PROFILE TECHNOLOGIES INC
Form 10QSB
May 09, 2007

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

FORM 10-QSB

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

For the quarterly period ended March 31, 2007

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

For the transition period from ___________ to ___________

Commission file number 000-29196

PROFILE TECHNOLOGIES, INC.

(Name of Small Business Issuer in Its Charter)

Delaware	**91-1418002**
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)
2 Park Avenue, Suite 201 **Manhasset, New York**	**11030**
(Address of principal executive offices)	(Zip Code)

(516) 365-1909
(Issuer s Telephone Number, Including Area Code)

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

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

State the number of shares outstanding of each of the issuer s classes of common equity, as of the latest practicable date: 12,727,278 shares of common stock as of May 4, 2007.

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

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

PROFILE TECHNOLOGIES, INC.
Balance Sheet
(unaudited)

		March 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$	321,192
Prepaid expenses and other current assets		13,494
Total current assets		334,686
Equipment, net of accumulated depreciation of $548,312		11,358
Deferred financing fees		360
Other assets		3,184
Total assets	$	349,588
Liabilities and Stockholders' Deficit		
Current Liabilities:		
Accounts payable	$	148,521
Notes payable to stockholders		57,500
Current portion of convertible debt		65,000
Deferred wages		736,210
Accrued professional fees		207,150
Accrued interest		1,594
Other accrued expenses		12,644
Total current liabilities		1,228,619
Long-term convertible debt, net of unamortized discount of $59,386		614
Stockholders' deficit:		
Common stock, $0.001 par value. Authorized 25,000,000 shares; issued and outstanding 12,627,278 shares		12,627
Additional paid-in capital		13,441,733
Accumulated deficit		(14,334,005)
Total stockholders' deficit		(879,645)

	March 31, 2007
Commitments, contingencies and subsequent events	
Total liabilities and stockholders' deficit	$ 349,588

See accompanying notes to financial statements.

PROFILE TECHNOLOGIES, INC.
Statements of Operations
(unaudited)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006	Nine Months Ended March 31, 2007	Nine Months Ended March 31, 2006
Revenue	$	$	$	$
Cost of revenues				
Gross profit				
Operating expenses:				
Research and development	66,575	56,852	381,297	303,718
General and administrative	124,081	158,891	1,101,005	494,335
Total operating expenses	190,656	215,743	1,482,302	798,053
Loss from operations	(190,656)	(215,743)	(1,482,302)	(798,053)
Interest expense	10,051	12,300	16,129	237,632
Interest income	1,812		1,812	
Net loss	$ (198,895)	$ (228,043)	$ (1,496,619)	$ (1,035,685)
Basic and diluted net loss per share	$ (0.02)	$ (0.02)	$ (0.12)	$ (0.12)
Weighted average shares outstanding used to calculate basic and diluted net loss per share	12,623,945	10,544,723	12,543,005	8,811,991

See accompanying notes to financial statements.

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

	Nine Months Ended March 31, 2007	Nine Months Ended March 31, 2006
Cash flows from operating activities:		
Net loss	$(1,496,619)	$(1,035,685)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	4,272	3,706
Accreted discount on convertible debt	560	106
Amortization of convertible debt discount included in interest expense	7,365	197,945
Accrued interest on convertible debt converted to equity		370
Accrued interest on notes payable to stockholders converted to equity		114,777
Amortization of debt issuance costs	480	10,450
Equity issued for services to consultants	192,950	85,850
Equity issued for services to employees and board of directors	685,300	
Changes in operating assets and liabilities:		
Prepaid expenses and other current assets	(772)	3,628
Other assets	(1,634)	865
Accounts payable	(23,532)	(26,905)
Deferred wages	24,609	68,510
Accrued professional fees	15,000	18,000
Accrued interest	(588)	(101,120)
Other accrued expenses		3,050
Net cash used in operating activities	(592,609)	(656,453)
Cash flows from financing activities:		
Common stock issuance costs		(110,750)
Allocated proceeds from issuance of common stock		377,806
Allocated proceeds from issuance of warrants attached to issuance of common stock		771,694
Proceeds from issuance of notes payable to stockholders		89,733
Proceeds from exercise of stock options and warrants	61,333	
Net cash provided by financing activities	61,333	1,128,483
Increase (decrease) in cash	(531,276)	472,030
Cash at beginning of period	852,468	27,045
Cash at end of period	$ 321,192	$ 499,075
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 6,339	$ 10,652
Convertible debt and related accrued interest converted into 100,000 and 456,740 shares of common stock during		

	Nine Months Ended March 31,	
the nine months ended March 31, 2007 and 2006, respectively	$ 50,000	$ 228,369
Notes payable to stockholder converted into 2,322,446 shares of common stock during the nine months ended March 31, 2006	$	$ 1,161,223
Accrued interest on notes payable to stockholder converted into 229,554 shares of common stock during the nine months ended March 31, 2006	$	$ 114,777

See accompanying notes to financial statements.

PROFILE TECHNOLOGIES, INC
March 31, 2007
Notes to Financial Statements (Unaudited)

1. Description of Business

Profile Technologies, Inc. (the Company), was incorporated in 1986 and commenced operations in fiscal year 1988. The Company is in the business of inspecting pipelines for corrosion and has developed a patented, non-destructive and non-invasive, high speed scanning process, using electro magnetic waves to remotely inspect buried, encased and insulated pipelines for corrosion. The Company is now actively marketing its inspection services for encased and insulated pipelines. In order to focus its resources on securing contracts for those services, it has temporarily suspended development work on its direct buried (encased) inspection service.

2. Basis of Presentation

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

The financial statements and related notes should be read in conjunction with the audited financial statements and notes thereto included in the Company s annual report on Form 10-KSB for the year ended June 30, 2006. The information furnished reflects, in the opinion of management, all adjustments, consisting of only normal recurring items, necessary for fair presentation of the results of the interim periods presented. Interim results are not necessarily indicative of results for a full year.

3. Liquidity

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. The Company incurred cumulative losses of $14,334,005 through March 31, 2007, and had negative working capital of $893,933 as of March 31, 2007. Additionally, the Company has expended a significant amount of cash in developing its technology and patented processes. These conditions raise substantial doubt about the Company s ability to continue as a going concern. Management recognizes that in order to meet the Company s capital requirements, and continue to operate, additional financing, including seeking industry-partner investment through joint ventures or other possible arrangements, will be necessary. The Company is evaluating alternative sources of financing to improve its cash position and is undertaking efforts to raise capital. If the Company is unable to raise additional capital or secure revenue contracts and generate positive cash flow, it is unlikely that the Company will be able to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

4. Summary of Significant Accounting Policies

Cash and cash equivalents

Cash and cash equivalents includes highly liquid investments with original maturities of three months or less. On occasion, the Company has amounts deposited with financial institutions in excess of federally insured limits.

Fair Value of Financial Instruments

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

Deferred Financing Fees

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

Contract Revenue Recognition

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

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

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

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

The Company does not currently have any revenue generating service contracts to which this contract revenue recognition policy applies.

Research and Development

Research and development costs are expensed when incurred. During the three months ended March 31, 2007 and 2006, the Company incurred $66,575 and $56,852 on research and development activities. During the nine months ended March 31, 2007 and 2006, the Company incurred $381,297 and $303,718 on research and development activities.

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

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

Valuation of Warrants and Options

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

Use of Estimates

The preparation of financial statements in conformity with U.S. 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.

Recently Issued Accounting Standards Not Yet Adopted

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements but does not require any new fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, with early adoption permitted as of January 1, 2007. The Company is currently evaluating the impact SFAS No. 157 will have on its Statement of Operations and Balance Sheet.

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108 (SAB 108). Due to diversity in practice among registrants, SAB 108 expresses SEC staff views regarding the process by which misstatements in financial statements are evaluated for purposes of determining whether financial statement restatement is necessary. SAB 108 is effective for fiscal years ending after November 15, 2006, and early application is encouraged. The Company does not expect any material impact from applying SAB 108.

In February 2007, the FASB issued FASB Statement No. 159*, The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159). SFAS No. 159 permits an instrument by instrument election to account for selected financial assets and liabilities at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007, with early adoption permitted as of January 1, 2007. The Company is currently evaluating the impact SFAS No. 159 will have on its Statement of Operations and Balance Sheet.

Vendor Concentration

Consultant Scientist Fees

The Company relies on the expertise of two consultant scientists to facilitate the development and testing of the Company s hardware and software. These scientists are also instrumental in compiling and interpreting the data captured during the testing of the hardware and software. The loss of the specialized knowledge provided by the scientists could have an adverse effect on the ability of the Company to successfully market its hardware and software. During the three and nine months ended March 31, 2007, the Company incurred cash fees payable to the scientists of $62,003 and $193,992, which are included in research and development expense in the Company s Statements of Operations. During the three and nine months ended March 31, 2006, the Company incurred cash fees payable to the scientists of $32,915 and $133,453, which are included in research and development expense in the Company s Statements of Operations.

As partial compensation for services rendered, on November 13, 2006, the Company granted the scientists stock options to purchase a total of 100,000 shares of common stock at an exercise price of $0.86 per share, expiring November 12, 2016. The 100,000 stock options had a fair value at the date of grant of $77,000, which is included in research and development expense in the Company s Statements of Operations for the nine months ended March 31, 2007.

As partial compensation for services rendered, on July 13, 2006, the Company granted one of the scientists a stock option to purchase 100,000 shares of common stock at an exercise price of $1.05 per share, expiring July 12, 2011. The 100,000 stock options had a fair value at the date of grant of $89,000, which is included in research and development expenses in the Company s Statements of Operations for the nine months ended March 31, 2007.

As partial compensation for services rendered, on December 12, 2005, the Company granted one of the scientists a stock option to purchase 50,000 shares of common stock at an exercise price of $1.12 per share, expiring December 12, 2010. The 50,000 stock options had a fair value at the date of grant of $50,500, which is included in research and development expense in the Company s Statements of Operations for the nine months ended March 31, 2006.

Total cash and equity compensation expense incurred for settlement of services rendered by the scientists totaled $62,003 and $359,992, or approximately 93% and 94%, of research and development expense for the three and nine months ended March 31, 2007.

Total cash and equity compensation expense incurred for settlement of services rendered by the scientists totaled $32,915 and $183,953, or approximately 58% and 61%, of research and development expense for the three and nine months ended March 31, 2006.

As of March 31, 2007, the Company owed the consultant scientists a total of $62,706, which is included in accounts payable at March 31, 2007.

5. Stock Based Compensation

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

Effective January 1, 2006, the Company adopted SFAS No. 123R, *Share-Based Payment (* SFAS 123R) using the modified prospective application method, which requires measurement of compensation cost for all stock-based awards at fair value on date of grant and recognition of compensation over the service period for awards expected to vest. The fair value of stock options is determined using the Black-Scholes valuation model, which is consistent with the Company s valuation techniques previously utilized for options in footnote disclosures required under SFAS No. 123, *Accounting for Stock Based Compensation*, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure.* Such value is recognized as expense over the service period. To date, all stock option grants have been fully vested upon grant.

Had compensation cost for the Company s stock options been determined using the fair value method consistent with SFAS 123R for all periods presented, the Company s net loss and net loss per share would have been reduced to the pro forma amounts indicated below:

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

6. Net Loss Per Share

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

Excluded from the computation of diluted net loss per share for the three and nine months ended March 31, 2007, because their effect would be antidilutive, are stock options and warrants to acquire 12,426,417 shares of common stock with a weighted-average exercise price of $0.99 per share. Also excluded from the computation of diluted net loss per share for the three and nine months ended March 31, 2007 are 250,000 shares of common stock that may be issued if investors exercise their conversion right under the Debentures related to the 2003 Offering as discussed in Note 8 because their effect would be antidilutive.

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

For the three and nine months ended March 31, 2007 and 2006, additional potential dilutive securities that were excluded from the diluted net loss per share computation are the exchange rights discussed in Note 9 that could result in options to acquire up to 223,000 shares of common stock with an exercise price of $1.00 per share at March 31, 2007 and 2006.

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

7. Related Parties

Notes Payable Stockholders

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

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

In January 2006, Mr. Evans converted the entire then outstanding principal and accrued interest on the Amended Evans Loan pursuant to the terms of the 2005 Offering as defined below.

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

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

The following is a summary of notes payable to stockholders as of March 31, 2007:

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

8. Convertible Debt

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

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

Warrants issued in connection with the 2003 Offering were recorded based on their relative fair value as compared to the fair value of the debt at issuance. The relative fair value of the warrants was recorded as paid-in capital. The intrinsic value of the Debentures results in a beneficial conversion feature, recorded as a discount against the Debentures, which reduces the book value of the convertible debt to not less than zero. The Company amortizes the discount using the effective interest method over the five-year life of the Debentures.

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

During the three and nine months ended March 31, 2007, two and three investors, respectively, exercised their conversion right and converted Debentures in the combined principal amounts of $25,000 and $50,000, respectively, pursuant to the terms of the 2003 Offering. Of the principal amounts of $25,000 and $50,000 converted during the three and nine months ended March 31, 2007, $7,500 was recorded as long-term convertible debt on the balance sheet at the time of conversion. Accordingly, upon conversion, the remaining unamortized discount of $7,365 at the conversion date was recognized as interest expense and is included in interest expense for the three and nine months ended March 31, 2007. The discount related to the remaining principal amounts of $17,500 and $42,500 for the three and nine months ended March 31, 2007 was previously expensed as interest expense during the quarter ended June 30, 2004 when the Company was deemed to be in default with respect to the interest payment terms.

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

As of March 31, 2007, accrued interest on the Debentures was $1,594. The Company recorded interest expense related to the accretion of the discount on the Debentures and amortization of the convertible debt discount as a result of the conversions discussed above of $7,604 and $7,925 for the three and nine months ended March 31, 2007. The Company recorded interest expense related to the accretion of the discount on the Debentures and amortization of the convertible debt discount as a result of the conversions discussed above of $8,039 and $198,051 for the three and nine months ended March 31, 2006. As of March 31, 2007 the carrying value of the long-term portion of the Debentures was $614, net of unamortized debt discount of $59,386.

9. Deferred Wages and Accrued Professional Fees

To reduce cash outflows, certain of the Company s employees, officers, consultants, and directors have agreed to defer a portion of their salaries and professional fees until the Company has sufficient resources to pay the amounts owed or to exchange such amounts into options as described below. At March 31, 2007, the Company has accrued $943,360 related to the deferred payment of salaries and professional fees of which $736,210 is included under deferred wages and $207,150 in accrued professional fees. On March 18, 2002, the Board approved a conversion right on all deferred wages and accrued professional fees deferred as of March 18, 2002 (the Conversion Right). Pursuant to the Conversion Right, employees, officers, consultants, and directors may elect to convert $1.00 of fees owed to them as of March 18, 2002 for an option to purchase two shares of the Company s common stock, at an exercise price of $1.00 per share for a term of five years. Of the total $943,360 deferred salaries and professional fees, the amount subject to the Conversion Right is $111,500, resulting in the potential issuance of 223,000 options under the terms mentioned above. No conversions have occurred to date. At March 18, 2002, there was no intrinsic value associated with these exchange rights. As such, no additional compensation cost was recorded.

10. Common Stock and Warrants

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

The 2005 Offering was terminated on June 9, 2006. As of the closing date of the 2005 Offering, the Company had raised $1,801,000 from the 2005 Offering. Accordingly, the Company issued 3,602,000 shares of common stock and warrants to purchase up to 3,602,000 shares of common stock at an exercise price of $0.75 per share.

The Company engaged a brokerage firm to help in the fund raising efforts of the 2005 Offering. Pursuant to the terms of the agreement with the brokerage firm, the Company paid the brokerage firm a ten percent cash commission on all funds that the brokerage firm helped raise. During the three and nine months ended March 31, 2006, the Company incurred $39,400 and $110,750 of fees that were paid in cash to the brokerage firm. The brokerage firm and the Company also agreed that the Company would issue warrants to purchase a total of 439,600 shares of common stock at an exercise price of $0.60. The warrants are exercisable for up to five years from the date of issuance, which is the date the proceeds were received under the 2005 Offering. Of the total 439,600 warrants that the brokerage firm received, 78,800 were earned during the three months ended March 31, 2006 as a result of the funds raised by the brokerage firm during that period. Accordingly, during the three months ended March 31, 2006, the Company recorded $100,076 as a reduction to paid-in capital for the fair value of the 78,800 warrants. The fair value of the warrants issued to the brokerage firm during the three months ended March 31, 2006 were estimated using the Black-Scholes option pricing model with the following weighted average assumptions: expected volatility of 151.04%, risk-free interest rate of 4.82%, expected lives of five years, and a 0% dividend yield.

Of the total 439,600 warrants that the brokerage firm received, 221,500 were earned during the nine months ended March 31, 2006 as a result of the funds raised by the brokerage firm during that period. Accordingly, during the nine months ended March 31, 2006, the Company recorded $207,260 as a reduction to paid-in capital for the fair value of the 221,500 warrants. The fair value of the warrants issued to the brokerage firm during the nine months ended March 31, 2006 were estimated using the Black-Scholes option pricing model with the following weighted average assumptions: expected volatility ranging from 151.04% to 376.15%, risk-free interest rates ranging from 4.14% to 4.82%, expected lives of five years, and a 0% dividend yield.

11. Stock Options and Warrants

Stock Options

Stock Option Grants

On November 13, 2006, the Board approved the issuance of stock options exercisable for a total of 575,000 shares of common stock pursuant to the 1999 Stock Option Plan to certain directors, officers, employees and four consultants of the Company. The stock options are fully vested upon grant and are exercisable until November 12, 2016. The exercise price of the stock options granted to insiders owning or controlling more than ten percent of the Company s common stock was $0.95, which is ten percent over the closing bid price of the Company s common stock as quoted on the Over the Counter Bulletin Board on the grant date, November 13, 2006. The exercise price of the stock options granted to non-insiders was $0.86. On November 13, 2006, the date of grant, the Company recognized $77,000 as research and development expense related to the fair value of 100,000 of the stock options and $365,750 as general and administrative expense related to the fair value of 475,000 of the stock options. The fair value of the stock option grants were estimated using the Black-Scholes option pricing model with the following weighted average assumptions: expected volatility of 142%, risk-free interest rate of 4.60%, expected lives of five years, and a 0% dividend yield.

On July 13, 2006, the Board approved an option grant to a consultant to purchase 100,000 shares of the Company s common stock at an exercise price of $1.05 per share. The option was granted in consideration for work the consultant is performing for the Company and was not granted pursuant to the 1999 Stock Option Plan. The option was fully vested upon grant and is exercisable until July 13, 2011. The Company recognized $89,000, at the time of grant, as research and development expense for the fair value of the option grant. The fair value of the option grant was estimated using the Black-Scholes option pricing model with the following weighted average assumptions: expected volatility of 160%, risk-free interest rate of 5.04%, expected life of five years, and a 0% dividend yield.

Stock Option Cancellations

On November 13, 2006, the Board cancelled 30,000 stock options that were originally granted on December 9, 2002 with an exercise price of $0.55 per share.

Stock Option Exercises

On October 18, 2006, a non-employee Board member exercised stock options to purchase shares of the Company s common stock. The following is a summary of the stock options exercised on October 18, 2006 by the non-employee Board member:

	Number of Shares of Common Stock Acquired	Exercise Price of Stock Option
Stock Option	20,000	$ 1.05
Stock Option	10,000	$ 0.55
Stock Option	20,000	$ 0.70

A summary of stock option-related activity follows:

		Options outstanding	
	Shares available for grant (1)	Number of shares (2)	Weighted average exercise price
Outstanding at June 30, 2006	115,000	2,700,000	$ 1.18
Increase in authorized stock options available for grant	2,000,000		
Grants	(575,000)	675,000	0.91
Cancellations	30,000	(30,000)	0.55
Exercises	50,000	(50,000)	0.81
Expirations	115,000	(115,000)	1.05
Outstanding at March 31, 2007	1,735,000	3,180,000	$ 1.14

(1) Consists of stock options available for grant under the Company s 1999 Stock Option Plan.

(2) Consists of stock options outstanding under the Company s 1999 Stock Option Plan and stock options outstanding that were granted outside of the 1999 Stock Option Plan.

Warrants

Warrant Grants

On November 13, 2006, the Board approved the issuance of warrants exercisable for a total of 450,000 shares of common stock to certain directors and officers of the Company. The warrants are fully vested upon grant and are exercisable until November 12, 2016. The exercise price of the warrants was $0.86, which is the closing bid price of the Company s common stock as quoted on the Over the Counter Bulletin Board on the grant date, November 13, 2006. During the three months ended December 31, 2006, the Company recognized $346,500 as general and administrative expense related to the fair value of the warrants. The fair value of the warrants grants were estimated using the Black-Scholes option pricing model with the following weighted average assumptions: expected volatility of 142%, risk-free interest rate of 4.60%, expected lives of five years, and a 0% dividend yield.

Warrant Cancellations

On November 13, 2006, the Board cancelled the following warrants: 5,000 warrants at an exercise price of $0.55 per share, 150,000 warrants at an exercise price of $1.05 per share, 190,000 warrants at an exercise price of $1.125 per share, and 80,000 warrants at an exercise price of $3.00 per share.

Warrant Exercises

On October 18, 2006, a non-employee Board member exercised a warrant to purchase 20,833 shares of the Company s common stock at an exercise price of $1.00 per share.

A summary of warrant-related activity follows:

	Number of warrants outstanding	Weighted average exercise price
Outstanding at June 30, 2006	9,943,418	$ 0.97
Grants	450,000	0.86
Cancellations	(425,000)	1.44
Exercises	(20,833)	1.00
Expirations	(701,168)	1.00
Outstanding at March 31, 2007	9,246,417	$ 0.94

12. Subsequent Events

On April 11, 2007, the Company entered into a three-year consulting agreement (Consulting Agreement) with a firm (Consultant) to provide consulting services and assist in obtaining both short and long-term financing. As compensation, upon execution of the Consulting Agreement, the Company issued to the Consultant 100,000 restricted shares of common stock and a warrant to purchase 50,000 shares of common stock at an exercise price of $1.00 per share. The warrant expires on April 10, 2012.

Item 2. Management s Discussion and Analysis or Plan of Operations.

Plan of Operations

In recent years, the Company has focused on the buried pipe market in the United States. It has redesigned and improved the hardware underlying its EMW Inspection Process. It has also performed lab and field testing of this new hardware and has developed computer models to better predict and interpret field conditions.

On March 27, 2007, the Company was issued a patent by the United States Patent and Trademark Office. This patent provides significant patent protection for the improvements made to the Company s EMW technology over the last three years. These improvements are now being incorporated into new hardware and software that will be deployed to the field.

The Company is now actively marketing a cased pipe inspection service; however, there can be no assurance that contracts for this service will be obtained. Failure to obtain such contracts could have a serious and material effect on the business and financial condition of the Company.

The Company has temporarily postponed further development work on its direct buried (uncased) pipe inspection equipment, so that, in the short term, its efforts can be focused on building field-ready test sets for cased and insulated pipe inspection and on the marketing of those services.

While the Company has, in the past, inspected only for external corrosion, it has recently filed a patent application covering the adaptation of its technology for internal pipe inspections. However, significant design, fabrication and testing must be done before the Company will be able to offer internal pipe inspection services.

Capital will be expended to support operations until the Company can generate sufficient cash flows from operations. In order for the Company to generate cash flows from operations, the Company must obtain revenue generating contracts. Management is currently directing the Company s activities towards obtaining service contracts, which, if obtained, will necessitate the Company attracting, hiring, training and outfitting qualified technicians. If service contracts are obtained, it will also necessitate additional field test equipment purchases in order to provide the services. The Company expects that if revenue contracts are secured, working capital requirements will increase. 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.

The Company has expended a significant amount of cash in developing its technology and patented processes. These conditions raise substantial doubt about the Company s ability to continue as a going concern. Management recognizes that in order to meet the Company s capital requirements, and continue to operate, additional financing, including seeking industry-partner investment through joint ventures or other possible arrangements, will be necessary within the next twelve months. 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 revenue contracts and generate positive cash flow, it is unlikely that the Company will be able to continue as a going concern.

Off Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

FORWARD-LOOKING STATEMENTS

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

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

Item 3. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

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

(b) Changes in Internal Control over Financial Reporting

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

PART II OTHER INFORMATION

Item 1. Legal Proceedings.

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

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

Convertible Debt

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

In January 2007, two investors exercised their conversion right, pursuant to the terms of the 2003 Offering and converted Debentures in the aggregate principal amount of $25,000 pursuant to the terms of the 2003 Offering. Accordingly, the Company issued 50,000 shares of common stock in accordance with the terms of the 2003 Offering.

Item 3. Defaults Upon Senior Securities.

None.

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

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

The following exhibits are filed with or incorporated by reference into this report:

Exhibit No.	Description of Exhibit
Exhibit 3.1	Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Company s Registration Statement on Form SB-2 filed with the Commission on May 10, 1996).
Exhibit 3.2	Bylaws of the Company (incorporated by reference to Exhibit 3.3 to the Company s Registration Statement on Form SB-2 filed with the Commission on May 10, 1996).
Exhibit 3.3	Amendment to Certificate of Incorporation (incorporated by reference to Exhibit A to the Company s Definitive Proxy Statement filed with the Commission on October 28, 2002).
Exhibit 3.4	Amendment to Certificate of Incorporation (incorporated by reference to Appendix A to the Company s Preliminary Proxy Statement filed with the Commission on September 13, 2006).
Exhibit 10.1	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, 2002).
Exhibit 10.2	Loan Amendment and Promissory Note dated March 6, 2003, by and between the Company and Murphy Evans (incorporated by reference to Exhibit 10.1 to the Company s Quarterly Report on Form 10-QSB filed with the Commission on May 20, 2003).
Exhibit 10.3	Lease Extension dated February 26, 2003 by and between the Company and Fatum LLC (incorporated by reference to Exhibit 10.5 to the Company s Annual Report on Form 10-KSB filed with the Commission on October 12, 2004).
Exhibit 10.4	Royalty Agreement (incorporated by reference to Exhibit 10.1 to the Company s Registration Statement on Form SB-2 filed with the Commission on May 10, 1996).
Exhibit 10.5	Assignment of Patent Rights (incorporated by reference to Exhibit 10.2 to the Company s Registration Statement on Form SB-2 filed with the Commission on May 10, 1996).
Exhibit 10.6	1999 Stock Option Plan (incorporated by reference to Exhibit 10.9 to the Company s Annual Report on Form 10-KSB filed with the Commission on October 12, 2004).

Exhibit 10.7	First Amendment to the 1999 Stock Option Plan (incorporated by reference to Appendix B to the Company s Preliminary Proxy Statement filed with the Commission on September 13, 2006).
Exhibit 10.8	Lease dated March 1, 2007 by and between the Company and Long Island Property Management LP. *
Exhibit 10.9	Consulting Agreement dated April 11, 2007, by and between the Company and R.F. Lafferty. *
Exhibit 31.1	Rule 13a-14(a)/15d-14(a) Certification of Henry E. Gemino, as Chief Executive Officer and Chief Financial Officer of the Company. *
Exhibit 31.2	Rule 13a-14(a)/15d-14(a) Certification of Philip L. Jones, as Chief Operating Officer and Executive Vice President of the Company. *
Exhibit 32.1	Certification under Section 906 of the Sarbanes-Oxley Act of 2002 by Henry E. Gemino, as Chief Executive Officer and Chief Financial Officer of the Company. *
Exhibit 32.2	Certification under Section 906 of the Sarbanes-Oxley Act of 2002 by Philip L. Jones, as Chief Operating Officer and Executive Vice President of the Company. *

* Filed herewith.

EXHIBIT INDEX

Exhibit 10.8	Lease dated March 1, 2007 by and between the Company and Long Island Property Management LP.*
Exhibit 10.9	Consulting Agreement dated April 11, 2007, by and between the Company and R.F. Lafferty. *
Exhibit 31.1	Rule 13a-14(a)/15d-14(a) Certification of Henry E. Gemino, as Chief Executive Officer and Chief Financial Officer of the Company.*
Exhibit 31.2	Rule 13a-14(a)/15d-14(a) Certification of Philip L. Jones, as Chief Operating Officer and Executive Vice President of the Company.*
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Exhibit 32.2	Certification under Section 906 of the Sarbanes-Oxley Act of 2002 by Philip L. Jones, as Chief Operating Officer and Executive Vice President of the Company.*

* Filed herewith.

SIGNATURES

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

PROFILE TECHNOLOGIES, INC.
(Registrant)

Date: May 9, 2007

/s/ Henry E. Gemino
Henry E. Gemino
Chief Executive Officer and
Chief Financial Officer