

Edgar Filing: WATER CHEF INC - Form 10KSB

WATER CHEF INC  
Form 10KSB  
March 12, 2004

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

FORM 10-KSB  
(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the Year Ended December 31, 2003

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 0-30544  
\_\_\_\_\_

WATERCHEF, INC

-----  
(Exact Name of Small Business Issuer as specified in its charter)

DELAWARE 86-0515678  
(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

1007 GLEN COVE AVENUE  
GLEN HEAD, NY 11545

-----  
(Address of principal executive offices)

(516) 656-0059

-----  
(Issuer's telephone number)

Securities registered under section 12(b) of the Exchange Act: None.

Securities registered under section 12 (g) of the Exchange Act: Common  
stock, Par value \$.001

Redeemable Common Stock Purchase Warrants.  
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Check whether the Issuer (1) filed all reports required to  
be filed by Section 13 or 15(d) of the Securities Exchange  
Act of 1934 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  
-----

Check if there is no disclosure of delinquent filers in response to Item 405 of

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Regulation S-B is 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.

YES            NO    X  
-----      -----

The issuer's net sales for the most recent fiscal year were \$ 0.

The aggregate market value of the voting stock held by non-affiliates based upon the last sale price on March 10, 2004 was approximately \$13,913,000.

As of March 10, 2004, the Registrant had 89,559,886 shares of its Common Stock, \$0.001 par value, issued and outstanding.

### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement to be issued in connection with the 2003 annual meeting of stockholders are incorporated by reference into Part III

WATERCHEF, INC.

ANNUAL REPORT ON FORM 10-KSB

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## ITEM 1. DESCRIPTION OF BUSINESS

### THE COMPANY

WaterChef, Inc. (the "Company", "WaterChef"), designs and markets water purification equipment Water coolers and filters were a substantial part of the Company's business from 1993 until the fourth quarter of 2001, at which time this business was sold so that WaterChef could concentrate on the further development , manufacturing and marketing of their patented line of "PureSafe" water purification systems. The accompanying financial statements have been prepared assuming the Company will continue as a going concern. To date, the Company has shipped 20 PureSafe units. Revenue has been recognized on only 2 PureSafe units as 18 units which were shipped to the Kingdom of Jordan have not met the criteria for revenue recognition due to no reasonable assurance of collectibility.

### BACKGROUND

The Company was originally incorporated under Arizona law in 1985 and merged into a Delaware corporation in 1987. In 1993 the Company, then known as Auto Swap, U.S.A., entered into a reverse merger with WaterChef, Inc., a Nevada corporation ("Water Chef-Nevada), which manufactured and marketed water coolers and filters.

### PRODUCTS

In 2001, The Company decided to concentrate its efforts on the further development, manufacturing and marketing of the PureSafe Water Station (the "PureSafe"), since WaterChef believed that its water dispensers and its wide variety of consumer oriented water filtration products met or exceeded the design, quality and performance of competitive products. Market considerations were such however as to limit the opportunities for profit and growth. Management determined that in order to build considerable shareholder value, they would transition out of the commodity dispenser and filter businesses and develop products that they felt were unique to the marketplace.

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In 1998, searching for a "killer application", WaterChef management focused on the worldwide need for safe drinking water for populations who are unserved by

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municipal water treatment facilities, or are served by municipal systems which have malfunctioned because of improper maintenance or faulty design. The result of that activity is the PureSafe Water Station, a turn-key unit that converts "gray", or bathing grade, water into United States Environmental Protection Agency ("EPA") grade drinking water. The PureSafe eliminates all living pathogens that pollute non-processed water - bacteria, cysts, viruses, parasites, etc. - at an affordable cost for the emerging economies of the world.

The PureSafe Water Station was tested by H2M Labs, Inc. which is approved by Nassau and Suffolk counties in New York to perform drinking water testing for the various municipalities in those counties. The specific test performed was a total and fecal coliform bacteria test, wherein the source water storage tank which feeds the PureSafe was tested for the presence of total and fecal coliform bacteria. The source water tank was found to have 50 colonies of coliform bacteria present. The source water tank was then "spiked" with a three (3) liter concentration of laboratory grown and cultured bacteria and the storage tank were measured again with 80,000,000 colonies of bacteria detected. After being processed through the PureSafe system, the water was tested again, and "FEWER THAN 2 COLONIES" were detected. In addition to the laboratory test conducted for WaterChef by H2M Labs, the available scientific literature, in industry journals such as Water Technology and Water Conditioning and Purification International, supports the statement that an ozone system such as the one utilized in the PureSafe effectively eliminates all living pathogens. Ozone was first used in municipal water treatment in Nice, France in 1904, and then in the Jerome Park Reservoir in the Bronx, New York in 1906.

The PureSafe Water Station is a self-contained, six stage water purification center. It is housed in the equivalent of a small storage container - approximately four feet wide, seven feet long, and six and one-half feet high. The unit weighs approximately eleven hundred pounds (without water) and has been configured for portability, durability, and easy access to its essentially off-the-shelf components. It is constructed with weather and UV resistant fiberglass, aluminum and steel, and is equipped with internal and external lighting.

The core version of the PureSafe can purify and dispense up to 15,000 gallons per day for an all-inclusive cost (labor, power, amortization of the capital cost, replacement filters, cartridges and media) of approximately one-half cent per gallon. The process wastes very little water, producing approximately one gallon of pure drinking water for every gallon processed. The unit can be moved with a single fork-lift and is transportable by truck or helicopter. Operating the PureSafe is simple and straightforward. Turn-key in design, minimum wage personnel can be trained to operate the unit. A system of fail-safes is built into the operation, and aside from easily installable spares such as filters and cartridges, a maintenance and oversight program established by WaterChef should maintain the operating efficiencies built into the system. WaterChef warrants each unit for a period of one year as long as the required maintenance protocols, using WaterChef supplied parts, as prescribed in the maintenance manual are adhered to. The Company also offers larger versions of the PureSafe Water Station to provide pure water in quantities up to 5,000 gallons per hour. To date, there have been no warranty claims for the PureSafe product operating in the field. WaterChef also plans to have periodic inspections of installed equipment by the Company's agents.

While each unit is configured to respond to the particular water quality of a particular site, such as arsenic removal, seawater desalination, oil separation, etc., the typical unit contains the following components:

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- a. Inlet connection with macro-filter - designed to strain the input water, removes large particulate and directs water into the system
- b. Inlet pump - self-priming pump which maintains water pressure at minimum 40psi throughout the system
- c. Pre-depth media filter - a multi-media mixed bed to remove pollutants. Pressure gauges mounted on the exterior front panel of the unit allow for visible monitoring of system performance.
- d. Ozone generator - provides a rich ozone source that effectively kills all living pathogens such as bacteria, viruses, cysts, parasites, etc. Unused ozone reverts back to oxygen and produces no harmful byproducts.
- e. Ozone mixing tank - WaterChef's proprietary process for effectively mixing the ozone into the water and maintaining the required contact time to ensure oxidation of contaminants.
- f. Process pump - provides optimal operation of the ozone processing.
- g. Post-depth media filter - another, different, multi-media mixed bed designed to filter out oxidized or precipitated pollutants and contaminants after the ozone treatment. Effectively removes metals, organics and inorganics. Pressure gauges on the front panel indicate the need for backwashing to maintain optimal performance.
- h. Ultraviolet treatment - provided by a UV lamp as a redundant sterilizer step to eliminate any surviving pathogens or micro-organisms. The UV lamp is tuned to a frequency which also converts O3 (ozone) back to O2 (oxygen).
- i. KDF filter - an ion exchange media containing a proprietary blend of copper, zinc and other alloys, effectively adsorbs chlorine and biological, inorganic and metallic contaminants.
- j. Carbon filter - prevents bacteria regrowth while removing inorganic compounds and improves water taste and removes odor. The carbon filter also acts as a redundant ozone destruct mechanism.
- k. Mixer - sends ozone treated water to the bottle washing stations.
- l. Bottle washing stations - incorporated on the outside front of the unit for easy access in order to effectively clean bottles used to carry water treated at the site.
- m. Dispensing stations - four individual dispensing lines, each with flow adjusting valves to help regulate a smooth, steady flow of water into clean bottles.

### MANUFACTURING

In 2000 the Company entered into a subcontracting agreement with Davis Aircraft Products Inc, ("Davis") for the manufacture of the PureSafe Water Station system. Based upon the experience and the resources of Davis, Company management believes that Davis can provide the production and manufacturing support

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services necessary to supply WaterChef's requirements over the foreseeable future at a price, and with the quality and performance standards necessary to meet, or exceed, the needs of the markets that the Company expects to serve.

### RAW MATERIALS

The PureSafe has been designed to use, for the most part, readily available off-the-shelf components, sub-systems and equipment. Inasmuch as each of the components and sub-systems are available from multiple vendors, the Company does not believe that obtaining these for its sub-contractor, for itself, or for others if it chooses to manufacture elsewhere, will be a problem. WaterChef has also incorporated patented and proprietary technology in the PureSafe and is confident that it can protect this intellectual capital throughout the manufacturing and distribution cycle.

### COMPETITION

WaterChef's modular, turn-key PureSafe Water Station directly addresses the drinking water needs of those environs which do not today, and are unlikely to, enjoy access to municipally treated water. The Company has produced a turnkey solution that produces pure water to meet U.S.EPA drinking water standards. This is a far different market than that addressed by the segment of the industry which has concentrated on the multi-billion dollar municipal water treatment sector, or the equally large residential sector. The municipal solution requires significant investment for infrastructure development (building plants and laying miles of distribution pipes), and products for residential markets do not offer the performance or features to meet the needs of the underdeveloped nations of the world.

Management does recognize that its potential competitors have far more resources, and that being first to the marketplace is no assurance of success. It must be assumed that others are working on systems that, if successfully brought to market, could seriously impact the viability of the company.

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### MARKETING

The potential market for the PureSafe is substantial and is both world-wide and domestic. According to studies performed by the World Health Organization (WHO) and the United Nations, major parts of Africa, the Middle East, Southeast Asia, the Indian sub-continent, Latin and South America, the Caribbean, and much of Eastern Europe is in need of adequate supplies of pure water. Parts of Florida, Georgia, and other regions in the United States have also reported fresh water deficits. In part, solving this problem has been a question of appropriate technology. Secondly, but just as important, in a vast part of the world is the need to secure third party financing so that the local populace can enjoy the benefits of clean water.

WaterChef believes that it has demonstrated that it possesses the technology. The Company also believes that financing is available for third world economies from a variety of sources. The challenge for the Company, a virtual unknown in the industry and with limited capital, is in getting its message in front of decision makers. To this end, WaterChef has enlisted the aid of some of the world's most outstanding experts in water purification, especially as it relates to the needs of underdeveloped countries.

The Company's Scientific Advisory Board is chaired by Dr. Ronald Hart, former Director of The National Center for Toxicological Research and a U.S. Food and

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Drug Administration "Distinguished Scientist in Residence". The Board also includes Dr. Mohamed M. Salem, Professor of Occupational and Environmental Medicine, Cairo University; Dr. Richard Wilson, Mallinckrodt Research Professor of Physics, Harvard University; Dr. Mostafa K. Tolba, former Under-Secretary-General of the United Nations and Director of the U.N.'s Environmental Program; and Lord John Gilbert, former Minister of State for Defence for the United Kingdom under three Prime Ministers and Secretary/Treasurer of the Tri-Lateral Commission.

Not only have the members of the Scientific Advisory Board provided valuable input and guidance to the Company with respect to system design, technological input, remediation approaches and a great deal of information relative to the unique water problems facing many areas of the world, but they have also been active in introducing the Company to commercial opportunities

During 2000 the Company entered into a master distribution agreement with 4Clean Waters Ltd., a newly formed Hong Kong corporation to market the PureSafe internationally. In addition to lending the Company money, with an option to convert to the Company's common stock, 4Clean Waters had certain threshold sales requirements necessary to retain their exclusivity. In addition to cash incentives, there were provisions that would have allowed 4Clean Waters to purchase additional shares in WaterChef from commissions earned. While there were a number of sales initiatives that had been initiated by 4Clean Waters, and the relationship has been cooperative and ongoing, 4Clean Waters was not able to produce sales for the Company as anticipated during the term of the agreement. Notwithstanding the agreement with 4Clean Waters, the Company retained the right to market the PureSafe Water Station itself, with the understanding that sales made directly by WaterChef, with the exception of certain "grand-fathered" accounts, would count against the minimum sales required in the year for 4Clean Waters to retain their sales exclusivity. The limited sales of the PureSafe thus far have been as a result of the Company's own marketing activities. Until the September 11, 2001 attacks on the World Trade Center and the Pentagon, the Company had not considered the U.S. domestic market an important part of their overall marketing strategy.

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Now, however, with the creation of the Homeland Security Agency and a new focus on possible terrorist attacks in the United States causing the creation of programs to ensure the protection and preservation of our water resources, opportunities for our products have opened up. WaterChef has been in discussion with political and government contacts to explore the applications for the PureSafe as a back-up drinking water system in case of damage to municipal systems. On the basis of these discussions and other information relative to homeland security, the Company will be pursuing various options for sales to this market.

### PATENTS

The Company filed for patent protection on its PureSafe Water Station in October of 1998 and received formal notification that the patent had been issued on February 19, 2002. The Company feels that this patent upholds the claims that the PureSafe system is a unique product. In addition to its U.S. patent, the Company has filed for patent protection in the countries of the European Union, and in Canada, Mexico, China, Hong Kong, India, Korea and Japan.

The name PureSafe Water Station and the stylized water droplet mark have been trademarked in the United States.

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There can be no assurance that any application of the Company's technologies will not infringe patent or proprietary rights of others, or that licenses which might be required for the Company's processes or products would be available on favorable terms. Furthermore, there can be no assurance that challenges will not be made against the validity of the Company's patent, or that defenses instituted to protect against patent violation will be successful.

### SEASONALITY

The Company does not expect the Pure Safe to be influenced by seasonality.

### RESEARCH AND DEVELOPMENT

Research and development takes place at the Company's office. Testing, modeling, simulation and prototype manufacturing are outsourced with much of the ongoing development taking place at the Company's contract manufacturing facilities under the supervision of Davis Water Products.

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### INSURANCE

The Company maintains a \$1,000,000 umbrella policy, in addition to a \$2,000,000 general and product liability policy, which covers the manufacture and marketing of its products. The Company believes its insurance coverage to be adequate.

### EMPLOYEES

As of December 31, 2003, the Company employed one executive personnel in its headquarters.

The Company believes there is a sufficient number of persons available at prevailing wage rates in or near our manufacturing locations that should expansion of its production require additional employees, they would be readily available. The Company has no collective bargaining agreement with any of its employees.

### ITEM 2. DESCRIPTION OF PROPERTY

In the fourth quarter of 2001 the Company closed its manufacturing facility in Montana, and sold its water cooler and filter business and has transferred its relationship with its JV in China to the buyer of this discontinued operation. It presently has no owned or leased manufacturing facilities, nor does the Company have a plan to acquire its own manufacturing facility. The PureSafe Water Station is manufactured for the Company under a contract by Davis Water Products.

### ITEM 3. LEGAL PROCEEDINGS

WaterChef was a defendant in a legal action brought by certain debenture holders ("Bridge Loans") in New Hampshire Superior Court seeking repayment of debenture principal of \$300,000 and accrued interest from 1997. On June 22, 2002 a settlement was reached whereby the Company agreed to pay \$497,500 in the form of shares of common stock. The number of shares to be issued was determined by dividing \$497,500 by the average daily trading price of the Company's common stock over a 30 day period subsequent to the execution of the settlement documents. Due to an average trading price of \$0.029 over the measurement period, the Company is obligated to issue 17,037,671 shares of common stock. The stock has not yet been issued, and will not be issued, and the terms of the

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settlement agreement will not be completed, until WaterChef's shareholders have approved an increase in the authorized common stock of the Corporation. As such, the Company has recorded these 17,037,671 shares as a liability, in common stock to be issued, totaling \$497,500 as of December 31, 2003.

In addition to the issuance of the above mentioned shares. Attached to the original Bridge Loans were warrants for the purchase of the Company's common stock at \$0.15 per share. The debenture holders that participated in the legal action had the lives of their warrants extended. Those warrants that were to have expired in March 2002 have been extended until March 2004. A total of 1,666,667 shares of common stock may be purchased under these extended warrants.

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The Company was a defendant in an action brought by a customer/licensee relating to a claim that the Company breached a contract by shipping certain goods in November 1997 that did not conform to the contract. A negotiated settlement was reached calling for the payment by WaterChef of \$27,500. The settlement amount of \$27,500 was paid in full during 2003, and the action was dismissed.

In May 2001, the Company entered into a distribution agreement with a company (the "Sub Distributor") based in Jordan. The Sub Distributor has agreed to purchase no fewer than 100 units of the Company's "Pure Safe Water Station" during 2001 and a minimum of 50 units in each of 2002 and 2003. During the year ended December 31, 2001, 18 units have been shipped under this agreement. The sale will be recognized when the Company receives payments due to the fact that collectibility cannot be reasonably assured. The Company has recorded the cost of the inventory shipped as a loss contingency of \$242,035 during the year ended December 31, 2001, since return of the items is uncertain. The Company has engaged legal counsel in Jordan, to pursue legal remedies and obtain payment for all units shipped.

### ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

A preliminary Proxy for the purpose of increasing the authorized common shares of the Corporation was submitted to the SEC, whose questions and comments are being addressed before resubmission. Upon approval by the SEC, the proxy will be mailed to the shareholders and a vote by the shareholders will be scheduled.

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## PART II

### ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

#### PRICE RANGE OF COMMON STOCK

The Company's common stock is traded on the OVER-THE-COUNTER ("OTC") Electronic Bulletin Board under the symbol WTER.OB. This market is categorized as being "thin" which means that there is generally a paucity of buyers and sellers as found in the more heavily traded Small Cap and NASDAQ markets. The Bulletin Board stocks generally do not have the trading characteristics of more seasoned companies as they lack the market-makers that will make orderly markets as well as the buyers and sellers that give depth, liquidity and orderliness to those markets. In addition, the solicitation of orders and/or the recommendations for

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purchase of Bulletin Board stocks is restricted in many cases by the National Association of Securities Dealers (the "NASD") and by individual brokerage firms as well.

The chart below sets forth the range of high and low bid prices for the Company's common stock based on closing transactions during each specified period as reported by the National Quotation Bureau, Inc. The prices reflect inter-dealer prices without retail mark-up, markdown, quotation or commission and do not necessarily represent actual transactions.

|                | HIGH | LOW |
|----------------|------|-----|
| 2002           |      |     |
| First Quarter  | .13  | .05 |
| Second Quarter | .08  | .03 |
| Third Quarter  | .04  | .02 |
| Fourth Quarter | .03  | .01 |
| 2003           |      |     |
| First Quarter  | .08  | .01 |
| Second Quarter | .07  | .04 |
| Third Quarter  | .16  | .04 |
| Fourth Quarter | .22  | .09 |

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### ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION.

#### INTRODUCTION

#### DEVELOPMENT OF THE COMPANY

The Company was originally incorporated under Arizona law in 1985 and merged into a Delaware corporation in 1987. In 1993 the Company, then known as Auto Swap, U.S.A., entered into a reverse merger with WaterChef, Inc., a Nevada corporation which manufactured and marketed water coolers and filters. The financial statements prior to June 4, 1993 are those of WaterChef (Nevada), which is considered to be the Predecessor Company.

The PureSafe has been designed by the Company to meet the needs of communities who either did not have access to municipal water treatment systems, or to those whose systems had been compromised, either by environmental factors or by faulty design or maintenance.

#### RESULTS OF OPERATIONS

Sales for the fiscal years ended December 31, 2003 and December 31, 2002 were \$0 and \$40,000, respectively. During the twelve month period ended December 31, 2003 the Company received payment for one PureSafe Water Station unit but will not recognize the revenue until the product is shipped in 2004. The Company sold one PureSafe Water Station in 2002 to White Cross Partners for installation in Juticalpa, Honduras.

Cost of sales decreased from \$246,430 for the year ended December 31, 2002, to \$88,000 for the year ended December 31, 2003, a decrease of \$158,430, or 64%. The decrease is largely due to an increase in inventory reserves recorded in the

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2002 period. An analysis of the components of cost of sales in the 2002 and 2003 periods follows:

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| Cost of Sales<br>Period | Inventory<br>Reserve | Actual<br>CGS | Rent and Overhead<br>Payments to Manufacturer | Total     |
|-------------------------|----------------------|---------------|---|-----------|
| 2002                    | \$159,250            | \$17,280      | \$69,900                                      | \$246,430 |
| 2003                    | 0                    | 0             | \$88,000                                      | \$ 88,000 |

Selling general and administrative expenses for the twelve months ended December 31, 2003 were \$817,625 compared to \$789,120 for the twelve months ended December 31, 2002, an increase of \$ 28,505 or 4%. The increase in expense is primarily due to cost of a negotiated settlement of a pending litigation.

Interest expense for the year ended December 31, 2003 was \$152,478, compared to \$179,111 for the year ended December 31, 2002, a decrease of \$26,633, or 15%. Interest expense during 2002 included an additional \$23,000 related to a settlement.

In 2003 the Company recognized a non-cash expense of \$2,477,376 attributable to the shares to be issued to the Company's CEO upon the voluntary surrender of his non-dilution agreement, compared to a non-cash charge of \$208,935 in 2002.

The net loss for the fiscal year ended December 31, 2003 was \$3,535,479 compared to \$1,589,746 for the fiscal year ended December 31, 2002, an increase of \$1,945,733.

### LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2003, the Company had a stockholders' deficiency of approximately \$6,059,000 and a working capital deficiency of approximately \$5,628,000. In addition, the Company has a net loss of approximately \$3,535,000 and \$1,590,000 for the years ended December 31, 2003 and 2002, respectively. The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. The auditor's report on its financial statements included elsewhere herein contains an explanatory paragraph about the Company's ability to continue as a going concern. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management's plans with respect to these matters include restructuring its existing debt, raising additional capital through future issuances of stock and / or debt. The accompanying financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern.

The Company, during 2003 and 2002, raised \$599,871 and \$417,500, respectively through the sale of common and preferred stock.

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During 2002 the Company continued the restructuring of its debt. In the second

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quarter of 2002 the Company reached a negotiated settlement in an action brought by certain debenture holders (the "Bridge Lenders") in New Hampshire Superior Court. The litigants sought repayment of \$300,000 of debenture principal, together with interest from 1997, and the issuance of penalty shares for non-payment of principal and interest. In addition, damages were sought relating to the Company's failure to register the shares issued under a related warrant agreement.

The Company and the Bridge Lenders settled this dispute for a total \$497,500, payable in shares of the Company's common stock. The number of shares of common stock to be paid was determined by dividing \$497,500 by the average daily trading price of WaterChef common over a thirty(30)day trading period, commencing upon the execution of the settlement agreement. Due to these requirements, the Company is obligated to issue 17,037,671 shares of common stock, based on an average price over the measurement period of \$0.0292. The total authorized common stock of the Company does not currently provide a sufficient number of authorized and unissued, shares to fulfill the terms of the settlement agreement. As such the Company has recorded these 17,037,671 shares to be issued as a liability in common stock to be issued for \$497,500 as of December 31, 2003.

In addition to the issuance of the above-mentioned shares, attached to the original Bridge Loans were warrants for the purchase of the Company's common stock at \$0.15 per share. The debenture holders that participated in the legal action had the lives of their warrants extended. Such warrants that were to have expired in March 2002 have been extended until March 2004. A total of 1,666,667 shares of common stock may be purchased under these extended warrants. The Company has recorded a non-cash charge of \$111,000 related to the extension of the lives of these warrants. Such charge is included in the loss on settlement of debt.

In addition to the above settlement with Bridge Lender who participated in the legal action, the Company settled its obligation with debenture holders that did not participate ("non-participating debenture holders") in the legal action. These non-participating debenture holders had total debentures of \$75,000, plus accrued interest of \$9,850, totaling \$84,850 as of the settlement date. In conjunction with the above settlement, the Company settled these outstanding non-participating debentures, plus accrued interest, with the issuance of 750,000 shares of common stock valued at \$0.0292 per share, or \$21,900. The terms of their warrants were not extended, nor are they entitled to receive additional shares based on the Company's common stock achieving a certain average trading price 30 days subsequent to the settlement with the participating debenture holders. The Company has recorded a \$62,950 gain with regard to the settlement of the non-participating debentures. As of December 31, 2002, the 750,000 shares have not been issued as the Company does not currently have a sufficient number of authorized and unissued common shares to settle these non-participating debentures. As such the Company has recorded these 750,000 shares to be issued as a liability in common stock to be issued for \$21,900 as of December 31, 2003. In addition the Company recorded charge of \$2,477,376 in 2003, and \$208,935 in 2002. for the voluntary surrender by the Company's President and CEO of his anti-dilution agreement. Such cost is expected to be satisfied with the issuance of 14,923,958 shares of common stock, upon approval by the Company's shareholders, in the number of authorized shares of the Company common stock. As such the Company has recorded these 14,923,958 shares to be issued as a liability in common stock to be issued for \$2,686,311 as of December 31, 2003.

During the year ended December 31, 2002, the Company received \$200,000 for 4,000,000 shares of its common stock. These shares will be issued upon the approval by the stockholders of the increase in the number of authorized common shares of the Company. Therefore the Company has recorded these 4,000,000 shares to be issued as a liability in common stock to be issued for \$200,000 as of

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December 31, 2003.

During the year ended December 31, 2002, the Company agreed to issue to various third parties an aggregate of 1,329,191 shares of its common stock in connection with professional services. These shares will be issued upon the approval by the stockholders of the increase in the number of authorized common shares of the Company.

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The Company intends to request approval of its stockholders for an increase in the authorized shares of the Company from 100,000,000 shares to 200,000,000 shares. This increase in the outstanding will dilute the ownership interest of current shareholders and will adversely affect earnings per share and may result in a lower market value for the Company's stock.

Failure to obtain shareholder approval of the proposed increase in the authorized common stock of the Corporation will prevent the Company from discharging its obligations, as listed above, which will have a material adverse impact on the Company's financial position, its operations and its ability to continue as a going concern.

Management is currently attempting to settle or restructure the remaining debt, and plans to raise additional capital through future issuances of stock and/or debentures to finance the growth of the Company.

### ITEM 7. FINANCIAL STATEMENTS

The Company's financial statements for the fiscal years ended December 31, 2003 and 2002 are included herein and consist of:

|  |          |
|--|----------|
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### ITEM 8. ACCOUNTING AND FINANCIAL DISCLOSURE CONTROLS

#### Evaluation and Disclosure Controls and Procedures

-----

The Company, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's "disclosure controls and procedures," as such term is defined in Rules 13a-15e promulgated under the Exchange Act as of this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer has

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concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report to provide reasonable assurance that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

### Changes in Internal Controls

-----

There have been no changes in internal controls or in other factors that could significantly affect those controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

### Limitations on the Effectiveness of Controls

-----

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a Company have been detected.

## PART III

### ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT

At year-end 2003 the Company's Directors, Executive Officers and Scientific Advisory Board Members are:

| Name                  | Age | Position(s) with the Company                                 |
|-----------------------|-----|--|
| David A. Conway       | 62  | Director, Chairman- President<br>and Chief Executive Officer |
| Ronald W. Hart +      | 61  | Chairman, Scientific<br>Advisory Board                       |
| Mohamed M. Salem +    | 52  | Scientific Advisory Board                                    |
| Marshall S. Sterman++ | 72  | Director   |
| Richard Wilson +      | 78  | Scientific Advisory Board                                    |
| Dr. Mostafa K. Tolba  | 82  | Scientific Advisory Board                                    |
| Lord John Gilbert     | 78  | Scientific Advisory Board                                    |

-----

+ Members of the Advisory Board will receive an honorarium, in the form of cash or common stock, for their service at the discretion of the Board of Directors.

++ Also Audit Committee (Marshall Sterman)  
Also Compensation Committee (Marshall Sterman)

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David A. Conway

Elected to the Board in 1997 and joined the Company as President and Chief Executive Officer in 1998. Previous experience as President, CEO of a privately held public relations and marketing company; Director and VP Administration of KDI Corporation (NYSE); VP Administration Keene Corporation (NYSE) and earlier positions with CBS and Goldman Sachs & Co. Mr. Conway who served as an infantry officer in the US Army, holds undergraduate and graduate degrees from Fordham University and is listed in Who's Who in America.

Lord John Gilbert (Ph.D.)

Lord Gilbert served as Minister of State for Transportation, Minister of State for Finance, and as Minister of State for Defence in the United Kingdom under three Prime Ministers. Lord Gilbert is Secretary/Treasurer of the Tri-Lateral Commission and a member of the House of Lords. He was educated at Marchant Taylors' School and St. John's College, Oxford, and holds a Ph.D. in International Economics and Statistics from New York University.

Ronald W. Hart (Ph.D.)

Agreed to form the Board of Scientific Advisors in 2000 and became Chairman. Dr. Hart is an internationally recognized scientist and scholar who was Director of the National Center for Toxicological Research and was named "Distinguished Scientist in Residence" by the US Food and Drug Administration in 1992. Recognized for his pioneering work on aging and his studies on nutrition and health, Dr. Hart has been appointed visiting professor at a number of universities, including Cairo University, Seoul National University and Gangzhou University. He received his doctorate in physiology and biophysics from the University of Illinois.

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Mohamed M. Salem (MD/Ph.D.)

Appointed to the Scientific Advisory Board in early 2001, Dr. Salem is Professor of Occupational and Environmental Medicine at the Kasr El-Aini School of Cairo University. An internationally recognized expert on the health effects of environmental and water contaminants including pesticides, lead and other metals, Dr. Salem is credited with establishing infectious disease control programs at medical centers and other public entities throughout the Middle East. Dr. Salem is a principal of Salem Industries, an import and export company, which is one of the leading suppliers of chemicals and oil field equipment in the Middle East. Dr. Salem holds both an MD and Ph.D. from Cairo University.

Marshall S. Sterman

Elected to the Board in 2000, Mr. Sterman is President of the Mayflower Group, a Massachusetts based merchant bank. He previously served as managing partner of Cheverie and Company and MS Sterman & Associates, merchant banking firms and principal of Sterman & Gowell Securities, an investment banking and securities firm. Mr. Sterman served as an officer in the US Navy and holds his BA from Brandeis University and his MBA from Harvard University.

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Mostafa K. Tolba (Ph.D.)

Dr. Tolba served as Under-Secretary-General of the United Nations, and Executive Director of the United Nations Environmental Program from 1976 to 1992. Dr. Tolba is currently President of the International Center for Environment and Development headquartered in Geneva, Switzerland, and Emeritus Professor of Science at the Kasr El-Aini School of Medicine at Cairo University. He received his Ph.D. in Macrobiology from Imperial College, London, England.

Richard Wilson (Ph.D.)

Appointed to the Scientific Advisory Board in 2001, Dr. Wilson is the Mallinckrodt Research Professor of Physics at Harvard University. Dr. Wilson is one of the foremost scientific authorities in the fields of water quality remediation and purification, and is currently Professor of the Energy Research Group at the University of California. Dr. Wilson is a member of the Advisory Board of the Atlantic Legal Foundation, and is one of the principal scientists of the water problems in Chernobyl and in Bangladesh where toxic levels of arsenic contaminate the water supply. Dr. Wilson holds his Ph.D. from Oxford University.

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### ITEM 10. EXECUTIVE COMPENSATION

#### SUMMARY COMPENSATION TABLE

| Name<br>Principal Position       | Year | ANNUAL COMPENSATION |       |                          | Total<br>Compensation |
|----------------------------------|------|---------------------|-------|--------------------------|-----------------------|
|                                  |      | Salary              | Bonus | Non-Cash<br>Compensation |                       |
| David A. Conway<br>President/CEO | 2003 | \$165,000           | 0     | 0                        | \$165,000             |

#### DIRECTORS' COMPENSATION

Directors of the Company do not receive cash compensation for serving as members ; they are reimbursed for their out of pocket expenses related to meetings and other Company related activity for which they are called upon. In the past they have received common stock for service to the Company.

In 2003 Mr. Sterman was compensated at the rate of \$6,000 per month for consulting services performed for the Company. The Company may pay for these services in cash or stock, and may terminate these services at its option.

Company Directors have been paid success fees for helping the Company in various equity and debt financings over the years. These payments have been both in cash and common stock, such payments being made based on industry-wide, third party standards.

#### LIMITATION OF LIABILITY AND INDEMNIFICATION MATTERS

The Company's Amended and Restated Certificate of Incorporation and Bylaws eliminate, in certain circumstances, the liability of Directors for breach of their fiduciary duty. This provision does not eliminate the liability of a Director (i) for breach of the Director's duty of loyalty to the Company or its stockholders (ii) for acts of omissions by the director not in good faith or

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which involve intentional misconduct or a knowing violation of law; (iii) for willful or negligent declaration of an unlawful dividend, stock purchase or redemption; (iv) for transactions from which the Director derived an improper personal benefit; or (v) for any act or omission occurring prior to the effective date of the Amended and Restated Certificate of Incorporation.

The Company's Amended and Restated Certificate of Incorporation provides generally for indemnification of the Directors and Officers to the full extent permitted under Delaware law, and permits indemnification for all other persons whom the Company is empowered to indemnify.

The Company's Bylaws provide that the Company may indemnify, to the fullest extent permitted under Delaware law, any person, including officers and directors, with regard to any action or proceeding.

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The Company believes that it is the position of the Securities and Exchange Commission that insofar as the foregoing provisions may be invoked to disclaim liability for damages arising under the Securities Act, those provisions, if against public policy as expressed in the Securities Act, will be unenforceable.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDERS MATTERS

Set forth below is information as of December 31, 2003, concerning stock ownership of all persons known by the Company to own beneficially 5% or more of the issued and outstanding common stock of the Company, all Directors, the Executive Officers, and all Directors and Executive Officers of the Company as a group based on the number of shares of common stock issued and outstanding as of the date of this Offering Memorandum. For purposes of the Memorandum, beneficial ownership is defined in accordance with the Rules of the Securities and Exchange Commission and generally means the power to vote and/or dispose of the securities regardless of any economic interest.

| Name and Address of<br>Beneficial Owner of Shares<br>-----                               | Number of Shares of Voting<br>Stock Beneficially Owned (1)<br>----- | Percentage of<br>Total Voting<br>----- |
|--|---|--|
| David A. Conway (2) (3)<br>WaterChef, Inc.<br>1007 Glen Cove Ave.<br>Glen Head, NY 11545 | 19,201,390  | 21.4%                                  |
| Marshall S. Sterman (5)<br>46 Neptune Street<br>Beverly, MA 01915                        | 500,000<br>-----  | 0.6<br>-----                           |
| All executive officers and<br>Directors as a Group (2) (4)                               | 19,701,390<br>=====   | 22.0%<br>=====                         |

(Two-2--Persons)

- Total Voting Shares are comprised of all common shares issued and outstanding.
- Includes 5,044,794 shares held by affiliates and 6,310,464 shares held

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in an IRA Trust.

3. In March, 2002 Mr. Conway voluntarily surrendered the anti-dilution agreement that insured 32.6% ownership of the voting shares to Mr. Conway and his affiliates.
4. Does not include Officers or Directors of the Company who were not such as of the date of record.
5. Mr. Sterman also has the right to have issued 800,000 shares of common stock and 500,000 shares of preferred stock eligible for immediate conversion upon the approval of increased authorization of common stock of the Company.

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### ITEM 12. RELATED PARTY TRANSACTIONS

None.

### ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K

#### (a) Exhibits:

| Exhibit No.<br>----- | Description<br>-----  |
|----------------------|---|
| 31                   | Certification of chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act.   |
| 32                   | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 8 U.S.C. Section 1350 As adopted pursuant to Section 906 of the Sarbanes- Oxley Act of 2002. |

(b) Reports on Form 8-K            None

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### ITEM 14. PRINCIPLE ACCOUNTANT FEES

For the year ended December 31, 2003 and 2002, the Company incurred fees for the audit and for the review of relevant quarterly reports totaling \$95,000 and \$65,000.

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### SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

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WATERCHEF, INC.

March 5, 2004

/s/ David A. Conway

Date

-----  
David A. Conway  
President, Chief Executive  
Officer and Chief Financial  
Officer (Principal Operating  
Officer)

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## Index of Exhibits

-----

| Exhibit No.<br>----- | Description<br>-----   |
|----------------------|--|
| 31                   | Certification of Chief Executive Officer pursuant to Section 302 of Sarbanes-Oxley Act of 2002.  |
| 32                   | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 8 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

## INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders of  
Water Chef, Inc.  
Glen Head, New York

We have audited the accompanying balance sheet of WaterChef, Inc., (a development stage company commencing January 1, 2002) as of December 31, 2003 and the related statements of operations, stockholders' deficiency and cash flows for the years ended December 31, 2003 and 2002. 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 Water Chef, Inc., (a development stage company commencing January 1, 2002) as of December 31, 2003 and the results of its operations and its cash flows for the years ended December 31, 2003 and 2002 in conformity with accounting principles generally

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accepted in the United States of America.

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 2(a) to the financial statements, the Company has suffered recurring losses, and has working capital and stockholders' deficiencies, which 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 2(a). The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Marcum & Kliegman LLP

-----  
 Marcum & Kliegman LLP

New York, New York

March 5, 2004

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WATERCHEF INC.

(A Development Stage Company Commencing January 1, 2002)

BALANCE SHEET  
 DECEMBER 31, 2003

ASSETS

CURRENT ASSETS:

|                      |            |
|----------------------|------------|
| Cash                 | \$ 102,831 |
| Inventory            | 26,500     |
| Prepaid expenses     | 11,220     |
|                      | -----      |
| TOTAL CURRENT ASSETS | 140,551    |

|   |        |
|---|--------|
| PATENTS AND TRADEMARKS (net of<br>accumulated amortization of \$ 5,089) | 20,966 |
|---|--------|

|              |            |
|--------------|------------|
| Other Assets | 3,162      |
|              | -----      |
|              | \$ 164,679 |
|              | =====      |

LIABILITIES AND STOCKHOLDERS' DEFICIENCY

CURRENT LIABILITIES:

|  |            |
|--|------------|
| Accounts payable.....  | \$ 169,053 |
| Accrued expenses and other current liabilities .....         | 1,117,768  |
| Notes payable (including accrued interest of \$393,092 ..... | 1,076,317  |
| Common stock to be issued .....                              | 3,405,711  |
|  | -----      |
| TOTAL CURRENT LIABILITIES .....                              | 5,768,849  |
|  | -----      |

LONG-TERM LIABILITIES:

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|   |         |
|---|---------|
| Loans payable to stockholder (including accrued interest of \$81,353) ..... | 454,134 |
|   | -----   |

### COMMITMENTS AND CONTINGENCIES

#### STOCKHOLDERS' DEFICIENCY:

|   |               |
|---|---------------|
| Preferred stock, \$.001 par value;<br>10,000,000 shares authorized;<br>887,166 shares issued and outstanding,<br>(liquidation preference \$1,407,700) ..... | 887           |
| Common stock, \$.001 par value;<br>90,000,000 shares authorized;<br>89,564,286 shares issued;<br>89,559,886 shares outstanding .....                        | 89,564        |
| Additional paid-in capital .....  | 13,513,834    |
| Treasury stock, 4,400 common shares, at cost .....  | ( 5,768)      |
| Accumulated deficit through December 31, 2001.....  | ( 14,531,596) |
| Deficit accumulated during development stage .....  | ( 5,125,225)  |
|   | -----         |
| TOTAL STOCKHOLDERS' DEFICIENCY .....  | ( 6,058,304)  |
|   | -----         |
|   | \$ 164,679    |
|   | -----         |

See notes to financial statements.

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### WATERCHEF, INC.

(A Development Stage Company Commencing January 1, 2002)

### STATEMENTS OF OPERATIONS

|   | Year Ended December 31, |              | For the Period                             |
|---|-------------------------|--------------|--|
|   | 2003                    | 2002         | January 1, 2002<br>to December 31,<br>2003 |
|   | -----                   | -----        | -----                                      |
| Sales .....   | \$ -                    | \$ 40,000    | \$ 40,000                                  |
| Costs and Expenses:   |                         |              |  |
| Cost of sales .....   | 88,000                  | 246,430      | 334,430                                    |
| Selling, general and administrative .....   | 817,625                 | 789,120      | 1,606,745                                  |
| Non-dilution agreement termination costs .....  | 2,477,376               | 208,935      | 2,686,311                                  |
| Interest expense (including interest<br>expense for related party of \$23,868<br>in both years) ..... | 152,478                 | 179,111      | 331,589                                    |
| Loss on settlement of debt .....  | -                       | 206,150      | 206,150                                    |
|   | 3,535,479               | 1,629,746    | 5,165,225                                  |
| Net loss .....  | ( 3,535,479)            | ( 1,589,746) | ( 5,125,225)                               |

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|   |                |                 |                 |
|---|----------------|-----------------|-----------------|
| Preferred stock dividends .....   | ( 152,876)     | ( 112,988)      | ( 265,864)      |
| Net loss applicable to<br>common stock .....                            | \$ (3,688,355) | \$ ( 1,702,734) | \$ ( 5,391,089) |
| Basic and Diluted Loss Per Common Share: .....                          | \$ ( 0.04)     | \$ ( 0.02)      |                 |
| Weighted Average Common Shares Outstanding -<br>Basic and Diluted ..... | 89,559,886     | 89,559,886      |                 |

See notes to financial statements.

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WATERCHEF, INC.  
(A Development Stage Company Commencing January 1, 2002)

STATEMENT OF STOCKHOLDERS' DEFICIENCY

|  | Preferred Stock |        | Common S   |
|--|-----------------|--------|------------|
|  | Shares          | Amount | Shares     |
| BALANCE - DECEMBER 31, 2001                              | 145,500         | 146    | 86,614,286 |
| Extension of life of warrants.....                       | --              | --     | --         |
| Sale of preferred stock<br>(\$1.00 per share - December) | 125,000         | 125    | --         |
| Shares issued for:                                       |                 |        |            |
| Cash   |                 |        |            |
| .....(\$0.025 per share - April)                         | --              | --     | 2,500,000  |
| Services   |                 |        |            |
| .....(\$0.08 per share - April).....                     | --              | --     | 450,000    |
| Collection of subscription receivable                    |                 |        |            |
| March .....  | --              | --     | --         |
| December   | --              | --     | --         |
| Net loss.....  | --              | --     | --         |
| BALANCE - DECEMBER 31, 2002.....                         | 270,500         | \$ 271 | 89,564,286 |
| Proceeds from sale of preferred stock                    |                 |        |            |
| (\$0.50 Per share)                                       | 75,000          | 75     | --         |
| (\$1.00 Per share)                                       | 150,000         | 150    | --         |
| (\$1.33 per share)                                       | 3,126           | 3      | --         |
| (\$1.36 Per share)                                       | 625             | 1      | --         |
| (\$1.52 Per share)                                       | 65,790          | 66     | --         |
| (\$1.60 Per share)                                       | 2,500           | 3      | --         |
| (\$1.70 Per share)                                       | 10,000          | 10     | --         |

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|                                       |         |        |            |
|---------------------------------------|---------|--------|------------|
| (\$1.78 Per share)                    | 11,250  | 11     | --         |
| (\$1.84 Per share)                    | 907     | --     | --         |
| (\$1.85 Per share)                    | 14,502  | 14     | --         |
| (\$1.92 Per share)                    | 781     | 1      | --         |
| (\$2.00 Per share)                    | 87,500  | 88     | --         |
| (\$2.40 Per share)                    | 16,250  | 16     | --         |
| (\$2.80 Per share)                    | 8,000   | 8      | --         |
| Preferred stock issued for services   |         |        |            |
| (\$1.00 Per share)                    | 148,285 | 148    | --         |
| (\$1.88 Per share)                    | 4,250   | 4      | --         |
| (\$3.20 Per share)                    | 17,500  | 18     | --         |
| (\$3.33 Per share)                    | 300     | --     | --         |
| (\$4.00 Per share)                    | 100     | --     | --         |
| Collection of subscription receivable | --      | --     | --         |
| Write-off of subscription receivable  | --      | --     | --         |
| Net Loss                              | --      | --     | --         |
|                                       | -----   | -----  | -----      |
| BALANCE - DECEMBER 31, 2003           | 887,166 | \$ 887 | 89,564,286 |
|                                       | =====   | =====  | =====      |

See notes to financial statements.

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WATERCHEF, INC.  
(A Development Stage Company Commencing January 1, 2002)

STATEMENT OF STOCKHOLDERS' DEFICIENCY

|                                     | Stock<br>Subscription<br>Receivable | Treasury<br>Stock | Accumulated<br>Deficit<br>Through<br>December<br>31, 2001 |
|-------------------------------------|-------------------------------------|-------------------|---|
|                                     | -----                               | -----             | -----   |
| -continued-                         |                                     |                   |   |
| BALANCE - DECEMBER 31, 2001         | (67,500)                            | (5,768)           | (14,531,596)  |
| Extension of life of warrants ..... | -                                   | -                 | -   |
| Sale of Preferred stock             |                                     |                   |   |
| (\$1.00 per share) .....            | -                                   | -                 | -   |
| Shares issued for:                  |                                     |                   |   |
| Cash                                |                                     |                   |   |
| (\$0.025 per share) .....           | -                                   | -                 | -   |
| Services                            |                                     |                   |   |

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|   |          |          |               |
|---|----------|----------|---------------|
| (\$0.08 per share) .....                    | -        | -        | -             |
| Collection of subscription receivable ..... | 30,200   | -        | -             |
| Net loss .....                              | -        | -        | -             |
|   | -----    | -----    | -----         |
| BALANCE - DECEMBER 31, 2002 .....           | (37,300) | (5,768)  | (14,531,596)  |
| Proceeds from sale of preferred stock       |          |          |               |
| (\$0.50 Per share)                          | -        | -        | -             |
| (\$1.00 Per share)                          | -        | -        | -             |
| (\$1.33 per share)                          | -        | -        | -             |
| (\$1.36 Per share)                          | -        | -        | -             |
| (\$1.52 Per share)                          | -        | -        | -             |
| (\$1.60 Per share)                          | -        | -        | -             |
| (\$1.70 Per share)                          | -        | -        | -             |
| (\$1.78 Per share)                          | -        | -        | -             |
| (\$1.84 Per share)                          | -        | -        | -             |
| (\$1.85 Per share)                          | -        | -        | -             |
| (\$1.92 Per share)                          | -        | -        | -             |
| (\$2.00 Per share)                          | -        | -        | -             |
| (\$2.40 Per share)                          | -        | -        | -             |
| (\$2.80 Per share)                          | -        | -        | -             |
| Preferred stock issued for services         |          |          |               |
| (\$1.00 Per share)                          | -        | -        | -             |
| (\$1.88 Per share)                          | -        | -        | -             |
| (\$3.20 Per share)                          | -        | -        | -             |
| (\$3.33 Per share)                          | -        | -        | -             |
| (\$4.00 Per share)                          | -        | -        | -             |
| Collection of subscription receivable       | 15,500   | -        | -             |
| Write-off of subscription receivable        | 21,800   | -        | -             |
| Net Loss                                    | -        | -        | -             |
|   | -----    | -----    | -----         |
| BALANCE - DECEMBER 31, 2003                 | -        | ( 5,768) | ( 14,531,596) |
|   | =====    | =====    | =====         |

See notes to financial statements.

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WATERCHEF INC.  
(A Development Stage Company Commencing January 1, 2002)

STATEMENTS OF CASH FLOWS

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|   | Years Ended December 31, |                |
|---|--------------------------|----------------|
|   | 2003                     | 2002           |
|   | -----                    | -----          |
| CASH FLOWS FROM OPERATING ACTIVITIES  |                          |                |
| Net loss .....  | \$( 3,535,479)           | \$( 1,589,746) |
| Adjustments to reconcile net loss to<br>net cash used in operating activities |                          |                |
| Amortization of patents .....   | 1,854                    | 1,853          |
| Non-cash compensation .....   | 213,685                  | 36,000         |
| Loss on settlement of debt .....  | -                        | 206,150        |
| Non-dilution agreement termination cost .....                                 | 2,477,376                | 208,935        |
| Inventory reserve .....   | -                        | 159,250        |
| Write-off of stock subscription receivable .....                              | 21,800                   | -              |
| Change in assets and liabilities  |                          |                |
| Inventory .....   | -                        | ( 26,500)      |
| Prepaid expenses and other current assets .....                               | ( 11,220)                | 56,500         |
| Accounts payable, accrued expenses<br>and interest.....                       | 296,686                  | 487,105        |
|   | -----                    | -----          |
| NET CASH USED IN OPERATING ACTIVITIES .....                                   | ( 535,298)               | ( 460,453)     |
|   | -----                    | -----          |
| CASH FLOWS FROM FINANCING ACTIVITIES  |                          |                |
| Reduction of stock subscription receivable .....                              | 15,500                   | 30,200         |
| Proceeds from sale of preferred stock .....                                   | 599,871                  | 117,500        |
| Proceeds from sale of common stock .....                                      | -                        | 100,000        |
| Proceeds from sale of common stock to be issued .....                         | -                        | 200,000        |
|   | -----                    | -----          |
| NET CASH PROVIDED BY FINANCING ACTIVITIES .....                               | 615,371                  | 447,700        |
|   | -----                    | -----          |
| NET INCREASE/(DECREASE) IN CASH .....   | 80,073                   | (12,753)       |
| CASH AT BEGINNING OF YEAR .....   | 22,758                   | 35,511         |
|   | -----                    | -----          |
| CASH AT END OF YEAR .....   | \$ 102,831               | \$ 22,758      |
|   | =====                    | =====          |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:                             |                          |                |
| Cash paid during the year for:  |                          |                |
| Interest .....  | \$ 2,250                 | \$ -           |
|   | =====                    | =====          |
| Income taxes .....  | \$ -                     | \$ -           |
|   | =====                    | =====          |

See notes to financial statements.

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WATERCHEF, INC.  
(A Development Stage Company Commencing January 1, 2002)

NOTES TO FINANCIAL STATEMENTS

1. DESCRIPTION OF BUSINESS

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WaterChef, Inc. (the "Company"), is a Delaware Corporation currently engaged in the design, marketing and sale of water dispensers and purification equipment both in and outside the United States.

### 2. BASIS OF PRESENTATION AND ACCOUNTING POLICIES

#### a. Basis of Presentation

The Company discontinued its water cooler and filtration operations in November 2001. As a result the Company has refocused its efforts on raising capital and developing markets for its proprietary technology. Therefore, for financial purposes, the Company has determined that it has re-entered the development stage commencing January 1, 2002. The Company's statements of operations, stockholders' deficiency and cash flows for the year ended December 31, 2003 represent the cumulative, from inception information, required by Statement of Financial Accounting Standards ("SFAS") No. 7, "Development Stage Enterprises".

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. The Company incurred losses from continuing operations of \$3,535,479 and \$1,589,746 for the years ended December 31, 2003 and 2002, respectively. Additionally, the Company has working capital and stockholders' deficiencies of \$5,628,000 and \$6,059,000 at December 31, 2003. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

Management's plans with respect to these matters include restructuring its existing debt and raising additional capital through future issuances of stock and/or debt. The accompanying financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern.

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WATERCHEF, INC.  
(A Development Stage Company Commencing January 1, 2002)

NOTES TO FINANCIAL STATEMENTS

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- b. Inventory - Inventory is stated at the lower of cost (average) or net realizable value.
- c. Patents and Trademarks - Patents and trademarks are amortized ratably over 9 to 14 years.
- d. Stock-Based Compensation - In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FASB Statement No. 123." SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both

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annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The disclosure requirements apply to all companies for fiscal years ending after December 15, 2002. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. The Company will continue to account for stock-based compensation according to APB Opinion No. 25.

- e. Revenue Recognition - Revenues are recognized when product is shipped, title passes and collectibility is reasonably assured. Allowances for estimated bad debts, sales allowance and discounts are provided when such sales are recorded.
- f. Income Taxes - Income taxes are accounted for under SFAS No. 109, "Accounting for Income Taxes", which is an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. Valuation allowances are established when necessary to reduce deferred assets to the amounts expected to be realized.

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WATERCHEF, INC.  
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### NOTES TO FINANCIAL STATEMENTS

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- g. Loss Per Share - Basic loss per share was computed using the weighted average number of outstanding common shares. Diluted per share amounts when applicable include the effect of dilutive common stock equivalents from the assumed exercise of options, warrants and convertible preferred stock. Diluted per share amounts are computed excluding common stock equivalents since their inclusion would be anti-dilutive. Total shares issuable upon the exercise of warrants and the conversion of preferred stock for the years ended December 31, 2003 and 2002, were 35,382,471 and 10,187,082, respectively. These shares have been excluded from loss per share calculations as they are anti-dilutive. In addition, common stock to be issued upon stockholder approval of the increase in the authorized stock of the Company, aggregating 38,040,820 shares are also excluded from loss per share calculations.
- h. Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 revenues and expenses during the reporting period. Actual results could differ from those estimates.
- i. Fair Value of Financial Instruments - The carrying amounts of the financial instruments reported in the balance sheet approximate their fair market value due to the short-term maturity of these instruments.
- j. Impairment of Long-Lived Assets - In the event that facts and circumstances indicate that the cost of an asset may be impaired, an

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evaluation of recoverability would be performed. If an evaluation is required, the estimated future undiscounted cash flows associated with the asset would be compared to the asset's carrying amount to determine if a write-down to market value is required.

- k. Research and Development - Research and development cost consist of expenditures incurred during the course of planned research and investigation aimed at the discovery of new knowledge, which will be useful in developing new products or processes. The Company expenses all research and development costs as incurred.

### 1. Recent Accounting Pronouncements:

In January 2003, the FASB issued Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51." FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after December 15, 2003.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 addresses certain financial instruments that, under previous guidance, could be accounted for as equity, but now must be classified as liabilities in statements of financial position. These financial instruments include: 1) mandatorily redeemable financial instruments, 2) obligations to repurchase the issuer's equity shares by transferring assets, and 3) obligations to issue a variable number of shares. SFAS No. 150 is effective for all financial instruments entered into or modified after May 31, 2003, and otherwise effective at the beginning of the first interim period beginning after June 15, 2003.

Management does not believe that the adoption of this pronouncements will have a material effect on the Company's financial statements.

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WATERCHEF, INC.  
(A Development Stage Company Commencing January 1, 2002)

NOTES TO FINANCIAL STATEMENTS

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### 3. INVENTORY

At December 31, 2003, inventory consisted of two complete units of the Company's water purification units valued at \$26,500.

### 4. NOTES PAYABLE

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Notes payable at December 31, 2003 consist of the following:

|     |              |
|-----|--------------|
| (a) | 156,396      |
| (b) | 654,533      |
| (c) | 265,388      |
|     | -----        |
|     | \$ 1,076,317 |
|     | =====        |

- (a) Loans payable - other: These are unsecured notes bearing interest ranging from 10% to 15% per annum, with no specific due date for repayment. Amounts due on these notes, inclusive of \$73,171 in interest is \$156,396, at December 31, 2003.
- (b) In April 2001, the Company issued a \$400,000 promissory note at an interest rate of 2% per month. In consideration for the issuance of this note, 500,000 shares of the Company's common stock were issued to the note holder and a \$74,000 debt discount was recorded and fully amortized in the year ended December 31, 2001. The principal balance and accrued interest were payable on September 1, 2001. The Company did not make such payment and was required to issue an additional 100,000 penalty shares of its common stock to the note holder. The Company recorded additional interest expense of \$12,300 related to the issuance of these penalty shares. Amounts due on this note, inclusive of \$254,533 in interest, is \$654,533 at December 31, 2003. As of December 31, 2003, the note holder has not demanded payment, although there is no assurance that the note holder will continue to defer demand for repayment.
- (c) In November 2000, the Company entered into a Convertible Promissory Note agreement, whereby the Company may be advanced a maximum of \$300,000. The Company was advanced the following: \$100,000 in November 2000, \$50,000 in December 2000 and \$50,000 in January 2001. No further cash advances were made to the Company. The Convertible Promissory Note agreement also called for the payment of \$100,000 of Company expenses. The advances bear interest at 10% per annum and were to have been repaid as of January 15, 2002. A maximum of 6,000,000 shares could have been issued upon conversion had the full \$300,000 been advanced. As of December 31, 2003, the Company owed \$265,388 on these advances, inclusive of \$65,388 in interest. The Company and the note holder, by mutual consent, had agreed to extend the due date of the note to May 1, 2002 which has not been extended. All other terms and provisions of the note are unchanged. In May 2003, these note holders received a judgment against the Company for the principal sum of \$200,000 plus interest.

### 5. LOANS PAYABLE - STOCKHOLDER

At December 31, 2003, the Company is obligated to its Chief Executive Officer and a significant stockholder for loans and advances made to the Company totaling \$372,781, plus accrued interest of \$81,353. These advances have been accruing interest ranging from 6% to 12% per annum. The loans have no repayment terms and the stockholder has agreed not to demand payment until July 1, 2005 at the earliest.

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WATERCHEF, INC.  
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6. COMMON STOCK TO BE ISSUED

In February 2002, the Company's Board of Directors approved, pending stockholder approval, the increase in the number of authorized common shares to be issued to 190,000,000 shares. Such approval has not been received.

During the year ended December 31, 2003, the Company had recorded liabilities for common stock to be issued for the following transactions:

a. Cash

During the year end December 31, 2002, the Company received \$200,000 for 4,000,000 shares of its common stock. These shares, will be issued upon the approval by the stockholders on the increase in the number of authorized common shares of the Company. These shares are not included in the loss per share calculations (\$200,000 is included in common stock to be issued as of December 31, 2003).

b. Non-Dilution Agreement Termination Cost

In May 2002, the Company agreed to issue to the Company's President and Chief Executive Officer, and to related parties of such, an aggregate of 14,923,958 shares of its common stock in connection with the voluntary surrender of a non-dilution agreement that the President had entered into with the Company in June 1997. These shares are not included in the loss per share calculations.

Since the issuance of these shares is subject to stockholder approval, the measurement date for purposes of valuation will be established when such stockholder approval has been obtained. Accordingly, the Company is utilizing variable accounting to determine the value of these shares and the related liability is included in common stock to be issued. The value of these shares as of December 31, 2003 is \$2,686,311.

c. Services

During the year ended December 31, 2002, the Company agreed to issue to various parties an aggregate of 1,329,191 shares of its common stock in connection with professional services. These shares will be issued upon the approval by the stockholders of the increase in the number of authorized common shares of the Company.

d. Settlement of Debt

The Company was a defendant in an action brought by certain debenture holders (The "Bridge Loans") in New Hampshire Superior Court seeking repayment of \$300,000 of debenture principal together with interest from 1997, and the issuance of penalty shares for non payment of principal and interest. In addition, the plaintiff's claim that they had suffered by the Company's failure to register the shares issued under the warrant agreement.

The Company had interposed defenses and counterclaims. In June 1997, in connection with the debentures, the Company had issued 6,667 shares of common stock for every \$1,000 of debt at a price of \$0.15 per

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share. The Company claimed that it was owed the \$300,000 consideration for such shares. In addition, the Company had issued warrants for the purchase of 2,500,000 shares of common stock at an exercise price of \$0.15 per share exercisable until March 2002.

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WATERCHEF, INC.  
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### NOTES TO FINANCIAL STATEMENTS

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Furthermore, the Company had issued another 100,000 shares of common stock to each debenture holder, or 1,300,000 shares, at a price of \$0.15 per share.

In the second quarter of 2002, the Company and the Bridge Lenders participating in the legal action, settled this dispute requiring the Company to: (i) Issue 3,000,000 shares of common stock valued at \$497,500 in lieu of the principal and interest owed to the debenture holders who participated ("participants") in this legal action. The Company prior to the settlement had recorded the debentures at \$300,000, plus accrued interest of \$39,400, for a total of \$339,400. The difference between the \$497,500 settlement and the \$339,400, or \$158,100, is recorded as a loss on settlement of debt. (ii) Extend the warrants attached to the participants' debentures for another two years until March 2004, for which the Company has recorded a non cash expense charge of \$111,000 which was recorded as loss on settlement of debt and (iii) Issue additional shares if the product of the \$497,500, as valued for the 3,000,000 shares above, divided by the average daily trading price for the 30 days subsequent to the settlement, is greater than the original 3,000,000 shares. Due to these requirements the Company is obligated to issue an additional 14,037,671 shares, due to the average trading price of \$0.0292 in the 30 days subsequent to the settlement. As of December 31, 2003, neither the 3,000,000 nor the additional shares of 14,037,671 have been issued, and accordingly the Company has recorded these shares as common stock to be issued valued at \$497,500. These shares are not included in the loss per share calculations.

The debenture holders that did not participate ("non-participating debentures") in the above legal action had total debentures of \$75,000, plus accrued interest of \$9,850 as of the settlement date, totaling \$84,850. In conjunction with the above settlement, the Company settled these outstanding non-participating debentures, plus accrued interest, with the issuance of 750,000 shares of common stock valued at \$0.0292 per share, or \$21,900. The terms of their warrants were not extended, nor are they entitled to receive additional shares based on the Company's common stock achieving a certain average trading price 30 days subsequent to the settlement with the participating debenture holders. The Company has recorded a \$62,950 gain with regard to the settlement of the non-participating debentures which was recorded as loss on settlement of debt. As of December 31, 2003, the 750,000 shares have not been issued, and accordingly the Company has recorded these shares as common stock to be issued valued at \$21,900. These shares are not included in the loss per share calculations.

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The total shares to be issued upon stockholder approval of the increase in the authorized stock of the Company as a result of the transactions described above aggregate 38,040,820.

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### NOTES TO FINANCIAL STATEMENTS

#### 7. PREFERRED STOCK

The Company is authorized to issue 10,000,000 shares of \$.001 par value preferred stock, issuable in series with rights, preferences, privileges and restrictions as determined by the board of directors.

At December 31, 2003, outstanding preferred shares were as follows:

|          | Authorized<br>Shares | Issued<br>Shares | Par<br>Value | Current<br>Annual<br>Dividend<br>Requirement | Total<br>Dividend<br>Arrearage | Dividend<br>Arrearage<br>Per Share | Liquidation<br>Preference<br>(including<br>dividend<br>arrearage) |
|----------|----------------------|------------------|--------------|--|--------------------------------|------------------------------------|---|
|          | -----                | -----            | -----        | -----  | -----                          | -----                              | -----   |
| Series A | 400,000              | 52,500           | \$ 53        | \$ 52,500                                    | \$ 465,100                     | \$ 8.86                            | \$ 990,100  |
| Series C | 400,000              | 218,750          | 218          | 26,438                                       | 27,137                         | .13                                | -   |
| Series D | 400,000              | 93,000           | 93           | 55,800                                       | 417,600                        | 4.49                               | 417,600   |
| Series F | 1,000,000            | 522,916          | 523          | 70,645                                       | 20,258                         | .04                                | -   |
|          |                      | -----            | -----        | -----  | -----                          |                                    | -----   |
|          |                      | 887,166          | \$ 887       | \$ 205,383                                   | \$ 930,095                     |                                    | \$ 1,407,700  |
|          |                      | =====            | =====        | =====  | =====                          |                                    | =====   |

#### Series A:

The Series A preferred stock provides for a 10% cumulative dividend, based on the \$10 per share purchase price, payable annually in the Company's common stock or cash, at the Company's option. The Series A preferred stock is not convertible, and is redeemable solely at the Company's option at a price of \$11 per share plus accrued dividends. The Series A preferred stockholders have voting rights equal to common stockholders.

In the event of the liquidation, dissolution or winding up of the Company, whether voluntary or involuntary, holders of the Series A preferred stock are entitled to receive out of the assets of the Company the sum of \$10.00 per share of Series A preferred stock then outstanding, plus a sum equal to all dividends (whether or not earned or declared) on such shares accrued and unpaid thereon to the date of final payment or distribution, before any payment or distribution upon dissolution, liquidation or winding up shall be made on any series or class of capital stock ranking junior to Series A preferred stock as to such payment or distribution.

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### Series C:

During the year ended December 31, 2002 the Company sold Series C 15% Convertible Preferred stock at \$1.00 per share. These shares convert in one year. All dividends are cumulative and are payable in shares of the Company's common stock valued at the then-current market price per share, or upon conversion, whichever is earlier. The conversion rate for shares, and accrued dividends payable, is 33.33 shares of common for each \$1.00 of preferred stock and dividends payable, or \$0.03 for each share of common stock. The Series C Preferred stockholders have voting rights equal to the common stockholders. The Series C preferred stock has no stated rights in the assets of the Company upon liquidation. During 2002, the Company sold 125,000 shares of Series C preferred stock. For each share of preferred stock purchased, the buyer also receive the right to receive an additional 33.33 shares of common stock upon conversion as the market value of the stock was \$0.015 at issuance.

### Cash

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In April 2003, the Company issued 12,500 shares and raised \$25,000 through the sale of Series C convertible preferred stock.

In the year ended December 31, 2002, the Company sold 125,000 shares and raised \$117,500 through the sale of Series C convertible preferred stock.

### Services

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In January 2003, the Company issued 30,000 shares of its Series C convertible preferred stock for professional services totaling \$30,000.

In April 2003, the Company issued an aggregate of 51,250 shares of its Series C convertible preferred stock for professional services totaling \$51,250.

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WATERCHEF, INC.  
(A Development Stage Company Commencing January 1, 2002)

NOTES TO FINANCIAL STATEMENTS

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### Series D:

The Series D preferred stock provides for a 12% cumulative dividend, based on the \$5 per share purchase price, payable semi-annually in the Company's common stock or cash, at the Company's option. The Series D preferred stock is not convertible, and is redeemable solely at the Company's option at a price of \$5.75 per share plus accrued dividends. The Series D Preferred stockholders have voting rights equal to the common stockholders.

In the event of the liquidation, dissolution or winding up of the Company, whether voluntary or involuntary, holders of the Series D preferred stock are entitled to receive out of the assets of the Company the sum all dividends (whether or not earned or declared) on such shares accrued and unpaid thereon to the date of final payment or distribution, before any

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payment or distribution upon dissolution, liquidation or winding up shall be made on any series or class of capital stock ranking junior to Series D preferred stock as to such payment or distribution.

### Series F

In April 2003, management authorized the Company to raise up to \$550,000 Through a private placement by issuing 105 two-year convertible preferred instruments. The preferred, designated as Series F, and providing for one million shares in total, will be convertible into shares of Water Chef's common stock at such time as the stockholders of the corporation approve an increase in the authorized capital stock of the corporation. All dividends are cumulative and are payable in shares of the Company's common stock valued at the then current market price per share, at the time of maturity, or upon conversion, whichever is earlier. The conversion rate for shares and accrued dividends payable is 40 shares of common for each share of preferred stock. The Series F convertible preferred stockholders have voting rights equal to the common stockholders. The Series F convertible preferred stock has no stated rights in the assets of the company upon liquidation.

Although there was a discount upon the issuance of all of the Series F preferred stock in accordance with Emerging Issue Task Force ("EITF") 98-5, a security is not yet convertible if certain contingencies exist which are dependent upon the occurrence of a future event outside the control of the security holder. In this case, the shares can only be converted into common stock after the stockholders of the Company approve an increase in the authorized capital stock of the corporation. In accordance with EITF 98-5, any beneficial conversion (discount) feature is measured at the commitment date, but will not be recognized as an adjustment to earnings until the contingency is resolved, (the date the increase in shares are approved). As of December 31, 2003, the deferred contingent beneficial conversion adjustment was approximately \$1,078,000.

### Cash

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In April 2003, the Company raised \$87,500 through the sale of Series F convertible preferred stock.

In July 2003 and August 2003, the Company raised an additional \$75,000 and \$153,510, respectively through the sale of Series F convertible preferred stock.

In the 4th Quarter of 2003, the Company raised an additional \$258,861 through the sale of Series F convertible preferred stock.

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WATERCHEF, INC.  
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NOTES TO FINANCIAL STATEMENTS

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Services

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In August 2003 and September 2003, the Company issued an aggregate of 67,035 shares of its Series F convertible preferred stock for professional services totaling \$67,035.

In December 2003, the Company issued an aggregate of 22,150 shares of its Series F convertible preferred stock for professional services totaling \$65,400.

### 8. COMMON STOCK

In February 2002, the Company's Board of Directors approved, pending stockholder approval, the increase in the number of authorized common shares to be issued to 190,000,000 shares. Such approval has not been received.

#### a. Cash -

In the year ended December 31, 2002, the Company sold 2,500,000 shares of its common stock for total proceeds of \$100,000, or \$.04 per share.

#### b. Services -

During the year ended December 31, 2002, the Company issued an aggregate of 450,000 shares of its common stock for consulting services totaling \$36,000.

### 9. Stock Option and Warrant Grant Plan

In 1994, the Company instituted a stock option plan, which is available to selected directors, officers, employees and consultants of the Company (the "Participants"). The term of each option is ten years from the date of grant or a shorter term as determined by the Stock Option Committee (the "Committee"). The exercise price is determined by the Committee and cannot be less than 110% of the fair market value of the shares on the date of the grant. The Committee as of the date of grant determines the terms, conditions and restrictions of the options. No options have been awarded under the plan.

In March 1997, the Company, in connection with Bridge Loans for \$375,000 issued warrants to purchase 2,500,001 shares of common stock at \$.15 per share. These warrants had a life of five years and were to have expired in March 2002. In the year ended December 31, 2000, a total of 333,334 common shares were issued upon the exercise of a like number of warrants, for net proceeds of \$50,000. Of the remaining 2,166,667 un-exercised warrants at March 2002, a total of 1,666,667 warrants had their lives extended for an additional two years until March 2004. The remaining balance of 500,000 warrants were not extended, and accordingly they have expired. The extension of the exercise date was part of a settlement that the Company had reached with certain debenture holders that had brought a legal action against the Company.

During 2002, the Company has valued the extension of these warrants at \$111,000, which has been included in the loss on settlement of debt.

The fair value of each stock option, or warrant granted, is estimated on the date of grant using the Black-Scholes option-pricing model. The Company did not grant, nor issue, options or warrants in the year ended December 31, 2003.

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NOTES TO FINANCIAL STATEMENTS

The following tables illustrates the Company's stock option and warrant issuances and balances outstanding as of, and during the years ended December 31, 2003 and 2002:

|                                  | Shares Underlying<br>Warrants | Weighted Average<br>Exercise Price |
|----------------------------------|-------------------------------|------------------------------------|
| Outstanding at December 31, 2002 | 2,166,667                     | \$ 0.15                            |
| Granted                          | -                             | -                                  |
| Expired                          | (500,000)                     | 0.15                               |
| Exercised                        | -                             | -                                  |
|                                  |                               |                                    |
| Outstanding at December 31, 2002 | 1,666,667                     | \$ 0.15                            |
| Granted                          | -                             | -                                  |
| Expired                          | -                             | -                                  |
| Exercised                        | -                             | -                                  |
|                                  |                               |                                    |
| Outstanding at December 31, 2003 | 1,666,667                     | \$ 0.15                            |

The following is additional information with respect to the Company's warrants as of December 31, 2003:

| WARRANTS OUTSTANDING |                                |                                   | WARRANTS EXERCISABLE            |                                |                                 |
|----------------------|--------------------------------|-----------------------------------|---------------------------------|--------------------------------|---------------------------------|
| Exercise Price       | Number of Outstanding Warrants | Weighted Average Contractual Life | Weighted Average Exercise Price | Number of Exercisable Warrants | Weighted Average Exercise Price |
| \$ 0.15              | 1,666,667                      | 1.25 years                        | \$ 0.15                         | 1,666,667                      | \$ 0.15                         |
| =====                | =====                          | =====                             | =====                           | =====                          | =====                           |

10. LEASES

The Company's lease for its administrative facilities located in Glen Head, New York on a month to month basis.

Rent expense, for the years ended December 31, 2003 and 2002 was \$25,797 and \$22,548, respectively.

11. INCOME TAXES

The Company accounts for income taxes under SFAS No. 109, Accounting for Income Taxes. SFAS No. 109 requires the recognition of deferred tax assets and liabilities for both the expected impact of differences between the

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financial statements and tax basis of assets and liabilities, and for the expected future tax benefit to be derived from tax loss and tax credit carry forwards. SFAS No. 109 additionally requires the establishment of a valuation allowance to reflect the likelihood of realization of deferred tax assets.

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WATERCHEF, INC.  
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### NOTES TO FINANCIAL STATEMENTS

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For the year ended December 31, 2003 and 2002, no provision for income taxes has been provided for, as a result of continued net operating losses. The Company is subject to certain state and local taxes based on capital.

The Company has net operating loss carryforwards for federal income tax purposes totaling approximately \$15,000,000 at December 31, 2003. These carryforwards expire between the years 2009 through 2023. Utilization of these loss carryforwards may be limited under Internal Revenue Code Section 382. The deferred tax asset arising from the net operating loss carryforwards has been offset by a corresponding valuation allowance.

The valuation allowance primarily relates to the federal and state net operating losses for which utilization in future periods is uncertain. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. The Company considers projected future taxable income and tax planning strategies in making this assessment. Based on projections for future taxable income over the periods that the deferred tax assets are deductible, the Company believes it is more likely than not that the Company will not realize the benefits of these deductible differences in the near future and therefore a full valuation allowance of \$6,000,000 is provided. The net change in the valuation allowance increased approximately \$500,000 during 2003 related to increased net operating losses.

#### 12. MAJOR CUSTOMERS

The Company recorded no sale and one sale to one major customer for the year ended December 31, 2003 and 2002 respectively.

#### 13. COMMITMENTS AND CONTINGENCIES

The Company was a defendant in an action brought by a customer on June 6, 2001, relating to a series of contracts that the Company entered into. The customer had claimed that the Company breached these contracts by shipping certain goods in November 1997, that did not conform to the contract. Most of the damages that the customer sought consist of lost business profits. Company management, and legal counsel, believed that the action was without merit. However, due to the costs in defending the Company in such a legal action, Company management opted for a settlement in 2003 as the most cost effective manner to handling this matter. The Company has agreed to pay the customer a total of \$27,500 over nine months which has been paid in full as of December 31, 2003.

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In May 2001, the Company entered into a distribution agreement with a company (the "Sub distributor") based in the State of Jordan. The Sub distributor has agreed to purchase no fewer than 100 units of the Company's "Pure Safe Water Station", in the calendar year commencing January 1, 2001. A minimum purchase of 50 units are required to be purchased in each of the subsequent years commencing January 1, 2002 and 2003, respectively. During the year ended December 31, 2001, 18 units had been shipped under this agreement. The sale will be recognized when the Company receives payments. The Company recorded the cost of the inventory shipped as a loss contingency of \$242,035 during the year ended December 31, 2001, since return of the items is uncertain.

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### NOTES TO FINANCIAL STATEMENTS

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On November 17, 2000, the Company entered into a three-year master distribution agreement for their "Pure Safe Water Station" with a distributor based out of Hong Kong ("the distributor"). Under this agreement, upon meeting minimum quantities of sales in each of the years of agreement, the distributor will receive a rebate of 20% of the total price for all products, parts and supplies purchased from the Company. Furthermore, the distributor, upon meeting these minimum sales quantities will have the right to purchase up to 30,000,000 shares of the Company's common stock at \$0.05 per share. The sales targets were never met and the agreement was cancelled on June 17, 2002.

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