal amount of \$34,047 payable to Henry E. Gemino, the Chief Executive Officer, Chief Financial Officer and a director and stockholder of the Company. The 2003 Gemino Note bears interest at the rate of 5% per annum, payable on each June 30 and December 31 of each year. The 2003 Gemino Note evidences the Company's obligation to repay Mr. Gemino certain amounts advanced by Mr. Gemino to pay certain expenses of the Company. The outstanding balance under the 2003 Gemino Note is due and payable in full on December 31, 2003. As of June 30, 2003, the outstanding principal balance of the 2003 Gemino Note was equal to \$34,047. As of September 29, 2003, the Company has not made the interest payment due on June 30, 2003 under the 2003 Gemino Note. As of September 29, 2003, Mr. Gemino has not made any demand for payment, or exercised any of his remedies, under the 2003 Gemino Note.

On March 18, 2002, the Board of Directors approved an offering of 1,000,000 shares of the Company's common stock at a price of \$0.70 per share, with attached warrants (the "2002 Offering"). Each warrant entitles the holder to purchase one share of common stock at an exercise price of \$1.05 per share until April 4, 2007. The Company did not incur or pay any commissions with respect to offers and sales of securities under the 2002 Offering. The 2002 Offering terminated on December 31, 2002. As of December 31, 2002, the Company had raised a total of \$403,200 from the 2002 Offering.

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

Upon the purchase of, and for each \$0.50 of the Debenture's principal amount, the Company will issue to an investor a warrant (the "Warrant") to purchase one (1) share of the Company's common stock at an exercise price of \$0.75 per share. For example, if an investor executes a Debenture in the

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principal amount of \$100,000, the Company will issue to such investor 200,000 Warrants. The Warrants will be exercisable at any time prior to the 5th anniversary date of the redemption of the Debenture. As of June 30, 2003, the Company had not received any funds from the 2003 Offering. As of September 26, 2003, the Company had raised \$25,000 from the 2003 Offering.

On September 25, 2002, the Company received notice from one of its Alaska customers that the results of a blind test on large diameter above-grade pipe were not satisfactory. Specifically, the customer indicated that, although the Company located all areas of corrosion, the severity of the anomalies reported did not march the severity of corrosion found on the pipe. As a result, the

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customer canceled approximately two weeks of remaining work for one of the Company's crews, resulting in the loss of approximately \$47,000 in expected, but not accrued, revenue.

The results that caused the customer the most concern were derived from data that was inadvertently taken by the Company using a faulty piece of grounding equipment. In the report provided to the customer, the Company identified the grounding problem and recommended that the pipe should be re-tested prior to verification.

The Company completed and submitted a detailed, written explanation of the equipment problem to the customer, including the steps already taken by the Company to preclude the recurrence of the problem. The Company was included in its customer's inspection plans for 2003, and the Company is hopeful that it will be included in the customer's inspection plans for 2004, although there can be no assurance that the customer will engage the Company to provide inspection services at any time in the future.

The Company currently requires additional cash to sustain existing operations and to meet current obligations (including those described in this Item 6, Management's Discussion and Analysis) and the Company's ongoing capital requirements. The continuation of the Company's operations is dependent in the short term upon its ability to generate sufficient cash flow to meet its obligations on a timely basis, to obtain additional financing as may be required, and ultimately to attain profitability.

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Item 7. Financial Statements

Profile Technologies, Inc.

Financial Statements

June 30, 2003 and 2002

(With Independent Auditors' Report Thereon)
PROFILE TECHNOLOGIES, INC.

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Independent Auditors' Report

The Board of Directors
Profile Technologies, Inc.:

We have audited the accompanying balance sheet of Profile Technologies, Inc. as of June 30, 2003, and the related statements of operations, stockholders' equity (deficit), and cash flows for each of the years in the two-year period ended June 30, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Profile Technologies, Inc. as of June 30, 2003, and the results of its operations and its cash flows for each of the years in the two-year period ended June 30, 2003, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in note 7 to the financial statements, the Company has incurred net losses since inception and has a working capital deficit at June 30, 2003 that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in note 7. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ KPMG LLP

KPMG LLP

Seattle, Washington
October 10, 2003

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PROFILE TECHNOLOGIES, INC.
Balance Sheet
June 30, 2003

| Assets | | |
|---|---|-------------|
| Current assets: | | |
| Cash and cash equivalents | | \$ -- |
| Contract work-in-progress | | 11,310 |
| Prepaid expenses and other current assets | | 50,733 |
| | Total current assets | 62,043 |
| Equipment, at cost | | 583,097 |
| Less accumulated depreciation | | 467,765 |
| | Net equipment | 115,332 |
| Patents, net of accumulated amortization of \$361,678 | | 61,308 |
| Other assets | | 2,415 |
| | Total assets | \$ 241,098 |
| Liabilities and Stockholders' Deficit | | |
| Current liabilities: | | |
| Notes payable to stockholders | | \$ 641,012 |
| Accounts payable | | 189,903 |
| Accrued liabilities | | 348,558 |
| | Total current liabilities | 1,179,473 |
| | Total liabilities | 1,179,473 |
| Stockholders' equity (deficit): | | |
| Common stock, \$0.001 par value. Authorized 10,000,000 shares; issued and outstanding 5,461,659 shares | | 5,462 |
| Additional paid-in capital | | 8,349,701 |
| Accumulated deficit | | (9,293,538) |
| | Total stockholders' deficit | (938,375) |
| Commitments, contingencies, and subsequent events | | |
| | Total liabilities and stockholders' deficit | \$ 241,098 |

See accompanying notes to financial statements.

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PROFILE TECHNOLOGIES, INC.
Statements of Operations
Years ended June 30, 2003 and 2002

| 2003 | 2002 |
|-------|-------|
| ----- | ----- |

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| | | |
|---|----------------|-------------|
| Revenues | \$ 350,919 | 409,313 |
| Cost of revenues | 321,212 | 356,910 |
| | ----- | ----- |
| Gross profit | 29,707 | 52,403 |
| | ----- | ----- |
| Costs and expenses: | | |
| Research and development | 173,795 | 394,005 |
| General and administrative | 941,893 | 1,018,124 |
| | ----- | ----- |
| Total costs and expenses | 1,115,688 | 1,412,129 |
| | ----- | ----- |
| Loss from operations | (1,085,981) | (1,359,726) |
| Interest and other income | 6,760 | 1,007 |
| Interest expense | (25,374) | (4,862) |
| | ----- | ----- |
| Net loss | \$ (1,104,595) | (1,363,581) |
| | ===== | ===== |
| Basic and diluted net loss per share | \$ (0.20) | (0.28) |
| Shares used to calculate basic and diluted net loss per share | 5,439,858 | 4,805,044 |

See accompanying notes to financial statements.

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PROFILE TECHNOLOGIES, INC.
Statements of Stockholders' Equity (Deficit)
Years ended June 30, 2003 and 2002

| | Common stock | | Additional paid-in capital | Accumulated deficit |
|---|--------------|----------|----------------------------------|------------------------|
| | Shares | Amount | | |
| | ----- | ----- | ----- | ----- |
| Balances at June 30, 2001 | 4,285,092 | \$ 4,285 | 7,585,830 | (6,825,362) |
| Issuance of common stock, net of issuance cost of \$40,242 | 672,000 | 672 | 362,286 | -- |
| Issuance of common stock in satisfaction of accounts payable | 2,750 | 3 | 5,497 | -- |
| Issuance of common stock purchase warrants for services | -- | -- | 14,725 | -- |
| Issuance of common stock purchase warrants as a discount on a note payable to stockholder | -- | -- | 15,000 | -- |
| Net loss | -- | -- | -- | (1,363,581) |
| | ----- | ----- | ----- | ----- |
| Balances at June 30, 2002 | 4,959,842 | 4,960 | 7,983,338 | (8,188,943) |
| Issuance of common stock | 480,388 | 481 | 335,791 | -- |
| Issuance of common stock in connection with loan conversion | 21,429 | 21 | 14,979 | -- |
| Issuance of common stock purchase | | | | |

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| | | | | |
|-----------------------------------|-------------|----------|-----------|-------------|
| warrants and options for services | -- | -- | 15,593 | -- |
| Net loss | -- | -- | -- | (1,104,595) |
| Balances at June 30, 2003 | \$5,461,659 | \$ 5,462 | 8,349,701 | (9,293,538) |
| | ===== | ===== | ===== | ===== |

See accompanying notes to financial statements.

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PROFILE TECHNOLOGIES, INC.
Statements of Cash Flows
Years ended June 30, 2003 and 2002

| | 2003 | 2002 |
|--|---------------|-------------|
| | ----- | ----- |
| Cash flows from operating activities: | | |
| Net loss | \$(1,104,595) | (1,363,581) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 163,675 | 166,615 |
| Accreted interest on notes payable | 10,139 | 4,862 |
| Stock compensation | 15,593 | 14,725 |
| Gain on asset disposal | (6,754) | -- |
| Changes in Assets and Liabilities: | | |
| Accounts receivable | -- | 32,129 |
| Contract work-in-progress | (11,310) | 17,850 |
| Prepaid expenses and other current assets | (10,330) | (8,434) |
| Other assets | 7,743 | 850 |
| Accounts payable - stockholder | -- | (3,262) |
| Other accounts payable | 5,744 | 137,135 |
| Accrued liabilities | 235,358 | 91,689 |
| | ----- | ----- |
| Net cash used by operating activities | (694,737) | (909,422) |
| | ----- | ----- |
| Cash flows from investing activities: | | |
| Proceeds from asset disposal | 8,690 | 65,830 |
| | ----- | ----- |
| Net cash provided by (used in) investing activities | 8,690 | (65,830) |
| | ----- | ----- |
| Cash flows from financing activities: | | |
| Proceeds from issuance of common stock and warrants, net | 105,022 | 362,958 |
| Proceeds from issuance of notes payable and related warrants to stockholders | 507,511 | 148,500 |
| Proceeds from subscriptions for common stock and warrants | -- | 231,250 |
| | ----- | ----- |
| Net cash provided by financing activities | 612,533 | 742,708 |
| | ----- | ----- |
| Decrease in cash and cash equivalents | (73,514) | (232,544) |
| Cash and cash equivalents at beginning of year | 73,514 | 306,058 |
| | ----- | ----- |
| Cash and cash equivalents at end of year | \$ -- | 73,514 |
| | ===== | ===== |

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Non-cash transactions:

| | | |
|--|---------|----|
| Issuance of stock previously subscribed | 231,250 | -- |
| Conversion of note payable to stock and warrants | 15,000 | -- |

See accompanying notes to financial statements.

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Profile Technologies, Inc.
Notes to Financial Statements
June 30, 2003 and 2002

(1) Nature of Business and Summary of Significant Accounting Policies

(a) Nature of Business

Profile Technologies, Inc. (Company), was incorporated in 1986 and commenced operations in fiscal year 1988. The Company is developing and commercializing potential processes for the nondestructive, noninvasive testing of both above ground and buried pipelines for the effectiveness of pipeline cathodic protecting systems and coating integrity. The Company's marketing and development efforts have primarily been focused towards large multinational oil companies.

(b) Contract Revenue Recognition

Revenue from service contracts primarily relates to testing of industrial pipeline integrity and is recognized using the percentage of completion method of contract accounting. Contract revenues earned are measured using either the percentage of contract costs incurred to date to total estimated contract costs or, when the contract is based on measurable units of completion, revenue is based on the completion of such units.

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

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

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

(c) Allowance for Doubtful Accounts

The Company estimates an allowance for doubtful accounts based on the credit worthiness of its customers as well as general economic conditions. Consequently, an adverse change in those factors could affect the Company's estimate of its allowance for doubtful accounts. Account balances are considered past due based on contractual terms

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and are charged off against the allowance after all means of collection have been exhausted, and the potential for recovery is considered remote.

(d) Research and Development

Research and development costs are expensed when incurred.

(e) Equipment

Equipment is stated at cost and is depreciated using the straight-line method over estimated useful lives of three to seven years.

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Profile Technologies, Inc.
Notes to Financial Statements
June 30, 2003 and 2002

(f) Patents

Patent and related application costs are amortized using the straight-line method over their estimated useful lives of approximately four to six years. Amortization expense was \$84,592 in 2003 and 2002 and is expected to be \$61,308 in 2004.

(g) Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is recorded for deferred tax assets when it is more likely than not that such deferred tax assets will not be realized.

(h) Major Customers

All of the Company's revenues were from two and six customers for the years ended June 30, 2003 and 2002, respectively.

Information related to the Company's customers accounting for greater than 10% of revenues follows:

| | Year ended June 30, 2003 |
|------------|-----------------------------|
| | Revenues |
| | ----- |
| Customer A | 37% |
| Customer B | 63% |
| | Year ended June 30, 2002 |
| | Revenues |
| | ----- |

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| | |
|------------|-----|
| Customer A | 37% |
| Customer B | 51% |

In addition, Customer A accounted for 100% of contract work-in-progress balance at June 30, 2003. The loss of Customer A or Customer B or the Company's failure to broaden the base of customers in 2003, could have a material adverse effect on the Company.

(i) Cash Equivalents

The Company considers all short-term investments with a maturity date at purchase of three months or less to be cash equivalents.

(j) Net Loss Per Share

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

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Profile Technologies, Inc.
Notes to Financial Statements
June 30, 2003 and 2002

Excluded from the computation of diluted loss per share, because their effect would be antidilutive, are warrants and options to acquire 2,913,817 shares of common stock with a weighted average exercise price of \$2.28 for the year ended June 30, 2003, and warrants and options to acquire 2,297,000 shares of common stock with a weighted average price of \$2.63 for the year ended June 30, 2002. Additional potential dilutive securities that were excluded from the diluted loss per share computation are the exchange rights discussed in footnote 7 that could result in options with an exercise price of \$1.00 to acquire up to 511,316 shares of common stock for the year ended June 30, 2003 and 223,000 shares for the year ended June 30, 2002.

(k) Use of Estimates

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

(l) Patents, Proprietary Technology, and Other Intellectual Property

The Company pursues a policy of generally obtaining patent protection both in the United States of America and abroad for patentable subject matter in its proprietary technology. The Company's success depends in a large part upon its ability to protect its products and technology under United States of America and international patent laws and other intellectual property laws. U.S. patents have a term of 17 years from date of issuance and patents in most foreign countries have a term of 20 years from the proprietary filing date of the patent application.

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The Company believes that it owns and has the right to use or license all proprietary technology necessary to license and market its products under development. The Company is not aware of the issuance of any patents or the filing of any patent applications which relate to processes or products which utilize the Company's proprietary technology in a manner which could be similar to or competitive with the Company's products or processes. The Company has no knowledge that it is infringing on any existing patent such that it would be prevented from marketing or licensing products or services currently being developed by the Company.

(m) Financial Instruments and Concentrations of Credit Risk

At June 30, 2003, the Company has the following financial instruments: notes payable to stockholders, contract work-in-progress, accounts payable and accrued expenses. The carrying value of these instruments approximate fair value based on their liquidity and based on their short-term nature. Credit is extended to customers based on an evaluation of their financial condition. The Company does not require any collateral. The Company regularly invests funds in excess of its immediate needs in money market mutual funds. These funds are generally uninsured and subject to investment risk. There were no amounts held in such funds at June 30, 2003.

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Profile Technologies, Inc.
Notes to Financial Statements
June 30, 2003 and 2002

(n) Stock-Based Compensation

The Company has elected to follow the measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations in accounting for its employee stock options rather than the alternative fair value accounting provided for by Statements of Financial Accounting Standards No. 123 (SFAS No. 123), Accounting for Stock Based Compensation. Compensation cost for stock options issued to employees is measured as the excess, if any, of the fair market price of the Company's stock at the date of grant over the amount an employee must pay to acquire the stock. Had compensation cost for the Company's option and warrant awards been determined consistent with SFAS No. 123, the Company's net loss would have been increased to the pro forma amounts indicated below:

| | Years ended June 30 | |
|--|---------------------|---------|
| | 2003 | 2002 |
| Net loss: | | |
| As reported | \$ 1,104,595 | 1,363,5 |
| Plus: stock-based employee compensation expense included in reported net loss | 15,593 | 10,1 |
| Less: stock based compensation expense determined under fair value based method for all employee rewards | 10,800 | 110,5 |
| Net Loss | \$ 1,109,388 | 1,263,2 |

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| | | | |
|--------------------------------|----|--------|-------|
| Net loss per share: | | ===== | ===== |
| Basic and diluted--as reported | \$ | (0.20) | (0. |
| Basic and diluted--pro forma | | (0.20) | (0. |

The fair value of option and warrant grants is estimated using the Black-Scholes option pricing model with the following weighted average assumptions used for grants in 2003: expected volatility of 120%, risk-free interest rate of 3.28%, expected lives of 5 years, and a 0% dividend yield. The weighted average assumptions used for grants in 2002: expected volatility of 120%, risk free interest rate of 5.25%, expected lives of 5 years, and a 0% dividend yield.

The Company recognizes compensation cost, if any, related to fixed employee awards on an accelerated basis over the applicable vesting period using the methodology described in FASB Interpretation No. 28, Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans.

(o) Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of

Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, provides a single accounting model for long-lived assets to be disposed of. SFAS No. 144 also changes the criteria for classifying an asset as held for sale;

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Profile Technologies, Inc.
Notes to Financial Statements
June 30, 2003 and 2002

and broadens the scope of businesses to be disposed of that qualify for reporting as discontinued operations and changes the timing of recognizing losses on such operations. The Company adopted SFAS No. 144 on January 1, 2002. The adoption of SFAS No. 144 did not affect the Company's financial statements.

In accordance with SFAS No. 144, long-lived assets, such as equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated.

Prior to the adoption of SFAS No. 144, the Company accounted for long-lived assets in accordance with SFAS No. 121, Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of.

(p) Segment Reporting

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The Company has one operating segment. Revenues consist almost entirely of fees generated from providing testing services. Expenses incurred to date are reported according to their expense category.

The Company's customers are located in the United States and various foreign countries, however, no revenue has been generated from contracts with customers in foreign countries in 2003 or 2002.

(q) New Accounting Pronouncements

In June 2001, FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations. SFAS No. 143 requires the Company to record the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development, and/or normal use of the assets. The Company also records a corresponding asset that is depreciated over the life of the asset. Subsequent to the initial measurement of the asset retirement obligation, the obligation will be adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The Company was required to adopt SFAS No. 143 on July 1, 2002. The adoption of SFAS No. 143 did not have an effect on the Company's financial statements.

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Profile Technologies, Inc.
Notes to Financial Statements
June 30, 2003 and 2002

In April 2002, the FASB issued SFAS No. 145, Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections. SFAS No. 145 amends existing guidance on reporting gains and losses on the extinguishment of debt to prohibit the classification of the gain or loss as extraordinary, as the use of such extinguishments have become part of the risk management strategy of many companies. SFAS No. 145 also amends SFAS No. 13 to require sale-leaseback accounting for certain lease modifications that have economic effects similar to sale-leaseback transactions. The provisions of the Statement related to the rescission of Statement No. 4 is applied in fiscal years beginning after May 15, 2002. Earlier application of these provisions is encouraged. The provisions of the Statement related to Statement No. 13 were effective for transactions occurring after May 15, 2002, with early application encouraged. The adoption of SFAS No. 145 did not have an effect on the Company's financial statements.

In June 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity. The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31, 2002, with early application encouraged. The adoption of SFAS No. 146 did not have an effect on the Company's financial statements.

In November 2002, the FASB issued Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including

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Indirect Guarantees of Indebtedness to Others, an interpretation of FASB Statements No. 5, 57 and 107 and a rescission of FASB Interpretation No. 34. This Interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. The Interpretation also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. The initial recognition and measurement provisions of the Interpretation are applicable to guarantees issued or modified after December 31, 2002 and are not expected to have an effect on the Company's financial statements. The disclosure requirements are effective for financial statements of interim or annual periods ending after December 15, 2002.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of FASB Statement No. 123. This Statement amends FASB Statement No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of Statement No. 123 to require prominent disclosures in both annual and interim financial statements. Certain of the disclosure modifications are required for fiscal years ending after December 15, 2002 and are included in the notes to these consolidated financial statements.

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Profile Technologies, Inc.
Notes to Financial Statements
June 30, 2003 and 2002

(2) Related Parties

(a) Notes Payable - Stockholders

On May 9, 2002, the Company entered into a bridge loan of up to \$150,000 with Murphy Evans, President and a director of the Company. Mr. Evans has currently loaned the Company \$126,000 pursuant to this bridge loan. Pursuant to the terms of the loan, once Mr. Evans loaned the Company \$125,000, the Company cancelled 150,000 warrants with exercise prices ranging from \$3.00 per share to \$7.50 per share (old warrants), previously held by Mr. Evans, with and issued to Mr. Evans 150,000 five-year warrants with an exercise price of \$1.05.

The cancellation of the old warrants is an effective re-pricing and will be accounted for as a "variable plan" until such time as the warrants are exercised, expire or are forfeited. Variable plan accounting will result in intrinsic value associated with the warrants being adjusted to compensation expense based on each reporting period's ending stock value. As of June 30, 2003, no intrinsic value had been recorded related to these warrants as the stock price was below the exercise price.

As a result of the cancellation and re-issuance of the warrants with a reduced exercise price, the Company recorded an additional \$15,000 discount on notes payable and an increase in additional paid in capital based on the difference between the fair value of the old warrants and the fair value of the new warrants. The fair value of the old and new warrants on the day of cancellation and issuance was based on an option pricing model with the following assumptions: warrant

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lives ranging from 5 to 5.5 years, risk free interest rates of 5.25%, volatility of 120% and a zero dividend yield. Corresponding interest expense related to the note was \$10,139 for the twelve months ended June 30, 2003.

The original note provided for interest of 6% per annum on the unpaid balance. Effective January 1, 2003, the Company and Mr. Evans entered into an agreement under which this note and all other past and future advances from Mr. Evans carry an interest rate of 5% per annum, interest is payable on June 30 and December 31 of each year, and the notes mature on December 31, 2003. Under the terms of this agreement, Mr. Evans loaned the Company an additional \$423,465 in 2003. As of September 30, 2003, the June 30, 2003 interest payment had not been made and Mr. Evans had made no demand for payment. All advances from Mr. Evans are convertible into any debt or equity offering by the Company.

In 2002, the Company issued non-interest bearing bridge notes payable to two officers in the amounts of \$15,000 and \$7,500, convertible into 21,428 and 10,714 equity units, respectively. Each equity unit is comprised of one share of common stock accompanied by a detachable five-year warrant to purchase an additional share of common stock with an exercise price of \$1.05. To the extent that the notes are not converted before maturity, both notes are payable in full when the Company determines it has sufficient working capital to do so. The note in the amount of \$15,000 was converted to 21,428 equity units described above in 2003.

In 2003, the Company obtained \$50,000 in non-interest bearing bridge notes payable to two stockholders of the Company, convertible into 71,428 equity units. Each equity unit is comprised of one share of common stock accompanied by a detachable five-year warrant to purchase an additional share of common stock with an exercise price of \$1.05. To the extent that the notes are not converted before maturity, the loans are payable in full when the Company determines it has sufficient working capital to do so.

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Profile Technologies, Inc.
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In addition, in 2003, the Company obtained \$34,047 from the officer of the Company. The note accrues interest at 5% and is due and payable on December 31, 2003. The note is convertible into any debt or equity offering made from time to time by the Company.

The following is a summary of notes payable to stockholders as of June 30, 2003.

| | |
|-------------------------|-----------|
| Evans | 549,645 |
| Officer Notes | 41,547 |
| Other Stockholder Notes | 50,000 |
| | ----- |
| | \$641,012 |
| | ===== |

(b) Consulting Services and Wages

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Consulting fees were paid in 2002 to a director of the Company, Dr. John Kuo, totaling approximately \$60,000.

(c) Royalty Arrangement

In July 1988, the primary technology rights used by the Company were contributed by Northwood Enterprises Inc. (NEI), a company wholly owned by certain Company stockholders. In exchange for contributing the technology, the Company agreed to pay a royalty of 4% of the Company's net earnings before taxes to certain Company stockholders. When the Company becomes profitable, royalties will be due quarterly. In March 1996, an additional 1% royalty arrangement was awarded to a director of the Company in exchange for his expertise, technological know-how and proprietary information, and trade secrets. No amounts are payable under these arrangements.

(3) Income Taxes

Federal income taxes reported by the Company differ from the amount computed by applying the statutory rate due primarily to an increase in the valuation allowance for deferred tax assets.

The tax effect of temporary differences that give rise to significant portions of federal deferred tax assets are comprised of the following at June 30, 2003:

| | |
|---|--------------|
| Deferred tax assets: | |
| Net operating loss carryforwards | \$ 2,847,000 |
| Stock compensation | 306,000 |
| Research and experimentation credit carryforwards | 141,000 |
| | ----- |
| Gross deferred tax assets | 3,294,000 |
| Less valuation allowance | (3,294,000) |
| | ----- |
| Net deferred tax assets | \$ -- |
| | ===== |

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Profile Technologies, Inc.
Notes to Financial Statements
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The net increase in the valuation allowance for deferred tax assets was \$385,000 and \$475,000 for 2003 and 2002, respectively. The increases were primarily due to net operating loss carryforwards, the realization of which was uncertain.

For federal income tax purposes, the Company has net operating loss carryforwards at June 30, 2003 available to offset future federal taxable income, if any, of approximately \$8,373,529 which began to expire in 2003. In addition, the Company has research and experimentation tax credit carryforwards of approximately \$141,000 at June 30, 2003 which are available to offset federal income taxes and began to expire in 2003.

The utilization of the tax net operating loss carry forwards may be limited due to ownership changes that have occurred as a result of sales of common stock.

The effects of state income taxes were insignificant for 2003 and 2002.

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(4) Sale of Common Stock and Common Stock Purchase Warrants

During the year ended June 30, 2002, the Company issued 672,000 shares of common stock and an equal number of warrants in connection with the sale of common stock. The warrants are exercisable at \$1.00 per share until September 2006. Each share of common stock and warrant was sold for a total of \$0.60. The total proceeds from sale of these securities, net of issuance costs, amounted to \$362,958. Directors and related parties to the directors purchased a total of approximately 307,500 shares of common stock. Additionally, the Company issued 2,750 shares of common stock for the payment of rent.

During the year ended June 30, 2003, the Company issued 480,386 shares of common stock, at a price of \$0.70 per share, with an equal number of attached warrants. Each warrant entitles the holder to purchase one share of common stock at an exercise price of \$1.05 per share until April 4, 2007. The total proceeds from sale of these securities amounted to \$336,272. As discussed in note 2(a), the note from officer in the amount of \$15,000 was converted to 21,428 shares of common stock and an equal number of attached warrants described above in 2003.

(5) Stockholders' Equity

(a) Stock Option Plan

The Company has granted stock options to compensate key employees, consultants, and board members for past and future services. During 1999, the Company adopted a stock option plan (Plan). The Plan provides for both incentive and nonqualified stock options to be granted to employees, officers, directors, and consultants. The Company has reserved 500,000 shares of common stock for option grants under the Plan.

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Profile Technologies, Inc.
Notes to Financial Statements
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A summary of stock option-related activity follows:

| | Shares available for grant | Options outstanding ----- Number of shares | Weighted average exercise price ----- |
|--------------------------|----------------------------------|---|--|
| Balance at June 30, 2001 | 370,000 | 130,000 | 6.13 |
| Grants | (135,000) | 135,000 | 1.00 |
| | ----- | ----- | |
| Balance at June 30, 2002 | 235,000 | 265,000 | 3.52 |
| Grants | (100,000) | 100,000 | 0.55 |
| | ----- | ----- | |
| Balance at June 30, 2003 | 135,000 ===== | 365,000 ===== | 2.70 |

The following is a summary of stock options outstanding at June 30, 2003:

Options outstanding Options exercisable

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| Exercise prices | Number outstanding | Weighted average remaining contractual life (years) | Weighted average exercise price | Number exercisable | Weighted average exercise price |
|-----------------|--------------------|---|---------------------------------|--------------------|---------------------------------|
| \$ 0.50 - 1.00 | 235,000 | 3.96 | \$ 0.81 | 235,000 | \$ 0.81 |
| 2.00 | 5,000 | 2.67 | 2.00 | 5,000 | 2.00 |
| 4.00 | 35,000 | 2.38 | 4.00 | 35,000 | 4.00 |
| 5.00 | 25,000 | 4.33 | 5.00 | 25,000 | 5.00 |
| 6.50 | 40,000 | 4.33 | 6.50 | 40,000 | 6.50 |
| 10.50 | 25,000 | 4.33 | 10.50 | 25,000 | 10.50 |
| \$ 0.50 - 10.50 | 365,000 | 3.88 | 2.70 | 365,000 | 2.70 |

The Company applies APB Opinion No. 25 and related interpretations in accounting for option grants to employees.

During 2003, the Company recorded stock compensation expense totaling \$11,400 for the fair market value of 60,000 options granted to third-parties in exchange for services. The options were valued using the Black-Scholes option pricing model and the assumptions listed below.

The weighted average fair value per share of the option grants made during the year ended June 30, 2003 was \$0.24. The weighted average fair value of the warrant and option grants made during the year ended June 30, 2002 was \$0.85.

The fair value of option and warrant grants is estimated using the Black-Scholes option pricing model with the following weighted average assumptions used for grants in 2003: expected volatility of 120%, risk free interest rate of 3.28%, expected lives of five years, and a 0% dividend yield. The weighted average assumptions used for grants in 2002: expected volatility of 120%, risk free interest rate of 5.25%, expected lives of 5 years, and a 0% dividend yield.

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(b) Warrants

The Company has granted warrants to compensate key employees, consultants, and board members for past and future services, and as incentives during placements of stock.

A summary of warrant-related activity follows:

| | Number of shares under warrants | Weighted average exercise price |
|------------------------------|---------------------------------|---------------------------------|
| Outstanding at June 30, 2001 | 1,300,000 | \$4.02 |
| Grants | 882,000 | 1.01 |

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| | | |
|------------------------------|-----------|------|
| Cancellations | (150,000) | 6.67 |
| | ----- | |
| Outstanding at June 30, 2002 | 2,032,000 | 2.52 |
| Grants | 516,817 | 1.04 |
| Exercises | -- | -- |
| | ----- | |
| Outstanding at June 30, 2003 | 2,548,817 | 2.22 |
| | ===== | |

The following is a summary of warrants outstanding, all of which are exercisable at June 30, 2003:

| Exercise prices | Number outstanding | Weighted average remaining contractual life (years) | Weighted average exercise price |
|-----------------|-----------------------|---|---------------------------------------|
| ----- | ----- | ----- | ----- |
| \$0.55 | 15,000 | 4.48 | \$ 0.55 |
| 1.00 - 1.50 | 1,728,817 | 3.77 | 1.05 |
| 3.00 - 3.50 | 530,000 | 4.33 | 3.27 |
| 6.00 | 100,000 | 0.33 | 6.00 |
| 7.20 | 65,000 | 4.33 | 7.20 |
| 8.40 | 90,000 | 4.33 | 8.40 |
| 13.50 | 20,000 | 4.33 | 13.50 |
| | ----- | | |
| 0.55 - 13.50 | 2,548,817 | 3.79 | 2.22 |
| | ===== | | |

During 2003, the Company recorded expense related to warrants totaling \$4,193 for the fair market value of 10,000 warrants granted to third-parties in exchange for services. The warrants were valued using the Black-Scholes option pricing model and the assumptions listed below.

During 2002, the Company recorded stock compensation expense totaling \$14,725 for the fair market value of 60,000 warrants granted to a third party in exchange for services. The warrants were valued using the Black-Scholes option pricing model and the assumptions listed below.

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The weighted average fair value per share of the warrant grants made during the year ended June 30, 2003 was \$0.21. The weighted average fair value of the warrant and option grants made during the year ended June 30, 2002 was \$0.85.

The fair value of option and warrant grants is estimated using the Black-Scholes option pricing model with the following weighted average assumptions used for grants in 2003: expected volatility of 120%, risk free interest rate of 3.28%, expected lives of five years, and a 0% dividend yield. The weighted average assumptions used for grants in 2002: expected volatility of 120%, risk free interest rate of 5.25%, expected lives of 5 years, and a 0% dividend yield.

(6) Operating Leases

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The Company leases office facilities in various states under operating lease agreements that expire during 2004. Future minimum rental payments as of June 30, 2003 on operating leases are \$11,874 for 2004.

Total rent expense under operating leases with third parties was \$35,297 and \$86,786 during 2003 and 2002, respectively. Rent expense incurred under an operating lease with a related party was \$0 and \$1,250 during 2003 and 2002, respectively.

(7) Liquidity

The Company's financial statements have been prepared assuming the Company will continue as a going concern. The Company has incurred cumulative losses of \$9,293,538 through June 30, 2003 and had negative working capital of \$1,117,430 as of June 30, 2003. These conditions raise substantial doubt about its ability to continue as a going concern.

Additionally, the Company has expended a significant amount of cash in developing its technology and patented processes. Management recognizes that in order to meet the Company's capital requirements, additional financing will be necessary. The Company is evaluating alternative sources of financing to improve its cash position and is undertaking efforts to raise capital. If the Company is unable to raise additional capital or secure additional revenue contracts and generate positive cash flow, there can be no assurance that the Company will be able to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

To reduce cash outflows, certain of the Company's employees, officers and directors have agreed to defer a portion of their salaries and consulting fees from August 2001 until the Company has sufficient resources to pay the amounts owed or to exchange such amounts into options as described below. The Company accrued approximately \$255,658 and \$111,500 at June 30, 2003 and 2002, respectively, related to the deferred payment of the salaries and consulting fees which is included under accrued liabilities. On March 18, 2002, the Board of Directors approved a right whereby for each dollar of deferred salary and fees, the employee, officer or director could exchange their deferred amount for an option to purchase two shares of common stock with a five-year term at an exercise price of \$1.00 per share. No conversions have occurred to date. As there was no intrinsic value associated with these exchange rights, no additional compensation cost has been recorded.

On June 19, 2003, the Board of Directors approved the offering of \$1,000,000 in convertible debentures. The Debentures are convertible into that number of shares of the Company's common stock equal to the amount of the converted indebtedness divided by \$0.50 per share. The Debentures bear

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Profile Technologies, Inc.
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interest at a rate of 5% per annum, payable quarterly. The Company is required to redeem each Debenture on the 5th anniversary of the date of the Debenture. The Company may, in its discretion, redeem any Debenture at any time prior to the mandatory redemption date of the Debenture by providing no less than 60 days' prior written notice to the holder of the Debenture.

Upon the purchase of, and for each \$0.50 of the Debenture's principal

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amount, the Company will issue to an investor a warrant (the "Warrant") to purchase one (1) share of the Company's common stock at an exercise price of \$0.75 per share. For example, if an investor executes a Debenture in the principal amount of \$100,000, the Company will issue to such investor 200,000 Warrants. The Warrants will be exercisable at any time prior to the 5th anniversary date of the redemption of the Debenture. As of June 30, 2003, the Company had not received any funds from this offering.

As of September 26, 2003, the Company had raised \$25,000 from this offering.

(8) NASDAQ Delisting

In June 2001, the Company announced that it received a NASDAQ Staff Determination indicating that the Company failed to comply with the minimum bid price and net tangible asset/shareholder equity requirements of the NASDAQ Marketplace Rules for continued listing set forth in Marketplace Rule 4310(c)(4), and that its securities were, therefore, subject to delisting from the NASDAQ SmallCap Market. On August 10, 2001, the NASDAQ Stock Market suspended trading in the Company's common stock. Effective Monday, August 13, 2001, the Company began trading on the Over the Counter Bulletin Board under the symbol PRTK.

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

None.

Item 8A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in the Company's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. The Company's executive officers, including the Company's Chief Executive Officer, who also serves as Chief Financial Officer, and the Chief Operating Officer, are responsible for establishing and maintaining disclosure controls and procedures for the Company. These executives have designed such controls to ensure that all material information related to the Company is made known to them by others within the organization. As of June 30, 2003, the Company's Chief Executive Officer and Chief Operating Officer completed an evaluation of the Company's disclosure controls and procedures and have determined that such disclosure controls and procedures are functioning

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properly and effectively. They did not discover any significant deficiencies or material weaknesses within the controls and procedures that require modification. There were no changes in the Company's internal control over financial reporting identified in connection with the Company's evaluation that occurred during the Company's fourth fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART III

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

The information regarding directors contained under the caption "Proposal One: Election of Directors" in the Company's Proxy Statement for the 2003 Annual Meeting of Shareholders, which will be filed with the Securities and Exchange Commission prior to October 28, 2003, is incorporated herein by reference.

The information regarding executive officers who are not directors is set forth in Item 1 of this Report under the caption "Executive Officers of the Company."

The information regarding reports required under Section 16(a) of the Securities Exchange Act of 1934, as amended, contained under the caption "Section 16(a) Beneficial Ownership Report Compliance" in the Company's Proxy Statement for the 2003 Annual Meeting of Shareholders, which will be filed with the Securities and Exchange Commission prior to October 28, 2003, is incorporated herein by reference.

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Item 10. Executive Compensation

The information contained under the caption "Executive Compensation" in the Company's Proxy Statement for the 2003 Annual Meeting of Shareholders, which will be filed with the Securities and Exchange Commission prior to October 28, 2003, is incorporated herein by reference.

Item 11. Security Ownership of Certain Beneficial Owners and Management

The information contained under the caption "Security Ownership of Certain Beneficial Owners and Management" in the Company's Proxy Statement for the 2003 Annual Meeting of Shareholders, which will be filed with the Securities and Exchange Commission prior to October 28, 2003, is incorporated herein by reference.

Securities Authorized for Issuance Under Equity Compensation Plans.

The following table sets forth information concerning equity compensation plans, including individual compensation arrangements, under which the Company is authorized to issue equity securities.

Number of
securities

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| | Number of securities to be issued upon exercise of outstanding options, warrants and rights | Weighted-average exercise price of outstanding options, warrants and rights | remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) |
|--|---|---|--|
| | (a) | (b) | (c) |
| Equity compensation plans approved by security holders | 365,000 | \$2.70 | 135,000 |
| Equity compensation plans not approved by security holders | 1,195,000 (1), (2), (3), (4) | \$3.70 | N/A (5) |
| Total | 1,560,000 | \$3.46 | 135,000 |

(1) Consists of various grants of compensatory warrants, all of which were issued prior to the adoption of the Company's 1999 Stock Plan, which was recommended by the Board of Directors in October, 1998 and approved by the shareholders on November 16, 1998, except for the warrants issued to R.F. Lafferty & Co., Scott Meaker, and Dr. Charles Frost, as described in Footnote 2 below, and none of whom are officers or directors of the Company.

(2) Consists of the following individual grants of compensatory warrants: (A) in March, 1996 and November, 1996, to Gale D. Burnett, compensatory warrants to purchase 210,000 shares at exercise prices ranging from \$1.25 to \$3.00 per share (of which 50,000 warrants at an exercise price of \$3.00 per share were transferred to Henry Gemino in November, 1996), (B) in March, 1996, to Henry E. Gemino, compensatory warrants to purchase 250,000 shares at exercise prices ranging from \$1.25 to \$3.00 per share, (C) in March, 1996 and November, 1996, to Allen Reeves, compensatory warrants to purchase 130,000 shares at exercise prices ranging from \$1.25 to \$7.20 per

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share, of which 15,000 shares have been exercised (at an exercise price of \$1.25 per share), (D) in March, 1996 and November, 1996, to G. L. Scott, compensatory warrants to purchase 70,000 shares at exercise prices ranging from \$1.25 to \$7.20 per share, (E) in March, 1996 and November, 1996, to Dr. John T. Kuo, compensatory warrants to purchase 350,000 shares at exercise prices ranging from \$3.00 to \$7.20 per share, (F) in February, 1998, to Joseph Galbraith, compensatory warrants to purchase 20,000 shares at an exercise price of \$13.50 per share, (G) in November, 2000, to R.H. Lafferty & Co., compensatory warrants to purchase 100,000 shares at an exercise price of \$6.50 per share, (H) in January, 2002, to Scott Meaker, compensatory warrants to purchase 50,000 shares at an exercise price of \$1.00 per share, and (I) in March, 2002 and May, 2002, to Dr. Charles Frost, compensatory warrants to purchase 15,000 shares at an exercise price

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of \$1.00 per share.

- (3) All of the compensatory warrants have fully vested, and none of the warrants that were issued to officers and directors of the Company will terminate if any such officer or director ceases to be employed by or to serve as a director of the Company. All of the warrants issued prior to February 12, 1997 are due to expire on October 31, 2004. The warrants issued: (A) to Joseph Galbraith on February 26, 1998, are due to expire on October 31, 2004, (B) to R.F. Lafferty & Co. on November 30, 2000, are due to expire on October 31, 2003, (C) to Scott Meaker on January 28, 2002, are due to expire on January 2, 2007, and (D) to Dr. Charles Frost, Marcy 6, 2002 and May 13, 2002, are due to expire on February 15, 2005.
- (4) All of the compensatory warrants issued to the individuals as set forth in Footnote 2 above were issued by the Company in exchange for services provided by such individuals as executive officers and directors of the Company, except as follows: (i) the warrants issued to Allen Reeves as described in Footnote 2 above were issued in exchange for legal services provided to the Company by Mr. Reeves; and (ii) the compensatory warrants issued to R.F. Lafferty & Co., Scott Meaker and Dr. Frost, as described in Footnote 2, were issued in exchange for consulting services provided to the Company.
- (5) All of the equity compensation plans aggregated as explained in Footnote 2 above represent individual compensation arrangements approved separately by the Board of Directors and are not part of any written or formal plan under which the Company will be obligated to issue equity compensation in the future.

Item 12. Certain Relationships and Related Transactions

The information contained under the caption "Transactions with Affiliates" in the Company's Proxy Statement for the 2003 Annual Meeting of Shareholders, which will be filed with the Securities and Exchange Commission prior to October 28, 2003, is incorporated herein by reference.

Item 13. Exhibits and Reports on Form 8-K

- (a) Exhibits. The following exhibits were filed with or incorporated by reference into this report.

| Exhibit No. ----- | Description of Exhibit ----- |
|----------------------|--|
| Exhibit 3.1 | Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Registration Statement on Form SB-2 filed with the Commission on May 10, 1996). |

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| Exhibit No. ----- | Description of Exhibit ----- |
|----------------------|--|
| Exhibit 3.2 | Bylaws of the Company (incorporated by reference to Exhibit 3.3 to the Company's Registration Statement on Form SB-2 filed with the Commission on May 10, 1996). |

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- Exhibit 10.1 Service Agreement dated as of August 16, 2001 between Profile Technologies, Inc. and BP Exploration(Alaska) Inc. (incorporated by reference to Exhibit 10.1 to the Company's Annual Report on Form 10-KSB filed with the Commission on September 28, 2001).
- Exhibit 10.2 Loan Agreement dated March 6, 2003, by and between the Company and Murphy Evans (incorporated by reference to Exhibit 4.1 to the Company's Quarterly Report on Form 10-QSB filed with the Commission on May 15, 2003).
- Exhibit 23.1 Consent of Independent Auditors.
- Exhibit 31.1 Certification of Henry E. Gemino, as Chief Executive Officer and Chief Financial Officer of the Company, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- Exhibit 31.2 Certification of Philip L. Jones, as Chief Operating Officer of the Company, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- Exhibit 32.1 Certification under Section 906 of the Sarbanes-Oxley Act of 2002 by Henry E. Gemino, as Chief Executive Officer and Chief Financial Officer of the Company.
- Exhibit 32.2 Certification under Section 906 of the Sarbanes-Oxley Act of 2002 by Philip L. Jones, as Chief Operating Officer of the Company.
- Exhibit 99.1 Press Release dated June 25, 2003.
- (b) Reports on Form 8-K. The Company did not file a Form 8-K during the last quarter of its fiscal year 2003.

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SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PROFILE TECHNOLOGIES, INC.

By /s/ Henry E. Gemino

Henry E. Gemino
Chief Executive Officer
and Chief Financial Officer

In accordance with the Exchange Act, this report has been signed below by

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the following persons on behalf of the registrant in the capacities and as of the dates indicated:

| Signature ----- | Title ----- | Date ----- |
|---|----------------|------------------|
| /s/ Charles Christenson ----- Charles Christenson | Director | October 14, 2003 |
| /s/ Murphy Evans ----- Murphy Evans | Director | October 14, 2003 |
| /s/ Henry E. Gemino ----- Henry E. Gemino | Director | October 14, 2003 |
| /s/ William A. Krivsky ----- William A. Krivsky | Director | October 14, 2003 |
| /s/ John Tsungfen Kuo ----- John Tsungfen Kuo | Director | October 14, 2003 |