SKYE INTERNATIONAL, INC
Form 10QSB
November 17, 2006

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

(Mark One)

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

For the quarterly period ended September 30, 2006

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _______ to __________

COMMISSION FILE NUMBER: 000-27549

SKYE INTERNATIONAL, INC.
(Exact name of Company as specified in its charter)

NEVADA	**88-0362112**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

7650 E. Evans Rd., Suite C Scottsdale, AZ 85260
(Address of principal executive offices) (Zip Code)

Company's telephone number: (480) 889-9999

7150 W. Erie St., Chandler, AZ 85226
(Former name, address and phone number if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the Company was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x Noo

Indicate by check mark whether the registrant is an accelerated filer (as defined in exchange A Rule 12b-2)
Yes ¨ No x

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

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common equity:

As of September 30, 2006 - 21,622,243 common shares of $0.001 par value.

Transitional Small Business Disclosure Format (check one): YES o NO x

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PART I. FINANCIAL INFORMATION

ITEM 1 Financial Statements (unaudited)

Skye International, Inc. and Subsidiaries
CONSOLIDATED BALANCE SHEETS

ASSETS

	September 30 2006	December 31 2005
CURRENT ASSETS		
Cash	10,070	2,711
Accounts Receivable, Net	96,505	2,773
Inventory at Cost	141,837	25,069
Prepaid Expenses	267,113	757
Total Current Assets	515,525	31,310
EQUIPMENT, NET	49,837	56,626
OTHER ASSETS		
Patents and Software, Net	-	-
Deposits	120,000	20,000
Intangible Assets	3,982	-
Total Other Assets	123,982	20,000
Total Assets	689,344	107,937

LIABILITIES AND STOCKHOLDERS' EQUITY

LIABILITIES		
Accounts Payable	1,629,580	234,557
Other Payables	375,541	870,914
Notes Payable	1,103,241	1,118,241
Accrued Interest Payable	70,458	81,626
Warranty Accrual	34,570	34,570
Customer Deposits	103,371	103,371
	3,316,760	2,443,279
Total Liabilities	3,316,760	2,443,279

STOCKHOLDERS' EQUITY		
Common Stock authorized is		
100,000,000 shares at $0.001par value.		
Issued and outstanding on September 30,		
2006 were 21,622,243 shares, December 31,		
2005 were 17,838,231	21,622	17,838
Common Stock Subscribed	86,838	275,000
Paid in Capital	9,208,170	7,436,333
Accumulated Deficit	(11,944,046)	(10,064,513)
Total Stockholders' Equity (Deficit)	(2,627,416)	(2,335,342)
TOTAL LIABILITIES AND		
STOCKHOLDERS EQUITY	689,344	107,937

The accompanying notes are an integral part of these financial statements.

Skye international, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30 2006	Nine Months Ended September 30 2005
Operating Activities		
Net (Loss)	(1,879,533)	(1,428,681)
Depreciation/Amortization Expense.	7,109	44,740
Changes in assets and liabilities:		
Inventory	(116,768)	(63,592)
Accounts Receivable	(93,732)	(79,751)
Prepaid Expense	(266,356)	(8,000)
Deposits	(100,000)	(70,000)
Accrued Interest Payable	(11,168)	8,070
Accounts Payable	1,395,023	203,653
Other Payables	(495,373)	-
Notes Payable	(15,000)	(812,589)
Customer Deposits	(0)	48,176
Intangible Assets	(3,982)	-
Net Cash Provided by Operating Activities	(1,579,781)	(2,157,974)
Investing Activities		
Purchase of Equipment	(318)	(47,838)
Net Cash (Used) by Investing Activities	(318)	(47,838)
Financing Activities		
Shares issued for services rendered.	684,127	305,638
Shares issued to retire debt and interest.	226,493	463,382
New Stock Subsciptions	21,838	
Stock Subscriptions	(210,000)	-
Proceeds from Issuance of Subscribed Stock	210,000	-
Proceeds from sale of Common Stock	655,000	1,410,650
Principal Received on Convertible Debentures	-	-
Principal Received on Related Party Loan	-	60,000
Cash Provided by Financing Activities	1,587,458	2,239,670
Net Increase/(Decrease) in Cash	7,359	33,858
Cash, Beginning of Period	2,711	18,690

Cash, End of Period	10,070	52,548
Supplemental Information:		

The accompanying notes are an integral part of these statements

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Skye International, Inc.
CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Mos. Ended September 30		Nine Mos. Ended September 30	
	2006	2005	2006	2005
INCOME				
Product Sales	$ 8,425	$ 41,324	$ 16,457	$ 192,885
Other Income	(5,471)	1,969	-	8,233
Total Income	2,954	43,293	16,457	201,118
Cost of Goods Sold	3,683	19,314	17,982	57,140
Gross Income	(729)	23,979	(1,525)	143,978
EXPENSES	-			
Legal and Professional	480,358	79,314	1,171,806	165,395
General and Administrative	231,633	355,484	590,622	830,177
Research and Development	12,681	156,935	26,928	366,623
Advertising/Marketing	303	2,350	38,406	3,163
Depreciation	2,306	9,178	7,109	27,535
Amortization	-	6,614	0	19,841
Total Expenses	727,281	609,875	1,834,871	1,412,734
OTHER INCOME AND (EXPENSE):				
Gain/Loss on Sale of Assets			5,312	
Interest Income/Expense	23,596	41,514	37,825	159,925
	28,908	41,514	43,137	159,925
Net (Loss) before Income Taxes	(756,918)	(627,410)	(1,879,533)	(1,428,681)
Income Tax Expense	-	-	-	-
NET (LOSS)	(756,918)	(627,410)	(1,879,533)	(1,428,681)
Basic and diluted (loss) per share	$ (0.04)	$ (0.04)	$ (0.09)	$ (0.10)
Weighted Average Number of Common				
Shares Outstanding	21,341,401	14,401,322	19,871,754	14,401,322

The accompanying notes are an integral part of these statements

Skye International, Inc. and Subsidiaries
STATEMENT OF STOCKHOLDER'S DEFICIT

	Common Stock Shares	Amount	Common Stock Subscribed	Paid in Capital	Accumulated Deficit	Total Equity
Balance December 31, 2000	580,000	$ 580		$ 333,920	$ (828,006)	$ (493,506)
Common Shares issued for Services	52,500	53		52,447		52,500
Contribution to Capital				24,265		24,265
Common Shares issued to retire Convertible Note and accrued Interest	60,000	60		187,022		187,082
Net (Loss)					(120,900)	(120,900)
Balance December 31, 2001	692,500	$ 693		$ 597,654	$ (948,906)	$ (350,559)
Common Shares issued for cash	104,778	105		96,895		97,000
Common Shares issued for services	455,800	455		110,045		110,500
Common Shares issued for prepaid service	162,500	163		16,087		16,250
Common Shares issued for proposed business acquisition	6,433,406	6,433		896,997		903,430
Common Shares issued to retire convertible note and accrued Interest	60,000	60		200,670		200,730
Common Shares issued to retire debt	22,500	22		23,272		23,294
Net (Loss)					-2,798,586	(2,798,586)
Balance December 31, 2002	7,931,484	$ 7,931		$ 1,941,620	$ (3,747,492)	$ (1,797,941)
Common Shares issued for Cash	434,894	435		967,925		968,360
Common Shares issued in	3,008,078	3,008		(166,940)		(163,932)

recapitalization					
Net (Loss)				(371,821)	(371,821)
Balance December 31, 2003	11,374,456	11,374	2,742,605	-4,119,313	-1,365,334
Common Shares issued for services	800,000	800	228,080		228,880
Common Shares issued to retire Debt and interest of $91,281	172,354	172	91,109		91,281
Common Shares issued for cash through exercise of warrants	66,667	67	16,600		16,667
Common Shares cancelled in acquisition settlement	(2,075,000)	-2,075	2,075		-
Common Stock Options issued for services			19,000		19,000
Common Stock issued for prepaid services	2,250,000	2,250	110,250		112,500
services					
Common Shares valued at $159,876	537,500	538	159,338		159,876
Issued to obtain $1,075,000 debt					
Net (Loss)				(1,893,330)	(1,893,330)
Balance December 31, 2004	13,125,977	13,126	3,369,057	(6,012,643)	(2,630,460)

Common Stock granted but not issued until 2006			275,000			275,000
Common Stock granted in 2004 but not earned by related party consulting agreements until 2005				945,000		945,000
Common Shares issued for consulting and outside services	260,525	261		237,162		237,423
Common Shares issued in conjunction with related party consulting contracts	391,832	392		414,129		414,521
Issuance of common stock for employee stock Awards	524,500	525		535,646		536,170
Issuance of common stock to reduce existing debt	78,067	78		52,266		52,344
Common Shares Issued in connection with Debt	50000	50		12450		12,500
Conversion of convertible bridge notes into common stock	842,511	843		462,539		463,382
Issuance of common stock in private placements	2,564,819	2,565		1,408,085		1,410,650
Net (Loss)					(4,051,870)	(4,051,870)
	17,838,231	17,839	275,000	7,436,333	(10,064,513)	(2,335,340)

Balance December 31, 2005						
Common Shares issued in conjunction with related party consulting services and to employees for services	378,750	379		262,496		262,875
Common Shares issued for consulting and outside services	808,100	808		420,444		421,252
Issuance of common stock in private placements, previously subscribed	370,000	370	-210,000	209,630		0
Shares Subscribed			21,838			21,838
Shares issued to retire debt and interest	412,902	413		226,080		226,493
Shares issued in private stock placements	1,814,260	1,814		653,186		655,000
Net (Loss)					(1,879,533)	(1,879,533)
Balance September 30, 2006	21,622,243	21,623	86,838	9,208,169	(11,944,046)	(2,627,415)

The accompanying notes are an integral part of these statements.

Note 1. THE COMPANY

The Company

Skye International, Inc., a Nevada corporation, was originally organized on November 23, 1993 as Amexan, Inc. On June 1, 1998, the name was changed to Nostalgia Motorcars, Inc. On June 11, 2002, the Company changed its name to Elution Technologies, Inc. It changed its name to Tankless Systems Worldwide, Inc. on June 4, 2003 and to Skye International, Inc. on October 21, 2005.

On November 7, 2003, the Company acquired Envirotech Systems Worldwide, Inc. (Envirotech), a private Arizona corporation, as a wholly owned subsidiary. Through this merger, the former shareholders of Envirotech acquired a controlling interest in Tankless Systems Worldwide, Inc. (Tankless) and accordingly, the Merger is accounted for as a reverse merger with Envirotech being the accounting acquirer of Tankless. Accordingly, the Financial Statements present the historic financial position, operations and cash flows of Envirotech for all periods presented with the December 31, 2003 balance sheet adjusted to consolidate and reflect the fair values assigned to the acquisition balance sheet of Tankless. Refer to Note 4, Acquisition of Subsidiary for additional information and disclosures related to the merger.

Envirotech was organized December 9, 1998 and has a limited history of operations. The initial period of its existence involved research and development of a line of electronic, tankless water heaters. The first sales of its products occurred in calendar year 2000.

With the acquisition of Envirotech, the Company is in the business of designing, developing, manufacturing and marketing several models of electronic, tankless water heaters. With SKYE name adopted in October 2005 the business of the Company was expanded to include the manufacture and sale of consumer lifestyle appliances, including tankless water heaters

During January 2004 the Company organized ION Tankless, Inc. (Ion) an Arizona Corporation as a wholly owned subsidiary. ION is organized to do research and development of new technologies upon which new consumer products can be based. Ion is not engaged in active business and serves to solely research new technologies and hold such technologies for the benefit of SKYE.

Nature of Business

The Company currently produces and will soon market tankless electronic water heaters. The company’s products, together with a limited quantity of related parts purchased for resale, are sold primarily through manufacturer’s representatives and wholesale distributors in the United States and Canada. Based upon the nature of the Company’s operations, facilities and management structure, the Company considers its business to constitute a single segment for financial reporting purposes.

Basis of Consolidation

The accompanying consolidated financial statements reflect the operations, financial position and cash flows of the Company and include the accounts of the Company and its subsidiaries after elimination of all significant inter-company transactions in consolidation.

Basis of Presentation

The Consolidated Financial Statements of Skye International include all of its wholly owed subsidiaries.

In January 2006, the Company's motion to withdraw its Chapter 11 filing was granted by the Bankruptcy Court for the District of Arizona without prejudice or relief from any of its liabilities previously classified as Subject to Compromise,

As such, the accompanying Consolidated Financial Statement for the nine months ended September 30, 2006 and the year ended December 31, 2005 were not prepared in accordance with Statement of Position 90-7 ("SOP 90-7"), "Financial Reporting by Entities in Reorganization under the Bankruptcy Code" (See Note 2) which requires that all pre-petition liabilities subject to compromise are segregated in the consolidated balance sheets as of end of the respective years and classified as Liabilities Subject to Compromise, at the estimated amount of allowable claims with liabilities not subject to compromise being separately classified.

Note 1. THE COMPANY - continued

These Consolidated Financial Statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. Accordingly, the financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern. As described more fully below, there is substantial doubt about the Company's ability to continue as a going concern which is predicated upon, among other things, the ability to generate cash flows from operations and, when necessary, obtaining financing sources sufficient to satisfy the Company’s future obligations.

The accompanying comparative Consolidated Financial Statement for the year ended December 31, 2005 has been restated to reflect the Company’s withdrawal of its bankruptcy court petition.

Recently Issued Accounting Standards

Below is a listing of the most recent accounting standards and their effect on the Company.

SFAS 123(R) Share-Based Payment

In December 2004, the FASB issued FAS No. 123R, “Share-Based Payment.” This statement is a revision to FAS No. 123, “Accounting for Stock-Based Compensation,” it supersedes APB Opinion No. 25, “Accounting for Stock Issued to Employees,” and amends FAS No. 95, “Statement of Cash Flows.” Generally the approach in FAS No. 123R is similar to the approach described in FAS No. 123. However, FAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. This statement also provides guidance on valuing and expensing these awards, as well as disclosure requirements of these equity arrangements.

FAS No. 123R must be adopted for the year ending December 31, 2006. Early adoption will be permitted in periods in which financial statements have not yet been issued.

As permitted by FAS No. 123, the Company currently accounts for share-based payments to employees using the Fair Market Value method and the Company recognizes compensation cost for employee stock options at fair market Value. Accordingly, the adoption of FAS No. 123R’s fair value method is expected to have a material impact on the Company’s results of operations, although it is not expected to have an impact on the Company’s overall financial position. [However, had the Company adopted FAS No 123R in prior periods using the Black-Scholes valuation model, the impact of that standard would have approximated the impact of FAS No. 123 as described in the disclosure of pro forma net loss and net loss per share in Note 3 to our consolidated financial statements.]

FAS No. 123R will also require the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. The Company cannot estimate what those amounts will be in the future (because they depend on, among other things, when employees exercise stock options, and whether the Company will be in a taxable position). There is no tax impact related to the prior periods since we are in a net loss position.

SFAS 149 Amendment of Statement 133 on Derivative Instruments and Hedging Activities

This Statement amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities.*

SFAS 150 Financial Instruments with Characteristics of both Liabilities and Equity

This statement requires that such instruments be classified as liabilities in the balance sheet. SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003.

FIN 46 Consolidation of Variable Interest Entities

Interpretation No. 46 (FIN46 *)* In January 2003, the FASB issued FASB Interpretation No. 46 ("FIN 46"), Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51, which addresses consolidation by business enterprises of variable interest entities ("VIEs"). In December 2003, the FASB completed deliberations of proposed modifications to FIN 46

Note 1. THE COMPANY - continued

(Revised Interpretations) resulting in multiple effective dates based on the nature as well as the creation date of the VIE. The Revised Interpretations must be applied no later than the second quarter of fiscal year 2004. The adoption of FIN 46 had no impact on the Company's consolidated financial statements as of December 31, 2004.

The adoption of these new Statements is not expected to have a material effect on the Company’s current financial position, results or operations, or cash flows.

Note 2. SUBSIDIARY’S PROCEEDINGS UNDER CHAPTER 11 OF THE BANKRUPTCY CODE

The Company’s wholly-owned subsidiary, Envirotech, filed for reorganization under Chapter 11, as it offered the most efficient alternative to restructure the Company’s balance sheet and access new working capital while continuing to sells its products and work with its parent to explore alternative business objectives to become financially viable. On August 6, 2004, Envirotech filed a voluntary petition with the United States Bankruptcy Court for the District of Arizona (Case No. 2:04-13908-RTB) seeking relief under Chapter 11 of the Bankruptcy Code as a means to resolve all existing litigation, judgments and efforts to collect on judgments entered against Envirotech. On December 2004, the Company filed its proposed plan of reorganization and disclosure statement with the Bankruptcy Court.

With the exception of a guarantee to one critical supplier in the approximate amount of $42,500 and a guarantee to the law firm of Susman and Godfrey, LLP, the Registrant has not assumed any liability for the obligations of Envirotech. As of the date of the filing of the Chapter 11 Bankruptcy Petition, Envirotech had liabilities of approximately $1.6 million. Several creditors not related to the supply of parts or the assemblies of products have obtained judgments against Envirotech and were seeking to collect such judgments, and an action was pending in the U.S. District Court, Southern District of Texas, alleging patent infringement. The filing of the Bankruptcy Petition temporarily stayed all creditors and lawsuits.

AICPA Statement of Position 90-7, "Financial Reporting by Entities in Reorganization under the Bankruptcy Code" ("SOP 90-7") provides financial reporting guidance for entities that are reorganizing under the Bankruptcy Code. The Company implemented this guidance in the consolidated financial statements for periods subsequent to September 30, 2004.

Pursuant to SOP 90-7, companies are required to segregate pre-petition liabilities that are subject to compromise and report them separately on the balance sheet. Liabilities that may be affected by a plan of reorganization are recorded at the amount of the expected allowed claims, even if they may be settled for lesser amounts. Obligations arising post-petition, and pre-petition obligations that are secured are not classified as liabilities subject to compromise.

Additional pre-petition claims (liabilities subject to compromise) may arise due to the rejection of executory contracts or unexpired leases, or as a result of the allowance of contingent or disputed claims.

As of December 31, 2004 and December 31, 2005, Tankless and its subsidiaries (including Envirotech the “Debtor”) operated their business as debtors-in-position pursuant to the Bankruptcy Code.

In January 2006, the Company withdrew its Chapter 11 filing without prejudice or relief from any of its liabilities previously classified as Subject to Compromise.

Note 3. SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates and Assumptions

The discussion and analysis of the Company's financial condition and results of operations are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires making estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from these estimates under different assumptions or conditions. Critical accounting policies are defined as those that entail significant judgments and estimates, and could potentially result in materially different results under different assumptions and conditions.

The accompanying balance sheets as of September 30, 2006 and December 31, 2005, and the related statements of operations, stockholders' equity, and cash flows for the periods ended September 30, 2005, and December 31, 2005 reports the activity of

Note 3. SIGNIFICANT ACCOUNTING POLICIES - continued

its subsidiary Envirotech up to the date of purchase November 7, 2003 and consolidates the activity of the Company for all reported periods from the date of purchase to September 30, 2006 and December 31, 2005 and its subsidiary ION from inception (January 2004) to September 30, 2006 and December 31, 2005 and its subsidiary Valeo from inception (January 2006) to September 30, 2006 and December 31, 2005.

The Consolidated Financial Statements for fiscal 2005 contained herein have been prepared in accordance with Statement of Position 90-7, "Financial Reporting by Entities in Reorganization under the Bankruptcy Code" ("SOP 90-7"). The Consolidated Financial Statements for fiscal 2003 are not prepared in accordance with SOP 90-7 because the Chapter 11 case was filed in fiscal 2005. See Note 2 to the Consolidated Financial Statements. The amounts reported in subsequent financial statements will materially change due to the restructuring of the Company's assets and liabilities as a result of the Plan and the application of the provisions of SOP 90-7 with respect to reporting upon emergence from Chapter 11 ("fresh start" accounting). Financial statements for periods subsequent to the Company's emergence from Chapter 11 will not be comparable with those of prior periods.

Cash Equivalent

Cash and Cash Equivalents - All highly liquid debt instruments with a maturity of six months or less at the time of purchase are considered to be cash equivalents. Cash equivalents are stated at cost, which approximates fair value because of the short-term maturity of these instruments.

Fair Value of Financial Instruments

Financial instruments consist of cash and cash equivalents, accounts payable, accrued expenses and short-term and long-term convertible debt obligations. Including promissory notes, and related party liabilities, the fair value of these financial instruments approximates their carrying amount as of September 30, 2006 and December 31, 2005 due to the nature of or the short maturity of these instruments.

Research and Development

The Company's research and development efforts concentrate on new product development, improving product durability and expanding technical expertise in the manufacturing process. The Company expenses product research and development costs as they are incurred. With the organization of its subsidiary ION, the Company continues to expense research and development costs as incurred in developing additional products based on new technologies.

Marketing Strategy

The Company sells to large wholesale distributors through its network of manufacturer's representatives.. The Company has periodically advertised on cable television stations, at trade shows and through trade magazines and it maintains an extensive website located at www.skye-betterliving.com.

Revenue Recognition

The Company records sales when revenue is earned. The Company sells on credit (10th prox.) to its distributors and manufacturer's representatives. Due to the company's Warranty and Right of Return policy, six percent of the sales are recognized immediately and the balance is recognized 25 - 40 days after shipment of the product to the customer. All shipments are FOB shipping point. Sales to distributors and manufacturer's representatives are sold FOB shipping point with receivables based upon the 10th prox. (25 -40 days post shipping). In 2005, substantially all of the

Company's gross revenues of $172,169 were generated by the Valeo subsidiary and were generated through sales of the ESI-2000 unit to individuals over the internet, the majority of whom paid in advance by credit card payments. The Company no longer manufactures the ESI-2000 product lines and so the Company plans to refund the purchase price paid for undelivered heaters or, alternatively, to ship the upcoming FORTIS™ branded heater to those customers that did not receive delivery of an ESI-2000 heater.

Note 3. SIGNIFICANT ACCOUNTING POLICIES - continued

Accounts Receivable

Accounts receivable are recorded when an order is received from a distributor and shipped. An allowance for doubtful accounts was set up based on the actual rate of uncollected accounts. Net accounts receivable is as follows:

	9/30/06	12/31/05
Accounts Receivable	$ 97,787	$ 4,056
Less: Allowance for Doubtful Accounts	(1,283)	($1,283)
Net Accounts Receivable	$ 96,505	$ $2,773

Allowance for Doubtful Accounts

The company maintains allowances for doubtful accounts for estimated probable losses resulting from inability of the company's customers to make the required payments. The company continues to assess the adequacy of the reserves for doubtful accounts based on the financial condition of the Company's customers and external factors that may impact collectability. As of September 30, 2006 and December 31, 2005 the allowance was $1,283

Advertising

Advertising expense included the cost of sales brochures, print advertising in trade publications, displays at trade shows and maintenance of an Internet site. Advertising is expensed when incurred. Advertising expense for the nine months ended September 30, 2006, and September 30, 2005, $38,406 and $3,163 respectively.

Inventory

The Company contracts with a third party to manufacture the units and is neither billed for nor obligated for any work-in-process. The Company only supplies certain parts and materials and is then billed for completed products. Parts and material inventory is stated at the lower of cost (first-in, first-out) or net realizable value.

Property and Equipment

Property and equipment are depreciated or amortized using the straight-line method over their estimated useful lives, which range from two to seven years. Fixed assets consist of the following:

	9/30/06	12/31/05
Property, Equipment, furniture and Fixtures	$ 64,777	$ 64,457
Less: Accumulated Depreciation	(14,940)	(7,831)
Net Fixed Assets	$ 49,837	$ 56,626

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Note 3. SIGNIFICANT ACCOUNTING POLICIES - continued

Patents

We evaluate potential impairment of long-lived assets in accordance with FAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets.” FAS No. 144 requires that certain long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable based on expected undiscounted cash flows that result from the use and eventual disposition of the asset. The amount of any impairment is measured as the difference between the carrying value and the fair value of the impaired asset. Patent and software costs include direct costs of obtaining patents. Costs for new patents are either expensed as they are incurred or capitalized and amortized over the estimated useful lives of seventeen years and software over five years.

Earnings per Share

The basic (loss) per share is calculated by dividing the Company’s net loss available to common shareholders by the weighted average number of common shares outstanding during the year.

The Company has potentially dilutive securities outstanding at the end of the statement periods. Therefore, the basic and diluted earnings (loss) per share are presented on the face of the statement of operations. There are 600,000 options at $.55 and 100,000 options at a variable price per share available at this time. There are also $100,000 of outstanding convertible debentures which within 12 months may be converted into restricted common shares of the Company at a 30% discount to the then current 10-day moving average of the Company’s common stock. All outstanding warrants were either exercised or cancelled and convertible debt is anti-dilutive.

Stock Based Compensation

The Company accounts for its stock based compensation based upon provisions in SFAS No. 123, *Accounting for Stock-Based Compensation* . In this statement stock based compensation is divided into two general categories, based upon who the stock receiver is, namely: employees/directors and non-employees/directors. The employees/directors category is further divided based upon the particular stock issuance plan, namely compensatory and non-compensatory. The employee/directors non-compensatory securities are recorded at the sales price when the stock is sold. The compensatory stock is calculated and recorded at the securities’ fair value at the time the stock is given. SFAS 123 also provides that stock compensation paid to non-employees be recorded with a value which is based upon the fair value of the services rendered or the value of the stock given, whichever is more reliable. The common stock paid to non-employees was valued at the value of the services rendered. Because the Company establishes the exercise price based on the fair market value of the Company’s stock at the date of grant, the options have no intrinsic value upon grant, and therefore no expense is recorded.

Equity instruments issued to non-employees for goods or services are accounted for at fair value and are marked to market until service is complete or a performance commitment date is reached.

We measure stock-based employee compensation based on FASB Statement No. 123R, Accounting for Stock-Based Compensation, therefore, we establish the price based on the fair market value of our common stock at the date of grant.

In December 2004, the FASB issued FAS No. 123R, “Share-Based Payment.” This statement is a revision to FAS No. 123, “Accounting for Stock-Based Compensation,” and it supersedes APB Opinion No. 25, “Accounting for Stock

Issued to Employees," and amends FAS No. 95, "Statement of Cash Flows." Generally the approach in FAS No. 123R is similar to the approach described in FAS No. 123. However, FAS No. 123R will require all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values.

FAS No. 123R must be adopted no later than January 1, 2006. We have adopted FAS No. 123R on January 1, 2006. FAS No. 123R permits public companies to adopt its requirements using one of two methods, the modified prospective or the modified retrospective method. We have chosen to adopt the modified prospective method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of FAS No. 123R for all share-based payments granted after the effective date and (b) based on the requirements of FAS No. 123 for all awards granted to employees before the effective date of FAS No. 123R that remain unvested on the effective date.

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Note 3. SIGNIFICANT ACCOUNTING POLICIES - continued

Warranty and Right of Return

In connection with the sale of each product, the Company provides a limited 30-day money back guarantee less a 6% restocking charge. After the 30 days the Company provides a five year warranty on replacement of parts. The tank chamber is warranted not to leak for 10 years. The Company has limited history with claims against its warranty. The Company defers a portion of the revenue as would generally be required for post-contract customer support ("PCS") arrangements under SOP 97-2. Accordingly, the revenue allocated to the warranty portion of such sales is deferred and recognized ratably over the life of the warranty. As of September 30, 2006 a total of $34,570 in refunds and warranty allowances were recorded against Product Sales.

Balance of Warranty Accrual for 2003	$ 3,240
Balance of Warranty Accrual for 2004	$ 9,725
Balance of Warranty Accrual for 2005	$ 21,625
Balance of Warranty Accrual for 2006	$ 0.00
Total Warranty Accrual as of September 30, 2006	$ 34,570

Note 4. ACQUISITION OF SUBSIDIARY

On November 7, 2003, the Company acquired Envirotech Systems Worldwide, Inc. a private Arizona corporation (Envirotech), as a wholly owned subsidiary. On the date of purchase the Company had 3,008,078 common shares issued and outstanding. The purchase was made in a one-for-one stock exchange of 8,366,778 shares of the Company's common stock for all of the issued and outstanding shares of Envirotech. The Statement of Stockholders' Equity has been retroactively restated to reflect the affect of a recapitalization of Envirotech at the time of purchase.

Note 5. NOTES PAYABLE AND CAPITAL LEASE OBLIGATIONS

In the third quarter the Company received $100,000 of subscription funds in exchange for the issuance of $100,000 of principal 12% convertible debentures (the "Debentures"). The Debentures, together with accrued interest thereon are convertible at the option of the holder any time during the 12 months from issuance thereof into restricted common stock of the Company at a price equal to a 30% discount to the then current 10-day moving average of the Company's common stock. Additionally, the investor received one (1) share of the Company's restricted common stock for each Two Dollar ($2.00) amount of debentures purchased. At the date of this report the Debenture shares had not yet been issued from treasury. When issued 50,000 shares will be delivered to investors.

Note 5. NOTES PAYABLE AND CAPITAL LEASE OBLIGATIONS - continued

Notes payable and capital lease obligations consist of the following:

	Nine Months Ended 9/30/06	Year Ended 12/31/05
Convertible Notes, Unsecured, Matured March 2001 bear 12.5% Interest, principle and interest convertible into one common share and one warrant at 75% of the average closing price over the 10-day period prior to conversion. Warrants have expired and notes have not been converted and are in default.	$ 170,000	$ 70,000
Convertible Notes, Unsecured, Matured one-year from issue date, bear 10% Interest payable quarterly, principle and interest convertible into one common share for each outstanding $1.00. Forty notes were issued between January 23, 2004 and January 15, 2005. Of these notes, thirty six had been either repaid or converted at December 31, 2005. Of the remaining four notes, three were converted in April 2006; the fourth has not been converted or repaid and is in default. Aggregate Amount:	$ 15,000	$ 215,000
Demand Note with Attorneys, 6% Interest, All Assets of Subsidiary, Envirotech, pledged as Collateral; Note is in default	$ 194,895	$ 194,895
Demand Note with Former Distributor of Subsidiary, Envirotech, in Settlement and Repurchase of Distributorship Territory, 7% Interest; Note is in default	$ 519,074	$ 519,074
Demand Note Made by Subsidiary, Envirotech, 10% Interest, Payable Monthly; Note is in default	$ 11,880	$ 11,880
Demand Note Made by Subsidiary, Envirotech, 6% Interest; Note is in default	$ 35,000	$ 35,000
Demand Note Made by Subsidiary, Envirotech; Note is in default	$ 72,391	$ 72,391
Demand Note Made by SKYE in favor of consultants; Note is in default	$ 10,000	$ -

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Note 6. STOCKHOLDERS’ EQUITY

On September 30, 2006 and December 31, 2005 common stock issued and outstanding were 21,622,243, and 20,588,493 shares respectively.

On March 24, 2005, the Company adopted an employee stock incentive plan setting aside 500,000 shares of the Company’s common stock for issuance to officers, employees, directors and consultants for services rendered or to be rendered. The proposed maximum offering price of such shares is $1.00 per share.

A compensation committee appointed by the Board of Directors who shall have the right to grant awards or stock options administers the plan.

On March 30, 2005, the Company filed a Registration on Form S-8 with the Securities Exchange Commission covering the 500,000 shares provided by this plan, at a maximum offering price of $1.00 per share.

As of September 30, 2006 and December 31, 2005, the Company has issued 432,541 and 252,357 shares respectively covered by the 2005 Stock Incentive Plan adopted by the Company on March 24, 2005. As of September 30, 2006, 67,459 remain unissued under this Plan.

The Company was initially capitalized on November 30, 1993 with the issue of 500,000 shares for $5,000. During 2005 the Company issued 652,357 shares for $651,943 in consulting services; 524,500 shares at $536,170 for employee stock awards; 78,067 shares for $54,647 in debt reduction; 842,511 shares to retire $881,536 in convertible notes; and 2,564,819 shares for $, 296,483 in cash in private placements. During the first nine months of 2006, the Company issued 205,000 shares for consulting and legal services valued at $230,753; 370,000 shares previously subscribed for cash in private placements; 412,902 shares to retire principal and interest on outstanding bridge loans; 1,814,260 shares in private placements for $655,000; 110,000 shares for legal fees valued at $48,000; 600,000 shares for consultants for fees valued at $330,000; 50,000 shares for investment banking fees and services valued at $17,500; 173,750 shares for employees in lieu of pay and for signing bonuses valued at $57,375, 50,000 and 50,000 shares to be issued in connection with the receipt of $100,000 in convertible bride notes . The total common stock issued and outstanding at September 30, 2006 is 21,622,243, shares.

Warrants

No warrants are outstanding.

Stock Options

In connection with the acquisition of Envirotech Systems Worldwide, Inc., the Company issued immediately vested stock options on October 29, 2003 to one of the principal shareholders of Envirotech. He was granted the right to purchase 300,000 restricted common shares at $0.55 per share until October 29, 2004 which was extended to December 31, 2004. This option expired without exercise on December 31, 2005.

On February 11, 2004 the company granted 5-year stock options to purchase 600,000 shares of restricted common stock at $0.50 per share to consultants assisting in company operations. Using a discounted stock price of $0.43, exercise price of $0.50, 5-year option, risk-free rate of 4.1% and a volatility rate of .038 the value of these options is calculated at $0.03 using the Black-Scholes model. The aggregate value of 600,000 options is $18,000. By amendment dated September 6, 2005, the option period has been extended for an additional 5 years, to expire February 11, 2014.

Note 6. STOCKHOLDERS' EQUITY - continued

In October 2005, the Company granted an option to its website developer to purchase 100,000 shares of common stock at a variable price based on market price, exercisable within one year.

At September 30, 2006 and December 31, 2005, none of the options have been exercised.

Outstanding stock options are as follows:

	Shares
Balance, December 31, 2003	300,000
Granted, 2004	700,000
Expired, 2004	(300,000)
Balance, December 31, 2004	700,000
Granted, 2005	100,000
Expired, 2005	(100,000)
Balance, December 31, 2005 and September 30, 2006	700,000

Note 7. INCOME TAXES

The Company provides for income taxes under Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* . SFAS No. 109. Under SFAS No. 109, deferred tax assets and liabilities are recognized based on temporary differences between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse. SFAS No. 109 requires current recognition of net deferred tax assets to the extent that it is more likely than not such net assets will be realized. To the extent that the Company believes that its net deferred tax assets will not be realized, a valuation allowance must be recorded against those assets.

SFAS No. 109 requires the reduction of deferred tax assets by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. In the Company's opinion, it is uncertain whether they will generate sufficient taxable income in the future to fully utilize the net deferred tax asset. Accordingly, a valuation allowance equal to the deferred tax asset has been recorded. The total deferred tax asset is calculated by multiplying a 35% estimated tax rate by the cumulative NOL of $11,944,046. The total valuation allowance is equal to the total deferred tax asset.

	Nine Mos. Ended 9/30/06	Yr. Ended 2005	Yr. Ended 2004
Deferred Tax Asset	$ 4,180,416	$ 3,522,580	$ 2,104,425
Valuation Allowance	$ (4,180,416))	$ (3,522,580)	$ (2,104,425)
Current Taxes Payable	-	-	
Income Tax Expense	-	-	

Below is a chart showing the estimated federal net operating losses and the years in which they will expire.

Year	Amount	Expiration
1993-2003	$ 4,119,312	2013-2023

2004	$ 1,893,331	2024
2005	$ 4,051,870	2025
2006	$ 1,807,366	2026
Total	$ 11,944,046	

Note 8. LEASES AND OTHER COMMITMENTS

The Company vacated its former offices located at 7150 W. Erie St., Chandler AZ on August 31, 2006. Since such time the Company has been operating out of sub-leased offices located at 7650 E, Evans Rd., Suite C Scottsdale, AZ. The Company expects to continue to occupy such sub-leased space until it has located suitable alternate offices to relocate into. The Company does not currently have any expense associated with its sub-lease.

Note 9. GOING CONCERN

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has incurred net losses since inception with an accumulated deficit of $11,934,879 as of September 30, 2006. The Company will probably not generate meaningful revenues in the foreseeable future. The Company has a working capital deficit of $1,870,366 as of September 30, 2006. These factors, among others, raise substantial doubt about the Company's ability to continue as a going concern.

Listed below are some of the other factors that contribute to the Company's assumed inability to continue as a going concern. Also described are management's plans for the future of the Company.

Company's Challenges

The Company has a substantial deficit in retained earnings from losses from prior years. Its subsidiary, Envirotech has not been able to generate enough sales to cover annual expenses and has survived only by raising private placement funds. The funds currently available to the Company are inadequate to fully implement the business plan of the Company. Until the Company has achieved a sales level sufficient to break even, it will not be self-sustaining or be competitive in the areas in which it intends to operate. The Company will require additional funding for continued operations, and will therefore be dependent upon its ability to raise additional funds through bank borrowings, equity or debt financing, or asset sales. The Company expects to need to access the public and private equity or debt markets periodically to obtain the funds needed to support operations and continued growth. There is no assurance that the Company will be able to obtain additional funding when needed, or that such funding, if available, can be obtained on terms acceptable to the Company. If the Company requires, but is unable to obtain, additional financing in the future on acceptable terms, or at all, it will not be able to continue its business strategy, respond to changing business or economic conditions, withstand adverse operating results or compete effectively. If the Company cannot obtain needed funds, the Company may be forced to curtail or cease its activities. If additional shares are issued to obtain financing, current shareholders may suffer a dilutive effect on their percentage of stock ownership in the Company and this dilutive effect may be substantial. The Company has no commitments or plans for any additional funding at the present time. Insufficient financial resources may require the Company to delay or eliminate all or some of its development, marketing and sales plans, which could have a material adverse effect on the Company's business, financial condition and results of operations. There is no certainty that the expenditures to be made by the Company will result in a profitable business.

Management's Plans

The Company has expended considerable efforts in working with its contract manufacturer, Jabil Circuit, Inc., in order to begin the production of the *FORTIS*™ line of products. The Company expects that the first *FORTIS*™ units will be produced in the fourth quarter of 2006 with sales and delivery to also commence during such period. Despite commencing production, the Company expects that it may take up to one year for the production design and processes to stabilize. The Company has continued to focus development efforts on the commercialization of its patent pending

Paradigm™ technology. To date the Company has not been successful in developing a cost effective means to commercialize the technology into a consumer product line. The Company is currently negotiating with a critical supplier to jointly complete the engineering and commercialization process and then subsequently engage in engineering for manufacturing phase

The Company has developed a sales and distribution network in the United States and beyond. All of the Company's products are sold through wholesale distribution utilizing manufacturer's representatives. As of September 30, 2006, we have appointed a total of 17 manufacturer representatives covering a total of 28 States. The Company is currently negotiating for the appointment of additional representatives in other US States, as well as Canada and Mexico.

Note 9. GOING CONCERN - continued

Access to capital remains one of the most pressing considerations for the Company. The Company is negotiating with several broker-dealers with a view to completing further private placements to fund our business strategy, but to date the Company has not yet concluded any such arrangement. The Company's business strategy requires it to raise in excess of $3 million over the next 12 month period in order to fully execute its business plan. Management believes that, in order to properly exploit the introduction of both the *FORTIS*™ and *Paradigm*™ technologies, it will be necessary to be positioned not only as a quality supplier of products, but also able to supply a sufficient volume of product to meet wholesale demand. Relative to the wholesale market, there is a very high expectation that product be available in a timely fashion when ordered. In order to meet this expectation we must be capable of not only producing our products in sufficient volume, but holding quantities of product in inventory as well.

Note 10. PENDING LITIGATION

Distributor Suit. Prior to the acquisition of Envirotech, by the Company, Envirotech was the defendant in a lawsuit filed by a former distributor alleging a breach of a Distributor Agreement entered into with Envirotech in May, 1998. On August 13, 2003, Envirotech entered into a Settlement Agreement and Release pursuant to which Envirotech agreed to pay the distributor the sum of $520,500 in installments over a period of ten years. The obligations under this Settlement Agreement are secured by a Security Agreement covering all assets of Envirotech except its intellectual properties, as defined therein, subordinated, however, to a first lien on all assets of Envirotech, tangible and intangible, granted to the Senior Secured Creditor in 2001 and 2002 by Envirotech to secure two promissory notes given in satisfaction of legal fees. As part of the settlement, Envirotech granted the distributor a Stipulated Judgment which was not to be filed of record so long as no default existed. On May 3, 2004, the distributor claimed a breach and filed the Stipulated Judgment. Management believes no default existed to warrant the filing of the judgment. With the filing of the Bankruptcy Petition by Envirotech (see below), this action was stayed. However, with the dismissal of the Chapter 11 Proceedings on February 28, 2006, this judgment is once again a claim against the assets of Envirotech, subject, however, to the claims and rights of the Senior Secured Creditor.

Seitz Suit. In 2002, Envirotech was named as a Defendant in a law suit filed in the U.S. District Court for the Southern District of Texas, Houston, Texas (Civil Action No. H-02-4782, David Seitz and Microtherm, Inc., vs. Envirotech Systems Worldwide, Inc., and Envirotech of Texas, Inc. (the "Seitz Suit"). The Company is not affiliated with Envirotech of Texas, Inc. The suit alleges that Envirotech has infringed upon patent rights of others and seeks damages and an order to cease and desist. Management believes the suit is without merit. The suit was stayed pending the disposition of the Chapter 11 Bankruptcy Petition filed by Envirotech in August 2004. On September 30, 2005, however, the Bankruptcy Court allowed the plaintiff to re-open the Seitz Suit and he has done so. The suit is in the discovery stage and the Company is vigorously engaged in the process. On December 5, 2005, the Houston Court issued an injunction against Envirotech and its affiliated entities, including Skye, enjoining them from further marketing, advertising or offering for sale, or accepting any orders for (i) the Envirotech ESI 2000 heater, (ii) any other heater, regardless of its model, using parts of the Model ESI 2000 heater, and (iii) any other heater, regardless of model number, utilizing in whole any part any technology embodied in the Model ESI 2000 heater. The Company does not consider this preliminary injunction detrimental to its ongoing business activities, as it had already discontinued production of the alleged offending product. Trial in the Seitz Suit has been scheduled for February 2007. At a hearing on May 18, 2006, the Court directed that discovery be expanded to include the technology and products of Skye, including, specifically the *FORTIS*™ and *Paradigm*™ technologies. Envirotech and Skye intend to aggressively pursue this litigation to conclusion. On July 26, 2006 Envirotech retained the Dallas, TX firm Hemingway, Hansen, LLP to continue the defense and prosecution of this litigation. Envirotech continues to aggressively defend the Seitz suit.

Unpaid Legal Fees. Subsequent to December 31, 2003, Envirotech has been named in five separate lawsuits for unpaid legal and consulting fees totaling $280,000. These include the Myers and Jenkins Suit and the Sensor Technologies Suit discussed below. On May 3, 2004, Envirotech settled one of these suits claiming fees of $112,500. In connection with that settlement, Envirotech reimbursed the plaintiff for alleged out-of-pocket expenses and the Company issued 10,000 shares of common stock, restricted under SEC Rule 144, to the plaintiff on the basis of a loan from the Company to Envirotech. The settlement, and any settlements of the other suits, will be reflected as a charge in the year of the settlement. In two of the other three suits judgments have been granted in the aggregate amount of approximately $155,500, both of which were stayed by the bankruptcy filing discussed above. The fourth suit is on behalf of a law firm that served as a contract arbitrator in Envirotech's dispute with the Distributor noted above. With the dismissal of the Chapter 11 proceedings, the Company has received notice from the plaintiff that it intends to resume the suit, which seeks approximately $3,500 in fees.

Myers and Jenkins Suit. On May 24, 2006, Envirotech was served with a Motion for Entry of Default in connection with an action filed in Arizona Superior Court, case number CV-2006-003671 by Envirotech's prior legal counsel, Myers and Jenkins. The motion seeks judgment for the payment of the principal sum of $103,830, together with interest and costs. Envirotech has not defended the action.

Note 10. PENDING LITIGATION - continued

Sensor Technologies Suit. On May 24, 2006, Envirotech was served with an Application for Entry of Default in connection with an action filed in the Arizona Superior Court, case number CV-2006-0060632, by Sensor Technologies & Systems, Inc., an engineering firm that provided engineering consulting services in connection with Envirotech's ESI-2000 product. The application seeks judgment for the payment of $72,391, together with interest and costs. Envirotech has not defended the action.

Bankruptcy Proceedings. On August 6, 2004, Envirotech filed a Voluntary Petition for protection under Chapter 11 of the United States Bankruptcy Code in Phoenix, Arizona. The filing of this Petition with the Bankruptcy Court stayed all existing litigation, judgments and efforts to collect on the judgments. Envirotech was acquired by the Company in November 2003 in a stock-for-stock transaction and has been held and operated by the Company as an operating subsidiary. With the exception of a guarantee to one critical supplier in the current amount of approximately $42,500, Skye has not assumed any liability for the obligations of Envirotech. As of the date of the filing of the Chapter 11 Bankruptcy Petition, Envirotech had liabilities of approximately $1.6 million. Several creditors, not related to the supply of parts or the assembly of products, have obtained judgments against Envirotech and an action was pending in the U.S. District Court, Southern District of Texas, alleging patent infringement (see above). All claims of creditors, including the above-mentioned judgments, and efforts to collect same, together with the litigation pending in the U.S. District Court in Houston, were stayed during the pendency of the Bankruptcy Proceedings. Envirotech filed a Disclosure Statement and Plan of Reorganization on November 7, 2004 and the Court approved its request to submit the plan to the creditors for approval. The Plan, however, did not receive approval of the Court and Envirotech subsequently filed a Motion to Dismiss the Chapter 11 proceedings which was granted, with prejudice, on February 28, 2006. As a result of this dismissal, all claims and judgments of creditors of Envirotech may be renewed.

Shareholder Inspection Claim. In April 2006 a shareholder purporting to have obtained consent from at least 15% of the Company's shareholders filed a lawsuit in the United States District Court for the District of Nevada (Case No. 2:06-CV-0541-RLH-GWF) seeking inspection of the Company's books and records pursuant to Nevada corporate law. The Court denied plaintiff's initial request. The Company has asserted several counterclaims against the plaintiff for tortious conduct and for abuse of the legal process in connection with the lawsuit. The matter is currently pending.

Shareholder Derivative Action. In May 2006 a small group of dissident shareholders (including the plaintiff from the Shareholder Inspection Claim) filed a lawsuit in the United States District Court for the District of Arizona (Case No. CV06-1291-PHX-ROS) as a derivative action seeking injunctive and declaratory relief. The Company was named as a nominal defendant and there are no claims for monetary damages against the Company. The primary claims involve the prior issuance of the Company's common stock to former consultants to the Company, as well as prior issuances of stock to certain members of current management. Among other things the plaintiffs seek to prevent these individuals from using their stock and related voting rights to solicit proxies and notice shareholder meetings, and have demanded that they return the shares to the Company. The parties have entered into a "standstill" arrangement in which the parties agreed to refrain from using their stock and voting rights in connection with proxy solicitations, shareholder consents, and the noticing of special shareholder meetings. The matter is currently pending. In addition to the foregoing claims, three of the defendants have demanded that the Company defend and indemnify them from the plaintiffs' claims. The Company is currently contemplating filing counter-claims against certain of the plaintiffs in the action.

Delisting. Because the Company has been unable to file this report on a timely basis, including the grace period permitted by the NASD Over the Counter Bulletin Board ("OTCBB"), it has been delisted from the OTCBB. As a result, the Company's securities now trade on the pink sheets. There is no assurance that the Company will be admitted to trade again on the OTCBB. Due to past delinquencies in its filings, the Company may be restricted from applying for listing on the OTCBB for at least a year.

Berry-Shino Claim. The Company has on several occasions during the past three years utilized the services of Berry-Shino Securities, Inc., Scottsdale, Arizona, in raising various forms of financing to further its business plan and operations. In the course of each of these engagements, the Company has paid Berry-Shino various fees and expenses and has issued a certain number of shares of its Common Stock to Berry-Shino. The Company has recently received correspondence from Berry-Shino stating that it believes it is entitled to be issued an additional 456,500 shares of Common Stock as additional consideration for its services. The Company is currently reviewing of validity of the entitlement.

Note 11. COMMON STOCK TO BE GRANTED

On December 24, 2004 the Company issued 2,250,000 shares of common stock for $112,500 in anticipation of executing various consulting agreements for services to be performed in 2005. This transaction was recorded in the 2004 financial statements as a prepaid expense and subsequently recorded as an operating expense in the 2005 financial statements.

Note 12. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures

Management, with the participation of our Chief Executive Officer and the Chief Financial Officer, carried out an evaluation of the effectiveness of our "disclosure controls and procedures" (as defined in the Exchange Act, Rules 13a-15(e) and 15-d-15(e)) as of the end of each of the periods covered by this report (the "Evaluation Date"). Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2004, our disclosure controls and procedures were ineffective to ensure that the information we were required to disclose in reports that we file or submit under the Securities and Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. More specifically, the company identified a material weakness due to a lack of sufficient personnel with appropriate knowledge in U.S. GAAP and lack of sufficient analysis and documentation of the application of U.S. GAAP to transactions, including but not limited to equity transactions. During the nine months ended September 30, 2006, and the year ended December 31, 2005, there was no change in our internal control over financial reporting identified in connection with the evaluation that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Management used the framework of conducting an extensive review of existing documentation and transactions to make that evaluation. As of December 31, 2004, the Company had a deficiency in internal controls over the application of current US GAAP principles. Specifically, an effective review of the Balance Sheet was not performed. As a result of the ineffective review, errors in the year-end 2004 were not detected prior to the issuance of the annual 2004 consolidated financial statements. This control deficiency resulted in the restatement of our annual 2004 consolidated financial statements as set forth in Form 10-KSB/A filed June 14, 2006. Management has concluded that this control deficiency constituted a material weakness that continued throughout 2005.

There were changes in our internal controls implemented during the first quarter of 2006, including, specifically, a process to review the balance sheet of the company by persons with significant experience with US GAAP principles. Additionally, internal controls were adopted to separate accounting tasks within the company so as to ensure the separation of duties between those persons who approve and issue payment from those persons who are responsible to record and reconcile such transactions within the Company's accounting system. Such internal controls were implemented during the first quarter period ending September 30, 2006, and, accordingly, as of the end of the first quarter 2006, management found the internal control over financial reporting to be effective, with no material weaknesses. There were no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

The Company's management is reviewing the Company's internal controls over financial reporting to determine the most suitable recognized control framework. The Company will give great weight and deference to the product of the discussions of the SEC's Advisory Committee on Smaller Public Companies (the "Advisory Committee") and the Committee of Sponsoring Organizations' task force entitled Implementing the COSO Control Framework in Smaller Businesses (the "Task Force"). Both the Advisory Committee and the Task Force are expected to provide practical, needed guidance regarding the applicability of Section 404 of the Sarbanes-Oxley Act to small business issuers. The Company's management intends to perform the evaluation required by Section 404 of the Sarbanes-Oxley Act at such time as the Company adopts a framework. For the same reason, the Company's independent registered public accounting firm has not issued an "attestation report" on the Company management's assessment of internal controls.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following is a discussion of the Company's financial condition and results of operations for the nine months ended September 30, 2006 and September 30, 2005. The following discussion may be understood more fully by reference to the financial statements, notes to the financial statements, and in the Company's Annual Report on Form 10-KSB filed on July 3, 2006.

Forward-Looking Statements

This report contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical fact, are "forward-looking statements" for purposes of federal and state securities laws, including statements regarding, among other items, the Company's business strategies, continued growth in the Company's markets, projections, and anticipated trends in the Company's business and the industry in which it operates. Forward-looking statements generally can be identified by phrases such as the Company or its management "believes," "expects," "anticipates," "foresees," "forecasts," "estimates" or other words or phrases of si import. Similarly, statements in this report describe the Company's business strategy, outlook, objectives, plans, intentions or goals also are forward-looking statements. Although we believe that the expectations reflected in any of our forward-looking statements are reasonable, actual results could differ materially from those projected or assumed in any of our forward-looking statements. Our future financial condition and results of operations, as well as any forward-looking statements, are subject to change and subject to inherent risks and uncertainties. The factors impacting these risks and uncertainties include, but are not limited to: the substantial losses the Company has incurred to date; demand for and market acceptance of new products; successful development of new products; the timing of new product introductions and product quality; the Company's ability to anticipate trends and develop products for which there will be market demand; the availability of manufacturing capacity; pricing pressures and other competitive factors; changes in product mix; product obsolescence; the ability of our customers to manage inventory; the ability to develop and implement new technologies and to obtain protection for the related intellectual property; the uncertainties of litigation and the demands it may place on the time and attention of company management, general economic conditions and conditions in the markets addressed by the Company; as well as other risks and uncertainties, including those detailed from time to time in our other Securities and Exchange Commission filings. The forward-looking statements are made only as of the date hereof. The Company does not undertake any obligation to update or revise the forward-looking statements, whether as a result of new information, future events or otherwise.

For a detailed description of these and other factors that could cause actual results to differ materially from those expressed in any forward-looking statement, please see "Factors That May Affect Our Results of Operation" in this document.

Throughout this Form 10-QSB, references to "we", "our", "us", "the Company", and similar terms refer to SKYE Internationa Inc. and its 100% owned Envirotech Systems Worldwide Inc., Valeo Industries Inc. and ION Tankless Inc.

Business Development

Skye International, Inc., a Nevada corporation ("Skye"), was originally organized on November 23, 1993 as Amexan, Inc. The name was changed on June 1, 1998 to Nostalgia Motorcars, Inc. Prior to the name change, Amexan was an inactive company from the date of incorporation. On June 11, 2002, the name was changed to Elution Technologies, Inc. On June 4, 2003, in connection with the pending acquisition of Envirotech Systems Worldwide, Inc., it changed its name to Tankless Systems Worldwide, Inc. On October 21, 2005, it changed its name to Skye International, Inc., as part of its overall plan to create a brand name for its revised business plan and expanded product lines.

Skye has three subsidiary corporations, all wholly-owned:

- Envirotech Systems Worldwide, Inc., an Arizona corporation ("Envirotech");
- ION Tankless, Inc., an Arizona corporation ("ION"); and
- Valeo Industries, Inc., a Nevada corporation ("Valeo").

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

On November 7, 2003, Skye acquired Envirotech in a one-for-one share exchange. On that date, Skye issued 8,366,778 shares of its common stock to the Envirotech shareholders. Subsequently, in December 2004, 2,075,000 of those shares were returned to Skye by the former principals of Envirotech and cancelled, and the number of Skye's issued and outstanding shares was correspondingly reduced, pursuant to a settlement of litigation brought by Skye.

In January 2004, Skye formed ION to perform research, development and marketing of new heating technologies. In January 2005, it created Valeo to license ION technologies and to manufacture products using those technologies.

The business office of the Company is located at 7150 West Erie Street, Chandler, Arizona 85226. The Company's fiscal year ends on December 31.

Envirotech

Envirotech was formed December 9, 1998 and has a limited history of operations. The initial period of its existence involved research and development of a line of electronic, tankless water heaters. The first sales of its products occurred in calendar year 2000. The United States Patent and Trademark Office granted a patent to Envirotech for its Modular Electronic Tankless Water Heater (ETWH) (Patent No. US 6,389,226). Proprietary rights to the design of the ETWH were Envirotech's principal assets. The existing patent and intellectual property of Envirotech were assigned as collateral security for debts owed by Envirotech for legal services arising prior to the acquisition of Envirotech by Skye. In 2002, Envirotech was named as a defendant in a patent infringement suit alleging that Envirotech's product infringed upon a patent owned by David Seitz and Microtherm, Inc. (the "Seitz Suit"), discussed more fully in "Item 1 of Part II. Legal Proceedings, Seitz Suit" below.

As a result of several lawsuits and adverse judgments obtained by third party creditors against Envirotech, Envirotech filed for relief under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Arizona, on August 6, 2004 (the "Chapter 11 Proceedings"). The Seitz Suit was initially stayed pending the disposition of the Chapter 11 Proceedings, but on September 30, 2005, the Court allowed the plaintiff to re-open the suit. On December 5, 2005, the Court issued a preliminary injunction against Envirotech and its affiliated entities, including Skye, enjoining them from further marketing, advertising or offering for sale, or accepting any orders for (i) the Envirotech ESI 2000 heater, (ii) any other heater, regardless of its model, using parts of the Model ESI 2000 heater, and (iii) any other heater, regardless of model number, utilizing in whole any part (sic) any technology embodied in the Model ESI 2000 heater. The Company does not consider this injunction detrimental to its ongoing business activities, as it had already discontinued production of the alleged offending product.

Envirotech has not been engaged in active business since March 2005 subsequent also to the granting of the preliminary injunction enjoining the Company from, among other things, engaging in the making , using or selling of the ESI-2000 product. Management is currently preparing a plan of reorganization for presentation to the Company's Board of Directors that will set forth a plan to rehabilitate Envirotech and bring it back into active business. Envirotech's prior plan of reorganization, filed in its Chapter 11 bankruptcy proceedings more fully describe elsewhere in this report, envisioned Envirotech becoming a manufacturer of products for sale and distribution exclusively by Skye International, Inc. As Skye has entered into Manufacturing Services Agreement with Jabil Circuit Inc. for the manufacture of its FORTIS™ line of products, such opportunity is not available to Envirotech at this time. Management expects that Envirotech will likely engage in the sale and distribution of private label branded products produced by or for the Company. There can be no certainty that Envirotech will succeed in rehabilitating its business, or that is rehabilitated, that such business will be profitable or sustainable.

ION

Recognizing the dynamic state of the industry and the need for an improved product line, Skye made a decision in early 2004 to pursue its own research and development for new water heating technologies, out of which it could develop a completely new line of products. In January 2004, Skye formed a wholly-owned, non-operating subsidiary, ION Tankless, Inc., through which it has since conducted research and development of alternative heating technologies and products. Skye has invested heavily in a research and development program to develop new and innovative methods of heating water, which has resulted in the filing of several applications for patents with the U.S. Patent and Trademark Office involving dozens of claims. In November 2005, the Company received notice from the USPTO that the first such patent request had been allowed, which was issued on May 16, 2006 as US Patent No. 7,046,922. On August 8, 2006, the USPTO issued a method patent (No, 7,088,915) to ION on the modular tankless water heater technology, the core technology of the *FORTIS*™ tankless water heater. While there can be no assurances that the other patents sought will be granted or that the technology will be considered proprietary to Skye or ION, the Company believes that its applications are meritorious and will be granted at least in part.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

With the exception of one patent held by Envirotech (discussed above), ION holds all patents and intellectual property of the Company and it may license that property to an affiliated or third party entity for manufacturing and distribution. The assets of ION are included in the consolidated financial statements for the Company.

Valeo

Valeo was formed by Skye in January 2005 as a wholly-owned operating subsidiary. Valeo will license technology from ION and contract for the manufacture of several lines of water heating products, as well as other products embodying ION patented technology. Valeo has begun to oversee the production and distribution of its FORTIS™ product line, which incorporate innovative technology. FORTIS™ together with the pending Paradigm™ products are expected to serve as the foundation for the future growth of the Company.

Company Headquarters and Capitalization

The business office of the Company is currently located 7650 E. Evans Road, Suite C Scottsdale, AZ 85260 where it occupies sub-leased offices on a temporary no-cost basis pending its relocation to new premises later in the fourth quarter 2006 or early 2007. The Company vacated its former offices on August 31, 2006 and on October 10, 2006 engaged in a purchase and re-sale transaction whereby the Company bought then sold its former offices for net proceeds to the Company of $75,000.

As of September 30, 2006 there were approximately 21,622,243 shares of common stock outstanding and the Company had approximately 259 shareholders of record on that date. As of June 5, 2006 the shares of common stock of the Company are traded on the OTC Pink Sheets under the ticker symbol SKYY. Prior to such date the shares of common stock of the Company were traded on the National Association of Securities Dealers OTC Bulletin Board under the symbols: SKYY, SKYYE and TSYW.

Our Business and Prospects

The Company is in the business of designing, developing, manufacturing and marketing consumer lifestyle products, including, initially, several models of an electronic, tankless water heater. The FORTIS™ water heater is small, easy to install and supplies endless amounts of heated water with energy savings. The unit is a microprocessor controlled electric water heater contained in a compact unit, eliminating the space demands of conventional water heaters. It incorporates automatic, precise temperature controls. It saves energy, space, and water and is suitable to all areas of the U.S. Prior to the development of new technology, which is discussed later in this section, the Company was dependent upon the operations of Envirotech for its revenue. Beginning in 2004 and continuing throughout 2005, production and sales have steadily declined while the Company embarked on an aggressive research and development program to development new technologies and products for the tankless water heater and consumer lifestyle appliance market. In January 2004, Skye formed ION through which it has since conducted research and development on alternative heating technologies and other lifestyle products. Skye's R&D program has developed new and innovative methods of heating water that has resulted in the filing of applications for several patents involving dozens of claims. The first product that resulted from Skye's R&D program will be ready production during the fourth quarter of 2006.

The Company has ceased to manufacture the ESI-2000 water heater line of products developed by Envirotech. Our *FORTIS*™ branded product line, which is expected to be delivered to the market during the fourth quarter of 2006, is the result of the R&D program discussed above. Skye's *FORTIS*™ series is scalable from 40 amps to 120 amps of heating power and is a microprocessor-controlled electric water heater contained in a compact unit, which is designed to operate in most any climate. Skye's new and innovative way of heating water for home and business is contained in a small and easy to install unit. Not only does it supply virtually endless amounts of heated water, but it also offers

energy savings as well. The *FORTIS*™ series saves energy, space, water, and is suitable for most areas of the world. Skye uses advanced technology and high quality parts in the construction of the *FORTIS*™ series, which will provide reliability and longevity. Electricity is only used when heated water is required; therefore the cost of heating water is reduced by 20% - 40%. Because the *FORTIS*™ series is compact it can be easily installed close to where hot water is being used and is thus ideal for hotels, motels, apartments, and homes where space is at a premium. Skye believes its *FORTIS*™ series heaters offers one of the most efficient solutions for on-demand heated water available today.

The Company has expended considerable efforts in working with its contract manufacturer, Jabil Circuit, Inc., in order to begin the production of the *FORTIS*™ line of products. The Company expects that the first *FORTIS*™ units will be produced in the fourth quarter of 2006, with sales and delivery to also commence during such period or early in 2007. Despite commencing production, the Company expects that it may take up to one year for the production design and processes to stabilize. Once the production and processes have stabilized the Company anticipates that it will move production of the *FORTIS*™ to a lower cost center in Mexico or China to improve gross margins.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

The Company has continued to focus development efforts on the commercialization of its patent pending *Paradigm*™ technology. Although we are enthusiastic about the functionality that the *Paradigm*™ technology offers, we have not been successful in developing a cost effective means to commercialize the technology into a consumer product line. We are currently in negotiations with a critical supplier to jointly complete the engineering and commercialization process, and then subsequently engage in engineering for manufacturing phase. In the event we are successful in concluding a strategic relationship in this regard the Company expects that it will have first delivery of product utilizing the *Paradigm*™ technology by early to mid-2007. As we have not yet completed our negotiations there can be no assurance that we will finalize any such agreement, or if we do finalize the agreement, that we will be successful in the completion of a commercialized product for distribution within a reasonable period of time.

We have developed a sales and distribution network in the United States and beyond. We have chosen to sell our products through wholesale distribution utilizing manufacturer's representatives. As of September 30, 2006, we have appointed a total of 17 manufacturer representatives covering a total of 28 States. We are currently negotiating for the appointment of additional representatives in other US States, as well as Canada and Mexico. We expect that we will complete the appointment of representatives in States across the United States by the mid-2007.

Access to capital remains one of the most pressing considerations for the Company. Although we were successful in concluding a $600,000 non-brokered private placement in April 2006 and a further $100,000 non-brokered private placement in the third quarter, such funds were not sufficient to provide adequate working capital to meet the needs of the Company. As such, the Company has been working to access additional funding likely by way of further private placements of equity and/or debt. We have commenced negotiations with several broker-dealers with a view to completing further private placements to fund our business strategy, but to date we have not yet concluded any such arrangement. Our business strategy will require us to raise in excess of $3 million over the next 12 month period in order to fully execute our current business plan. There can be no assurance that we will be able to raise such additional funding by way of either new debt or equity, and in the event we are unable to raise the funds necessary to fund our business plan it will be necessary to curtail such plans and this could have a detrimental impact on our business. Management believes that, in order to properly exploit the introduction of both the *FORTIS*™ and *Paradigm*™ technologies, it will be necessary that we be positioned not only as a quality supplier of products, but that we also be able to supply a sufficient volume of product to meet wholesale demand. We believe that, relative to the wholesale market, there is a very high expectation that product be available in a timely fashion when ordered. In order to meet this expectation we must be capable of not only producing our products in sufficient volume, but holding quantities of product in inventory as well. These things all require capital and we must be successful in our efforts to obtain this funding if we are to be successful in the wholesale sales and distribution channel.

Over the balance of the fourth quarter of 2006 we will continue to focus our efforts on producing the *FORTIS*™ product, obtaining regulatory approvals, and in getting such product into the market to be sold. We will continue to develop our markets and train installers and field service personnel in cooperation with our appointed manufacturer's representatives. This is no small task and it will require a significant effort on the part of our existing staff, as well as new staff that must be hired in order to provide sales and customer service to the field. We will also focus our efforts on completing the *Paradigm*™ technology and we are challenged by the opportunity to introduce this powerful technology to the US marketplace. While *Paradigm*™ will require a significant investment of time and capital in order to yield a line of marketable products, we are confident that products based on this technology will be amongst the most efficient and technologically advanced in the market. Many challenges remain and our staff is committed to the challenge.

Manufacturing

On February 15, 2006, Skye entered into a Manufacturing Services Agreement with NYSE Listed Jabil Circuit, Inc. ("Jabil") pursuant to which Jabil has agreed to manufacture certain components and to assemble Skye's FORTIS™ branded tankless water heater products as specified by Skye from time to time. The agreement has an effective date of January 30, 2006. Additionally, Skye is also actively negotiating with critical suppliers to qualify them to supply *Paradigm*™ components, as well as potentially expedite the earlier market availability of products utilizing the patent pending *Paradigm*™ technology.

Skye management believes that a strategic alliance for the product development and production of the Paradigm™ series of product is imminent and should be expected during the fourth quarter 2006 or early 2007.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Intellectual Property

In May 2002, Envirotech was granted a patent by the United States Patent Office for its Modular Electronic Tankless Water Heater (ETWH) (Patent No. US 6,389,226). The Founders of Envirotech and Steve Onder, and each of the contractors or consultants who have performed research and development services for and on behalf of Envirotech made written assignments to Envirotech of proprietary and intellectual property rights relating to the ETWH and that research and development, and have signed non-disclosure, non-competition agreements with Envirotech.

During the past two years, based on newly developed technology, ION has filed several applications for patents with the United States Patent and Trademark Office, and expects the products offered using this new technology to replace the products previously manufactured by Envirotech. All persons deemed inventors have executed written assignments to ION of proprietary and intellectual property rights relating to the inventions forming the basis of the various applications for patents and the attendant research and development. In November 2005, the Company received notice from the USPTO that the first such patent request has been allowed, which was issued on May 16, 2006 as US Patent No. 7,046,922. On August 8, 2006, the USPTO issued a method patent (No, 7,088,915) to ION on the modular tankless water heater technology, the core technology of the *FORTIS*™ tankless water heater. ION has further been notified that another patent has been allowed in connection with certain control technology used in connection with the FORTIS™ product line. Skye expects that such patent will be published in due course. While there can be no assurances that the other patents sought will be granted or that the technology will be considered proprietary to Skye or ION, the Company believes that its applications are meritorious and will be granted at least in part.

In addition to the applications of patents filed by the Company, Skye has also registered its name and graphics art logo with the U.S. Patent and Trademark Office. Effective protection may not be available for our service marks. Although we have registered our service marks in the United States and in certain countries in which we do business or expect to do business, we cannot assure you that we will be able to secure significant protection for these marks. Our competitors or others may adopt product or service names similar to "Skye", thereby impeding our ability to build brand identity and possibly leading to client confusion. Our inability to adequately protect the name "Skye" could adversely affect our business, but would not detract from the Company's proprietary ownership of its other intellectual property.

Research and Development

The Company conducts all of its research and development activities through ION. All employees, contractors and consultants engaged in the research and development process by ION were required to execute non-disclosure, non-competition agreements covering the subject, scope and work product of the program. The Company expended approximately $450,000 in 2005 and $285,000 in 2004 on research and development.

Dependence on Major Customer

Skye is just beginning the wholesale introduction of its products it has not developed a dependence upon any single customer or group of customers. By necessity, initial sales of Skye's products may be concentrated with certain distributors until a broader distribution network can be achieved. Skye will continue to monitor its sales and distribution activities closely to avoid any such reliance.

Costs of Environmental Compliance

Because Skye does not manufacture any of its products, it does not anticipate incurring material costs related to environmental compliance, which is the responsibility of the manufacturer.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Materials and Principal Suppliers.

Skye has retained Jabil Circuit, Inc. to manufacture its products, and, as such, is heavily dependent upon Jabil to perform satisfactorily so as to ensure the availability of product for sale. Jabil is required to buy components for Skye's products from the market at large, as well as an approved list of suppliers, including Siemens, AG (electrical components), Lake Monitors (flow sensors), Tru-Heat (heating elements), Hydro Aluminum (extruded heating chamber), and Arnold Bros. (stainless steel sheet metal and components). Although limited production experience has been obtained, Skye is satisfied that Jabil has the necessary experience to avoid supplier delivery problems. In order to avoid losses associated with lack of production components, Skye has worked closely with Jabil to identify suppliers that have traditionally performed well in addition to ensuring that multiple suppliers for most components are available. With the exception of certain proprietary components manufactured by Jabil, and the preferred vendors noted above, the balance of components are readily available from a variety of sources both domestically and internationally. Skye is satisfied that it and Jabil have adequately planned to avoid production disruption resulting from a breakdown in its supply chain.

Recent Developments

On May 16, 2006, the USPTO issued a design patent (No, 7,046,922) to ION on the modular tankless water heater, the core technology of the *FORTIS*™ tankless water heater.

On August 8, 2006, the USPTO issued a method patent (No, 7,088,915) to ION on the modular tankless water heater, the core technology of the *FORTIS*™ tankless water heater.

In October 2006 the USPTO advised ION that it has allowed ION's patent in connection with the control technology used in connection with the FORTIS™ product line. Upon the payment of regulatory publication fees to the USPTO, the Company expects that such patent will be published in due course.

The Company completed engineering on the *FORTIS*™ series of products in October 2005. Initial samples were produced in December 2005. On February 15, 2006, the Company entered into a Manufacturing Services Agreement with Jabil, Inc., pursuant to which Jabil will manufacture certain parts and assemble the Company's products. A copy of that agreement was filed with the Company's current report on Form 8-K dated February 23, 2006. Steps to commence production of the FORTIS™ product line began with Jabil in April 2006, and the first articles were produced by Jabil on or about November 10, 2006. The Company expects that it will continue to work with Jabil to raise the production levels of the FORTIS™ product over the ensuing months to come.

Other Activities

Between July 15, 2006 and September 30, 2006, the Company received $100,000 in bridge funding from five individuals from the placement of convertible bridge notes (the "Notes"). The Notes, and the shares to be issued in connection therewith, were not issued as of the date of this report but are expected to be issued in November 2006. The Company will issue 50,000 shares from treasury and 12% convertible notes entitling the holder to convert the principal and interest of such Notes into common stock at a 30% discount to the then prevailing 10-day moving average of the Company's common stock. The shares will be restricted pursuant to the provisions of Section 144 of the Securities Exchange Act of 1933. The securities were sold only to persons who met the Accredited Investor requirements. Additionally the Company issued shares to certain employees, consultants and professional advisers in lieu of cash payments during this period, all as more fully reported in the financial statements that form a part of this

report.

Results of Operations

Results of Operations for the Nine Months Ended September 30, 2006 and 2005 Compared.

The following table is a summary of our operations for the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

	For the Nine Months Ended Sept. 30, 2006	For the Nine Months Ended Sept. 30, 2005
Revenues	$ 16,457	$ 201,118
Cost of Sales	$ 17,982	$ 57,140
General and Administrative Expenses	$ 590,622	$ 830,177
Share-based compensation	$ 684,127	$ 305,638
Research and development	$ 26,928	$ 366,623
Total Operating Expenses	$ 1,834,871	$ 1,572,659
Net Income (Loss)	$ (1,879,533)	$ (1,428,681)

Revenues

For the nine months ended September 30:	2006	2005	**Increase/(decrease)** $	%
Revenue	$ 16,457	$ 201,118	$ (184,661)	(92%)

Revenues for the nine months ended September 30, 2006 were $16,457, compared to revenues of $201,118 in the nine months ended September 30, 2005. This resulted in a decrease in revenues of $184,661, from the same period ended September, 2005. The decrease in revenues is directly related to the cessation of sales of the Envirotech ESI-2000.

Cost of sales

For the nine months ended September 30:	2006	2005	**Increase/(decrease)** $	%
Cost of sales	$ 17,982	$ 57,140	$ (39,158)	(69%)

Cost of sales for the nine months ended September 30, 2006 was $ 17,982, a decrease of $ (39,158) from $57,140 for the same period ended September 30, 2005.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

General and Administrative expenses

For the nine months ended September 30:	2006	2005	**Increase/(decrease)** $	%
General & Administrative expenses	$ 590,622	$ 830,177	$ (334,454)	(29%)

General and administrative expenses were $590,622 for the nine months ended September 30, 2006 versus $830,177 for the nine months ended September 30, 2005, which resulted in a decrease of $334,454. The decrease in general and administrative expenses was primarily due to the Company's decrease in compensation to our consultants.

We anticipate an increase in the general and administrative expenses by the Company as we continue to add more operational and administrative personnel, legal and other professional assistance with our continued efforts to execute our business plan and market our products in the US. We anticipate this transition to create up front costs, as well as continuing costs for additional personnel.

Total Operating Expenses

For the nine months ended September 30:	2006	2005	**Increase/(decrease)** $	%
Total operating expenses	$ 1,834,871	$ 1,412,712	$422,159	30%

Overall operating expenses were $ 1,834,871for the nine months ended September 30, 2006 versus $1,412,712 for the nine months ended September 30, 2005, which resulted in an increase of $422,159. The increase is attributed to a substantial increase in legal and professional fees arising from the litigation discussed elsewhere in this Report and an increase in advertising and marketing expenses in preparation of the rollout of the new FORTIS™ product line and increased facilities costs.

Net Loss

For the nine months ended September 30:	2006	2005	**Increase/(decrease)** $
Net Profit (Loss)	$ (1,879,533)	$ (1,428,681)	$ 450,852

The net loss for the nine months ended September 30, 2006 was $1,879,533, versus a net loss of $1,428,681 for the nine months ended September 30, 2005. The increase in the net loss was primarily due to the increase in total operating expenses as mentioned above.

Liquidity and Capital Resources at September 30, 2006 and December 31, 2005.

The following table summarizes total assets, accumulated deficit and stockholders' equity.

	September 30, 2006	December 31, 2005

Total Assets	$	689,344	$	107,937
Accumulated Deficit	$	(11,944,046)	$	(10,064,513)
Stockholders' Equity (Deficit)	$	(2,627,416)	$	(2,335,342)
Working Capital (Deficit)	$	(2,801,235)	$	(2,411,601)

A critical component of our operating plan impacting our continued existence is the ability to obtain additional capital through equity and/or debt financing. Since inception, we have financed our cash flow requirements through issuances of common stock and cash generated from our operations. As we continue our activities, we may continue to experience net negative cash flows from operations, pending receipt of significant revenues.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

The Company expects that additional operating losses will occur until revenue is sufficient to offset the costs incurred for marketing, sales and product development. Until the Company has achieved a sales level sufficient to break even, it will not be self-sustaining or be competitive in the areas in which it intends to operate. The Company will require additional funds to complete the ramping up for production of the *FORTIS*™, and to fully implement its marketing plans and for continued operations. Additionally, the Company will also require further development funds in order to finalize a commercialized version of its consumer product utilizing ION's patent pending *Paradigm*™ technology. We anticipate obtaining additional financing to fund operations through common stock offerings, debt offerings and bank borrowings, to the extent available, or to obtain additional financing to the extent necessary to augment our working capital. In the event we cannot obtain the necessary capital to pursue our strategic plan, we may have to significantly curtail our operations. This would materially impact our ability to continue operations. There is no assurance that the Company will be able to obtain additional funding when needed, or that such funding, if available, can be obtained on terms acceptable to the Company.

As of September 30, 2006 the existing capital and anticipated funds from operations were not sufficient to sustain operations and expansion over the next twelve months. We anticipate substantial increases in our cash requirements; which will require additional capital generated from either the sale of common stock, the sale of preferred stock, or debt financing. No assurance can be made that such financing would be available, and if available it may take either the form of debt or equity. In either case, the financing will likely have a negative impact on our financial condition and our stockholders.

We anticipate that we will incur operating losses in the next twelve months. Our prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in their early stage of development. Such risks for us include, but are not limited to, an evolving and unpredictable business model and the management of growth. To address these risks, we must, among other things, expand our customer base, implement and successfully execute our business and marketing strategy, respond to competitive developments, and attract, retain and motivate qualified personnel. There can be no assurance that we will be successful in addressing such risks, and the failure to do so can have a material adverse effect on our business prospects, financial condition and results of operations.

Critical Accounting Policies

We have identified the following policies as critical to our business operations and the understanding of our results of operations. The preparation of these financial statements require us to make estimates and assumptions that effect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of our financial statements, and the reported amounts of revenue and expenses during the reporting period. There can be no assurance that actual results will not differ from those estimates. The effect of these policies on our business operations is discussed below where such policies affect our reported and expected financial results.

Revenue Recognition. Our revenue recognition policy is significant because our revenue is a key component of our results of operations. We recognize revenue when delivery of the product has occurred or services have been rendered, title has been transferred, the price is fixed and collectability is reasonably assured. Sales of goods are final with no right of return.

Warranty Costs. We warrant our products against manufacturing defects for a period of five years on electrical components and 10 years on other components. Once sales of our new products commence, we expect to make an accrual for warranty claims based on our sales.

Intangible Assets. We have intangible assets in the form of patents issued and pending. Our estimate of the remaining useful life of these assets and the amortization of these assets will affect our gain from operations. Since we do not have a method of quantifying the estimated number of units that may be sold we have elected to amortize these intangibles over a seven year period beginning in the first quarter of 2006.

Purchase Accounting. Our purchase accounting policy is to record any acquisitions in accordance with current accounting pronouncements and allocate the purchase price to the net assets. The Company evaluates the fair market values of tangible and intangible assets based on current market conditions, and financial and economic factors. Intangible assets are valued using several cash flow projection models and financial models to establish a baseline for their respective valuations. The Company's policy is to expense in-process research and development costs at acquisition.

Stock Options. We have a stock option plan under which options to purchase shares of our common stock may be granted to employees, consultants and directors at a price no less than the fair market value on the date of grant. We account for grants to employees in accordance with the provisions of APB No. 25, *Accounting for Stock Issued to Employees* ("APB No. 25").

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Under APB No. 25, compensation expense is based on the difference, if any, on the date of the grant between the fair value of our stock and the exercise price of the option and is recognized ratably over the vesting period of the option. Because our options must be granted with an exercise price equal to the quoted market value of our common stock at the date of grant, we recognize no stock compensation expense at the time of the grant in accordance with APB No. 25. On January 1, 2006 we adopted the fair value based method set forth in Statement of Financial Accounting Standards ("SFAS") No. 123, *Accounting for Stock-Based Compensation* ("SFAS No. 123"), we would recognize compensation expense based upon the fair value at the grant date for awards under the plans. The amount of compensation expense recognized using the fair value method requires us to exercise judgment and make assumptions relating to the factors that determine the fair value of our stock option grants. We account for equity instruments issued to non-employees in accordance with SFAS No. 123 and Emerging Issues Task Force Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services*.

Going Concern

The financial statements included in this filing have been prepared in conformity with generally accepted accounting principles that contemplate the continuance of us as a going concern. Our cash position may be inadequate to pay all of the costs associated with our operations. We intend to use borrowings and security sales to mitigate the effects of our cash position, however no assurance can be given that debt or equity financing, if and when required will be available. The financial statements do not include any adjustments relating to the recoverability and classification of recorded assets and classification of liabilities that might be necessary should we be unable to continue existence.

Off-Balance Sheet Arrangements.

The Company's subsidiary Envirotech granted a security interest in all of its tangible and intangible assets in 2001 and 2002, including its intellectual property (the "Envirotech Security"), to its law firm Jennings, Strouss and Salmon (the "Senior Secured Creditor"). On August 6, 2004 Envirotech was granted a voluntary petition for Chapter 11 bankruptcy proceedings. During the pendency of such Chapter 11 proceedings, the Company unsuccessfully attempted to reach a settlement with the Senior Secured Creditor to acquire the Envirotech Security. Fearful that the Senior Secured Creditor might sell the Envirotech Security to an adverse party, a shareholder of the Company, Sundance Financial Corporation ("Sundance"), successfully negotiated and concluded the purchase of the Envirotech Security from the Senior Secured Creditor. The Company agreed to purchase the Envirotech Security from Sundance and the Company made a series of payments to Sundance totaling $83,000 between June 2005 and November 2005. On June 1, 2006 the Company negotiated and concluded a definitive agreement to reacquire the Envirotech Security by way of the payment of $2,000 to Sundance, the amount being representative of the fees and expenses incurred by Sundance to acquire the Envirotech Security. The Company, through its wholly owned subsidiary Ion Tankless, Inc., now owns the Envirotech Security.

We have no other off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

FACTORS THAT MAY AFFECT OUR RESULTS OF OPERATIONS

Risks Relating To Our Business and Our Marketplace

History of Operations and Dependence on Future Development.

Skye International, Inc. ("Skye") was organized November 23, 1993 and existed as a development stage company until its acquisition of Envirotech Systems Worldwide, Inc. ("Envirotech"), on November 7, 2003. Envirotech was organized December 9, 1998. Envirotech has a limited history of operations. The first sales of its products occurred in calendar year 2000. Subsequent to its formation, the Company has generated approximately $4,043,572 in losses through November 7, 2003, the date of acquisition by Skye. However, $489,658 of this loss occurring in 2003 was attributable to a re-purchase of a distributorship in a major market where Envirotech believed the distributor was not performing as well as the market would justify. The Company on an operating and consolidated basis has continued to incur losses from operations since the date of acquisition. The Company has yet to generate significant revenue from sales of product, and has not generated any revenues yet from the sale of the products from its research and development initiatives.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Prior to the development of its new FORTIS™ and Paradigm™ technologies and product lines, the Company was dependent upon the operations of Envirotech for its revenue. The Company expects that additional operating losses will occur until revenue is sufficient to offset the level of costs to be incurred for marketing, sales and product development. The Company is subject to all of the risks inherent in establishing a new business enterprise. Since the Company has a very limited record of operations, there can be no assurance that its business plan will be successful. The potential for success of the Company must be considered in light of the problems, expenses, difficulties, complications and delays frequently encountered with the start-up of new businesses and the competitive environment in which the Company will operate. A prospective investor should be aware that if the Company is not successful in achieving its goals and achieving profitability, any money invested in the Company might be lost. The Company's management team believes that its potential near-term success depends on the Company's success in completing product development, then in manufacturing, marketing and selling its products and in developing new products.

The Company has not had sufficient funds to date with which to fully implement its marketing plans. We cannot be certain that our business strategy will be successful because these strategies are unproven. There can be no assurance that the Company will generate sufficient revenues to the extent necessary to render it profitable. Many of Envirotech's activities during its early years have involved research and development concerning tankless water heaters. This has required the investment of substantial capital with no period in which to realize the benefits of such activities. There can be no assurance that Management has accurately forecast the Company's performance or that planned operations will lead to profits in the future. In addition, outside of product know-how, intellectual property and contractual relationships, the Company has only limited hard assets. If the Company is unable to develop marketable products, obtain customers and/or generate sufficient revenues so that it can profitably operate, the Company's business will not succeed. We will be particularly susceptible to the risks and uncertainties described in these risk factors and will be more likely to incur the expenses associated with addressing them. Our business and prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in early stages of development. These risks are particularly severe among companies in new and rapidly evolving markets such as those that we expect will serve as our target markets. Accordingly, purchasers of Units will bear the risk of loss of their entire investment in the Company.

Awaiting SEC Response to Amended Financial Filings for the Year Ended December 31, 2004

On September 15, 2005 the Company received a letter from the U.S. Securities and Exchange Commission ("SEC") relating to information provided by the Company in its financial filings for the year ended December 31, 2004 (the "2004 10KSB"), as well as the interim quarterly filings preceding such date. The SEC has requested, among other things, that we clarify and restate certain disclosures in the 2004 10KSB and possibly some related quarterly disclosures on form 10QSB during such year. On June 14, 2006 the Company filed an amended and restated 10KSB/A for the year ended December 31, 2004, and, to date, we have not received any comments thereon from the SEC. The SEC contacted the Company in September 2006 and requested that the Company provide a detailed written submission embodying all of the steps taken in connection with the restatement of the 2004 financials as filed on the Company's form 10KSB/A for the period ended December 31, 2004 as filed. The Company has not yet provided such response to the SEC.

Company's Shares Quoted on the Pink Sheets

Because the Company did not file its 2005 10KSB within such grace period it did not maintain its quotation on the NASD OTC Bulletin Board. On June 5, 2006 the Company's shares began trading on the largely unregulated Pink Sheet market. Although the Company has committed to rectifying its regulatory compliance so as to qualify for quotation on the OTC Bulleting Board there can be no assurance that the Company's shares will resume quotation on

the OTC Bulletin Board, or if they resume, that such quotation can be maintained.

Limited Capital and Need for Additional Financing.

Until the Company has achieved a sales level sufficient to break even, it will not be self-sustaining or be competitive in the areas in which it intends to operate. The Company will require additional funding for continued operations, and will therefore be dependent upon its ability to raise additional funds through bank borrowings, equity or debt financing, or asset sales. We expect to need to access the public and private equity or debt markets periodically to obtain the funds we need to support our operations and continued growth. There is no assurance that the Company will be able to obtain additional funding when needed, or that such funding, if available, can be obtained on terms acceptable to the Company. If we require, but are unable to obtain, additional financing in the future on acceptable terms, or at all, we will not be able to continue our business strategy, respond to changing business or economic conditions, withstand adverse operating results or compete effectively. If the Company cannot obtain needed funds, the Company may be forced to curtail or cease its activities. If additional shares were issued to obtain financing, current shareholders may suffer a dilutive effect on their percentage of stock ownership in the Company and this dilutive effect may be substantial. The Company has no commitments or plans for any additional funding at the present time.

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Insufficient financial resources may require the Company to delay or eliminate all or some of its development, marketing and sales plans, which could have a material adverse effect on the Company's business, financial condition and results of operations. There is no certainty that the expenditures to be made by the Company will result in a profitable business.

On-Going Litigation

The Company is currently engaged in a significant amount of litigation (See Part II item No. 1 “Legal Proceedings” below for further details). The cost of this litigation is significant and it is expected that associated costs will continue to be incurred until such matters are concluded. The Company expects that such continuing costs will be significant if all matters proceed to trial. Although management is attempting to settle or otherwise expeditiously resolve such matters, there can be no assurance that such early resolution can be achieved, and, if not expeditiously resolved, that substantial costs and a diversion of our management’s attention and resources will likely occur and this will hurt our business and will likely lead to the need to raise additional capital thus resulting in a dilutive effect to shareholders..

Lack of Diversification.

The size of the Company makes it unlikely that the Company will be able to commit its funds to diversify the business until it has a proven track record, and the Company may not be able to achieve the same level of diversification as larger entities engaged in this type of business.

Competition.

The water heater market is mature, highly concentrated and highly competitive. Steep discounts and rebates as high as 20% or more are standard. Some contractors are loyal to favorite brands and on occasion resistant to tankless systems, and the plumbing industry is on occasion also resistant to tankless systems. Pricing competition has increased in recent years, and major manufacturers are increasing their expenditures on research and development. Conventional water heaters (tank heaters) are slightly more efficient and reliable than conventional tank water heaters in previous years. There are several companies around the world who manufacture water heaters, conventional and tankless. It is reasonable to expect to encounter intense competition in all aspects of our business and that such competition would increase. Substantial competition could emerge at any time. Many of our competitors and potential competitors have longer operating histories and significantly greater experience, resources, and managerial, financial, technical, and marketing capabilities than us. In addition, many of these competitors offer a wider range of products and services than we contemplate offering. Many current and potential competitors also have greater name recognition, industry contacts and more extensive customer bases that could be leveraged to accelerate their competitive activity. Moreover, current and potential competitors have established and may establish future cooperative relationships among themselves and with third parties to enhance their products and services in this space. Consequently, new competitors or alliances may emerge and rapidly acquire significant market share. We cannot assure you that we will be able to compete effectively with current or future competitors or that the competitive pressures faced by us will not harm our business. This intense competition, and the impact it has on the valuation of companies of this nature, could limit our opportunities and have a materially adverse effect on the Company’s profitability or viability.

The Company believes that its primary competition will be the manufacturers of conventional tank water heaters, who are firmly established with the plumbing industry. There are a large number of manufacturers of tank water heaters, both domestic and foreign. The dominant manufacturers are five large, multinational, established companies with significantly more resources than the Company (Bradford-White, Rheem, A. O. Smith, State Industries and American

Standard). Manufacturers of tank water heaters dominate the U.S. market, maintaining over 99% market share of residential water heater sales. The Company cannot predict the likelihood that it will take market share away from those manufacturers, or whether or how long it will take the Company to build up sales of its product. In addition, there can be no assurance that larger, more established companies with significantly more financial, technical, research, engineering, development and marketing resources; with established distribution networks and worldwide manufacturing capabilities; and with greater revenues and greater name recognition than the Company; will not develop competing systems and products which will surpass the Company’s business.

To the Company's knowledge, the competition in electric tankless water heaters in the United States consists primarily of five companies that have done business mostly in North America, Central America and South America, with combined annual revenue in excess of $10 million. The Company expects it will encounter greater competition from tankless manufacturers in other countries, where tankless water heaters have a longer history of sales and greater acceptance in the marketplace. Competitive factors, including competitors entering the tankless water heater market, could have a material adverse effect on the Company's business, results of operations, financial condition and forecasted financial results**.**

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Performance; Market Acceptance.

The quality of the Company's products, manufacturing capability, and marketing and sales ability, and the quality and abilities of its personnel, are among the operational keys to the Company's success. A primary management challenge will be to penetrate the market for water heaters, a mature, highly competitive and concentrated market. Also, distributors and users of water heaters may resist or be slow to accept a tankless water heater. Other important factors to the success of the Company will be the ability to complete the development process for new products in a timely manner and the ability to attract an adequate number of buyers, distributors and investors. There can be no assurance that the Company can complete development of new technology so that other companies possessing greater resources will not surpass it. There can be no assurance that the Company can achieve its planned levels of performance, or can be successful in establishing relationships with the number and quality of distributors it needs to be successful, in a timely way. If the Company is unsuccessful in these areas, it could have a material adverse effect on the Company's business, results of operations, financial condition and forecasted financial results.

Dependence on Intellectual Property - Design and Proprietary Rights.

Our success and ability to compete depend to a significant degree on our intellectual property. Others could use our intellectual property without our consent because we may not be able to protect our intellectual property adequately. We will rely on copyright and trademark law, as well as confidentiality arrangements, to protect our intellectual property.

Envirotech was granted a patent by the United States Patent and Trademark Office for its Modular Skye Electronic Water Heater (ETWH) (Patent No. US 6,389,226 B1). Proprietary rights to the design of the ETWH were Envirotech's principal assets. The existing patent and intellectual property of Envirotech were assigned as collateral for debts owed by Envirotech for legal services arising prior to the acquisition of Envirotech by Skye. Envirotech, in 2005, discontinued production of all models of the ESI-2000 tankless water heater previously manufactured by it. On December 5, 2005 by order of Judge Lee Rosenthal of the US District Court for the Southern District of Texas in Houston a preliminary injunction against the Company was issued in connection with the civil action H-02-4782 between David Seitz and Microtherm (as Plaintiff) and Envirotech (as Defendant and Plaintiff by counterclaim) enjoining the Company and others from manufacturing, assembling, selling or offering for sale, any Product (as defined in the order) including the Envirotech ESI-2000 heater, any other heater regardless of its model number utilizing parts from the ESI-2000 or any other heater, regardless of its model number, utilizing in whole any part any technology embodied in the ESI-2000 heater (sic).

The new line of tankless water heaters designed by the Company do not utilize the Envirotech patent or technology related to the ESI-2000 product, and are constructed entirely using parts and operational methodologies distinct from the Envirotech ESI-2000 heater. The Company does not produce the ESI-2000 heater and believes all future water heaters will embody designs and technologies related to newly developed intellectual property of the Company's research and design subsidiary Ion Tankless, Inc.

During the past year, based on newly developed technology, Skye has filed several applications for patents with the United States Patent and Trademark Office, and expects that a range of products using this new technology will replace the products previously manufactured by Envirotech. On May 16, 2006, the Company's subsidiary, ION Tankless, Inc. received notice from the USPTO that the first such patent had been published as Patent No 7,046,922 for a Modular Tankless Water Heater. On August 8, 2006, the USPTO issued a method patent (No, 7,088,915) to ION

on the modular tankless water heater, the core technology of the *FORTIS*™ tankless water heater. Additionally, ION has also been notified by the USPTO that ION's patent covering the control technology used in the FORTIS™ product line has been allowed. Such patent will be published in due course subsequent to the payment by ION of regulatory and publication fees prescribed by the USPTO. While there can be no assurances that the other patents sought will be granted or that the technology will be considered proprietary to Skye or ION, the Company believes that its applications are meritorious and will be granted at least in part. It is expected that further research and development undertaken by the Company through its subsidiary, ION Tankless, Inc., will result in the creation of new technologies, some of which may be patentable.

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ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Effective Protection may not be available for our Trademarks.

Although we have applied to register our trade marks in the United States, we cannot assure you that we will be able to secure significant protection for these marks. Our competitors or others may adopt product or service names similar to "Skye", thereby impeding our ability to build brand identity and possibly leading to client confusion. Our inability to adequately protect the name "Skye” could seriously harm our business.

Policing unauthorized use of our intellectual property is made especially difficult by the global nature of the high technology industry and difficulty in controlling hardware and software. The laws of other countries may afford us little or no effective protection for our intellectual property. We cannot assure you that the steps we take will prevent misappropriation of our intellectual property or that agreements entered into for that purpose will be enforceable. In addition, litigation may be necessary in the future to: enforce our intellectual property rights; determine the validity and scope of the proprietary rights of others; or defend against claims of infringement or invalidity. Such litigation, whether successful or unsuccessful, could result in substantial costs and diversions of resources, either of which could seriously harm our business. There can be no assurance that competitors of the Company, some of which have substantially greater resources, will not obtain patents or other intellectual property protection that will restrict the Company’s ability to make and sell its products. If the Company were unsuccessful in protection of proprietary and intellectual property rights, it could have a material adverse effect on the Company's business, results of operations, financial condition and value, and forecasted financial results.

Some of our markets are cyclical, and a decline in any of these markets could have a material adverse effect on our operating performance.

Our business is cyclical and dependent on consumer spending and is therefore impacted by the strength of the economy generally, interest rates, and other factors, including national, regional and local slowdowns in economic activity and job markets, which can result in a general decrease in product demand from professional contractors and specialty distributors. For example, a slowdown in economic activity that results in less home renovations can have an adverse effect on the demand for some of our products. In addition, unforeseen events, such as terrorist attacks or armed hostilities, could negatively affect our industry or the industries in which our customers operate, resulting in a material adverse effect on our business, results of operations and financial condition.

Disaster.

A disaster that disables the Company’s operations will negatively impact the Company’s ability to perform for a period of time. The Company’s disaster recovery plan includes future multiple-site storage of inventory and the possibility of multiple manufacturing facilities.

We increasingly manufacture and/or source critical components for our products outside the United States, which may present additional risks to our business.

A significant portion of our future production will likely be manufactured outside of the United States, principally in China, and expanding international manufacturing capacity in China and Mexico is part of our strategy to reduce costs. International operations generally are subject to various risks, including political, religious and economic instability, local labor market conditions, the imposition of foreign tariffs and other trade restrictions, the impact of foreign government regulations, and the effects of income and withholding tax, governmental expropriation, and

differences in business practices. We may incur increased costs and experience delays or disruptions in product deliveries and payments in connection with international manufacturing and sales that could cause loss of revenue. Unfavorable changes in the political, regulatory, and business climate could have a material adverse effect on our financial condition, results of operations, and cash flows.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Our operations will suffer if we are unable to complete our internal cost reduction programs.

We plan to implement a cost reduction program in our business, which includes a transfer of portions of our manufacturing and assembly work from of existing United States operations to proposed operations in China or Mexico. In implementing this program, we may not be able to successfully consolidate management, operations, product lines, distribution networks, and manufacturing facilities, and we could experience a disruption in our inventory and product supply or in administrative services. In addition, we may not be able to complete this program without unexpected costs or delays, or the need for increased management time and effort. If we do not successfully implement this program on a timely basis, we will not achieve the planned operational efficiencies and cost savings, and there could be an adverse impact on ongoing relationships with our customers, all of which would impact our profitability.

Our results of operations may be negatively impacted by product liability lawsuits.

Our consumer products business exposes us to potential product liability risks that are inherent in the design, manufacture, and sale of our products in that business. While we currently maintain what we believe to be suitable product liability insurance, we cannot assure you that we will be able to maintain this insurance on acceptable terms or that this insurance will provide adequate protection against potential liabilities. In addition, we self-insure a portion of product liability claims. A series of successful claims against us could materially and adversely affect our reputation and our financial condition, results of operations, and cash flows.

Loss of key suppliers, lack of product availability or loss of delivery sources could decrease sales and earnings.

Our ability to manufacture a variety of products is dependent upon our ability to obtain adequate product supply from manufacturers or other suppliers. While in many instances we have agreements, including supply agreements, with our suppliers, these agreements are generally terminable by either party on limited notice. The loss of, or a substantial decrease in the availability of, products from certain of our suppliers, or the loss of key supplier agreements, could have a material adverse effect on our business, results of operations and financial condition. In addition, supply interruptions could arise from shortages of raw materials, labor disputes or weather conditions affecting products or shipments, transportation disruptions or other factors beyond our control. Furthermore, since we acquire a portion of our supply from foreign manufacturers, our ability to obtain supply is subject to the risks inherent in dealing with foreign suppliers, such as potential adverse changes in laws and regulatory practices, including trade barriers and tariffs, and the general economic and political conditions in these foreign markets.

Our ability to both maintain our existing customer base and to attract new customers is dependent in many cases upon our ability to deliver products and fulfill orders in a timely and cost-effective manner.

To ensure timely delivery of our products to our customers, we frequently rely on third parties, including couriers such as UPS, DHL and other national shippers as well as various local and regional trucking contractors. Outsourcing this activity generates a number of risks, including decreased control over the delivery process and service timeliness and quality. Any sustained inability of these third parties to deliver our products to our customers could result in the loss of customers or require us to seek alternative delivery sources, if they are available, which may result in significantly increased costs and delivery delays. Furthermore, the need to identify and qualify substitute service providers or increase our internal capacity could result in unforeseen operations problems and additional costs. Moreover, if customer demands for our products increases, we may be unable to secure sufficient additional capacity from our current service providers, or others, on commercially reasonable terms, if at all.

In some cases we are dependent on long supply chains, which may subject us to interruptions in the supply of many of the products that we distribute.

An increasing portion of the products that we manufacture and distribute are imported from foreign countries, including China and Mexico. We are thus dependent on long supply chains for the successful delivery of many of our products. The length and complexity of these supply chains make them vulnerable to numerous risks, many of which are beyond our control, which could cause significant interruptions or delays in delivery of our products. Factors such as labor disputes, changes in tariff or import policies, severe weather or terrorist attacks or armed hostilities may disrupt these supply chains. We expect more of our name brand and private label products will be imported in the future, which will further increase these risks. A significant interruption in our supply chains caused by any of the above factors could result in increased costs or delivery delays and have a material adverse effect on our business, results of operations and financial condition.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Our results of operations could be adversely affected by fluctuations in the cost of raw materials.

As a manufacturer we are subject to world commodity pricing for many of the raw materials used in the manufacture of our products. Such raw materials are often subject to price fluctuations, frequently due to factors beyond our control, including changes in supply and demand, general U.S. and international economic conditions, labor costs, competition, and government regulation. Inflationary and other increases in the costs of raw materials have occurred in the past and may recur in the future. Any significant increase in the cost of raw materials could reduce our profitability and have a material adverse effect on our business, results of operations and financial condition.

Dilution.

The Company presently has 21,622,243 shares issued and outstanding. If the Company issues additional shares either outright or through any future options or warrants programs, or if it requires additional financing, further dilution in value and in the percentage ownership represented by the shareholder's holdings will occur and the dilutive effect could be significant. Given that the Company has not achieved any meaningful product sales profitability as at the date of this report, it is likely that the Company will engage in future financings that will have a further significant dilutive effect.

Expect to Incur Losses for the Foreseeable Future.

We expect to incur losses for the foreseeable future and we may never become profitable. Although our current revenue model contemplates revenues from sale of products sufficient to break-even within nine to twelve months from the commencement of active FORTIS™ sales, there is no assurance that these revenues will occur. Because technology companies, even if successful, typically generate significant losses while they grow, we do not expect to generate profits for the foreseeable future, and we may never generate profits. In addition, we expect our expenses to increase significantly as we develop the infrastructure necessary to implement our business strategy. Our expenses will continue to increase as we: hire additional employees; pursue research and development; expand our information technology systems; and lease and purchase more space to accommodate our operations.

Costs associated with designing, developing, manufacturing and marketing products to our target markets and developing the infrastructure we will need to support our customers will depend upon many factors, including the number of customers, and the size, nature, market, and financial capabilities of each. Therefore, we cannot now determine the amount by which our expenses will increase as we grow.

Possible Claims That the Company Has Violated Intellectual Property Rights of Others.

Envirotech has been named as a Defendant in a law suit filed in the U.S. District Court for the Southern District of Texas, Houston, Texas (Civil Action No. H-02-4782, David Seitz and Microtherm, Inc., vs. Envirotech Systems Worldwide, Inc., and Envirotech of Texas, Inc., referred to herein as the "Seitz Patent Suit"). The Company is not affiliated with Envirotech of Texas, Inc. The suit alleges that Envirotech has infringed upon patent rights of others and seeks damages and an order to cease and desist. Envirotech has engaged counsel to represent it in the matter. Management believes the suit is without merit and that Envirotech will prevail in the matter. The suit was stayed pending the disposition of the Chapter 11 Bankruptcy Petition filed by Envirotech in August 2004, but the Court has allowed the plaintiff to re-open the Houston suit and a motion to that effect has been filed by the Plaintiff. The Company engaged the law firm of Hemingway & Hansen, LLP, Dallas, Texas, to defend it in this matter. On

December 05, 2005, the Court issued a preliminary injunction against Envirotech and its affiliated entities, including Skye, enjoining them from further marketing, advertising or offering for sale, or accepting any orders for (i) the Envirotech ESI 2000 heater, (ii) any other heater, regardless of its model, using parts of the Model ESI 2000 heater, and (iii) any other heater, regardless of model number, utilizing in whole any part (sic) any technology embodied in the Model ESI 2000 heater. The Company does not consider this injunction detrimental to its ongoing business activities as it had already discontinued production of the alleged offending product. The Seitz Patent Suit involves Envirotech and, except to the limited extent covered by the injunction and the discovery matters in connection with technology used in connection with FORTIS™ and Paradigm™, neither Skye nor any of its others subsidiaries are defendants/counter-plaintiffs in the matter.

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ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Except as described above, neither Skye nor Envirotech is the subject of any other dispute, claim or lawsuit or threatened law suit alleging the violation of intellectual property rights of a third party. To the extent that the Company is alleged to have violated a patent or other intellectual property right of a third party, it may be prevented from operating its business as planned, and it may be required to pay damages, to obtain a license, if available, to use the patent or other right or to use a non-infringing method, if possible, to accomplish its objectives. Any of these claims, with or without merit, could subject the Company to costly litigation and the diversion of their technical and management personnel. If the Company incurs costly litigation and its personnel are not effectively deployed, the expenses and losses incurred by them will increase, and their profits, if any, will decrease.

Business Plans and Operational Structure May Change.

We will continually analyze our business plans and internal operations in light of market developments. As a result of this ongoing analysis, we may decide to make substantial changes in our business plan and organization. In the future, as we continue our internal analysis and as market conditions and our available capital change, we may decide to make organizational changes and/or alter some of our overall business plans.

Reliance on Management.

The Company has recently accepted the resignation of certain members of management and thus it does not have management in-place, capable of executing its business plan. In response, we have undertaken to recruit additional persons to key management positions, including finance and audit, sales, engineering and customer support. Should the Company be unsuccessful in recruiting persons to fill the key management positions or in the event any of these individuals should cease to be affiliated with the Company for any reason before qualified replacements could be found, there could be material adverse effects on the Company's business and prospects. The officer and other key personnel, has an employment agreement with the Company, which contains provisions dealing with confidentiality of trade secrets, ownership of patents, copyrights and other work product, and non-competition. Nonetheless, there can be no assurance that these personnel will remain employed for the entire duration of the respective terms of such agreements or that any employee will not breach covenants and obligations owed to the Company.

In addition, all decisions with respect to the management of the Company will be made exclusively by the officers and directors of the Company. Investors will only have rights associated with minority ownership interest rights to make decision that affect the Company. The success of the Company, to a large extent, will depend on the quality of the directors and officers of the Company. Accordingly, no person should invest in the Units unless such person is willing to entrust all aspects of the management of the Company to its officers and directors.

Inability to Attract and Retain Qualified Personnel.

The future success of the Company depends in significant part on its ability to attract and retain key management, technical and marketing personnel. As we grow, we will also need to continue to hire additional technical, marketing, financial and other key personnel. Competition for highly qualified professional, technical, business development, and management and marketing personnel is intense. We may experience difficulty in attracting new personnel, may not be able to hire the necessary personnel to implement our business strategy, or we may need to pay higher compensation for employees than we currently expect. A shortage in the availability of required personnel could limit the ability of the Company to grow, sell its existing products and services and launch new products and services. We cannot assure you that we will succeed in attracting and retaining the personnel we need to grow.

Regulatory Factors.

The Federal Government, a State Government, a Local Government or industry regulator could, at any time enact, repeal or change law in such a way as to eliminate, reduce or postpone certain advantages available to the water heater industry. In addition, possible future consumer legislation, regulations and actions could cause additional expense, capital expenditures, restrictions and delays in the activities undertaken in connection with the business, the extent of which cannot be predicted. The exact affect of such legislation cannot be predicted until it is proposed. Additionally, much of the Company's business is regulated by National, State and Municipal codes that affect the manner in which the Company's products are installed and used. Although the Company strives to remain aware of existing practices around the United States, there can be no assurance that the Company becomes aware of any such changes in a timely fashion, or that one or more governing jurisdictions could make changes to such codes, the effect of which could be detrimental to the Company and its business in such jurisdictions.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Inability to Manage Rapid Growth.

The Company expects to grow very rapidly. Rapid growth often places considerable operational, managerial and financial strain on a business. To successfully manage rapid growth, the Company must accurately project its rate of growth and:

· rapidly improve, upgrade and expand its business infrastructures;
· deliver products and services on a timely basis;
· maintain levels of service expected by clients and customers;
· maintain appropriate levels of staffing;
· maintain adequate levels of liquidity; and
·

Our business will suffer if the Company is unable to successfully manage any aspect of its growth.

Effects of Amortization Charges.

Our losses will be increased, or our earnings, if we have them in the future, will be reduced, by charges associated with our issuances of options. We have adopted the 2005 Stock Incentive for the benefit of our directors and employees and we may adopt future stock option plans that reserve additional shares for issuance thereunder. The options and restricted stock granted under such plan(s), may have exercise prices lower than the fair value of our common stock at the dates of grant. The total unearned stock-based compensation will be amortized as stock-based compensation expense in our consolidated financial statements over the vesting period of the applicable options or shares, generally five years in the case of options granted to employees and one year in the case of options granted to non-employee directors and restricted stock issued to employees. These types of charges may increase in the future. Future unearned stock-based compensation charges may also include potential additional charges associated with options granted to consultants. The future value of these potential charges cannot be estimated at this time because the charges will be based on the future value of our stock.

Dividend Policy

There can be no assurance that the proposed operations of the Company will result in significant revenues or any level of profitability. We do not anticipate paying cash dividends on our capital stock in the foreseeable future. We plan to retain all future earnings, if any, to finance our operations and the acquisitions of interests in other companies and for general corporate purposes. Any future determination as to the payment of dividends will be at our Board of Directors' discretion and will depend on our financial condition, operating results, current and anticipated cash needs, plans for expansion and other factors that our Board of Directors considers relevant. No dividends have been declared or paid by the Company, and the Company does not contemplate paying dividends in the foreseeable future.

Terms of subsequent financings may adversely impact your investment.

We will engage in common equity, debt, or preferred stock financings in the future. Your rights and the value of your investment in the common stock will be reduced. Interest on debt securities will increase costs and negatively impacts operating results. Shares of our preferred stock are likely to be issued in series from time to time with such designations, rights, preferences, and limitations as needed to raise capital. The terms of preferred stock could be more advantageous to those investors than to the holders of common stock. In addition, if we need to raise more equity

capital from sale of common stock, institutional or other investors may negotiate terms at least as, and likely more, favorable than the terms of your investment. Shares of common stock which we sell will, at some point, be sold into the market, which will likely adversely affect market price.

Conflicts of Interest.

Existing and future officers and directors may have other interests to which they devote time, either individually or through partnerships and corporations in which they have an interest, hold an office, or serve on boards of directors, and each may continue to do so. As a result, certain conflicts of interest may exist between the Company and its officers and/or directors that may not be susceptible to resolution. All potential conflicts of interest will be resolved only through exercise by the directors of such judgment as is consistent with their fiduciary duties to the Company and it is the intention of management to minimize any potential conflicts of interest.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

The industry in which we operate is characterized by rapid technological change that requires us to develop new technologies and products.

Our future will depend upon our ability to successfully develop and market innovative products in a rapidly changing technological environment. We will likely require significant capital to develop new technologies and products to meet changing customer demands that, in turn, may result in shortened product lifecycles. Moreover, expenditures for technology and product development are generally made before the commercial viability for such developments can be assured. As a result, we cannot assure you that we will successfully develop and market these new products; that the products we do develop and market will be well received by customers, or that we will realize a return on the capital expended to develop such products.

Our future operating results may fluctuate and cause the price of our common stock to decline, which could result in substantial losses for investors.

Our limited operating history and the lack of established products make it difficult to predict accurately our future operations. We expect that our operating results will fluctuate significantly from quarter to quarter, due to a variety of factors, many of which are beyond our control. If our operating results fall below the expectations of investors or securities analysts, the price of our common stock will likely decline significantly. The factors that could cause our operating results to fluctuate include, but are not limited to:

- ability to commercialize new products from ongoing research and development activities;
- other third party advancements or developments in tankless water heating technology;
- price and availability of alternative solutions for water heating systems;
- availability and cost of technology, parts and components;
- our ability to establish and maintain key relationships with distributors and industry partners;
- the amount and timing of operating costs and capital expenditures relating to maintaining our business, operations, and infrastructure;
- our ability to effectively communicate with our shareholders;
- general economic conditions and economic conditions specific to the cost of electricity and water; and
- the ability to maintain a product margin on sales, given the early stage of our market for our products.

These and other external factors have caused and may continue to cause the market price and demand for our common stock to fluctuate substantially, which may limit or prevent investors from readily selling their shares of common stock and may otherwise negatively affect the liquidity of our common stock. In the past, securities class action litigation has often been brought against companies following periods of volatility in the market price of their securities. If securities class action litigation were to be brought against us it could result in substantial costs and a diversion of our management's attention and resources, which could hurt our business.

Our common stock is subject to penny stock regulation that may affect the liquidity for our common stock.

Our common stock is subject to regulations of the Securities and Exchange Commission relating to the market for penny stocks. These regulations generally require that a disclosure schedule explaining the penny stock market and the risks associated therewith be delivered to purchasers of penny stocks and impose various sales practice requirements on broker-dealers who sell penny stocks to persons other than established customers and accredited investors. The regulations applicable to penny stocks may severely affect the market liquidity for our common stock and could limit

your ability to sell your securities in the secondary market. Additionally, our common stock is currently quoted on the OTC Pink Sheets and not on a recognized exchange. Many investors are unwilling to purchase the securities of companies traded on such OTC markets, including the Pink Sheets.

We have incurred losses and may continue to incur losses in the future.

At September, 2006, our accumulated deficit was $11,934,879. We have not been able to generate enough sales to cover our expenses and have survived only by raising funds through the sale of debt and equity securities. We must continue to raise funds in the near future to survive. While management has been successful in the past in raising these funds, there is no assurance that management can continue to find investors to fund operations.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - continued

Future equity transactions, including exercise of options or warrants, could result in dilution.

From time to time, we sell restricted stock, warrants, and convertible debt to investors in private placements. Because the stock is restricted, the stock is sold at a greater discount to market prices compared to a public stock offering, and the exercise price of the warrants sometimes is at or even lower than market prices. These transactions cause dilution to existing stockholders. Also, from time to time, options are issued to officers, directors, or employees, with exercise prices equal to market. Exercise of in-the-money options and warrants will result in dilution to existing stockholders. The amount of dilution will depend on the spread between the market and exercise price, and the number of shares involved but this dilution could be significant.

Our future existence remains uncertain and the report of our auditors on our December 31, 2004 and 2005 financial statements contains a "going concern" qualification.

The report of the independent auditors on our financial statements for the years ended December 31, 2004 and 2005, includes an explanatory paragraph relating to our ability to continue as a going concern. We have suffered substantial losses from operations, require additional financing, and need to continue the development and marketing of our products. Ultimately we need to generate additional revenues and to attain profitable operations. These factors raise substantial doubt about our ability to continue as a going concern. There can be no assurance that we will be able to develop commercially viable products or an effective marketing system. Even if we are able to develop commercially viable products, there is no assurance that we will be able to attain profitable operations.

Our results of operations may be negatively impacted by product liability lawsuits.

Our residential water heater business exposes us to potential product liability risks that are inherent in the design, manufacture, and sale of our products in that business. Although the Company expects to obtain product liability insurance we do not currently maintain product liability insurance, and we cannot assure you that we will be able to obtain or maintain any such insurance on acceptable terms, or that such insurance, if obtained, will provide adequate protection against potential liabilities. The Company currently self-insures all product liability claims. A series of successful claims against us could materially and adversely affect our reputation and our financial condition, results of operations, and cash flows.

ITEM 3. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures.

Our Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of September 30, 2006 to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 (i) is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and (ii) is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Our disclosure controls and procedures are designed to provide

reasonable assurance that such information is accumulated and communicated to our management. Our disclosure controls and procedures include components of our internal control over financial reporting.

During the period covered by this report, there were no changes in internal controls that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

Distributor Suit. Prior to the acquisition of Envirotech, by the Company, Envirotech was the defendant in a lawsuit filed by a former distributor alleging a breach of a Distributor Agreement entered into with Envirotech in May, 1998. On August 13, 2003, Envirotech entered into a Settlement Agreement and Release pursuant to which Envirotech agreed to pay the distributor the sum of $520,500 in installments over a period of ten years. The obligations under this Settlement Agreement are secured by a Security Agreement covering all assets of Envirotech except its intellectual properties, as defined therein, subordinated, however, to a first lien on all assets of Envirotech, tangible and intangible, granted to the Senior Secured Creditor in 2001 and 2002 by Envirotech to secure two promissory notes given in satisfaction of legal fees. As part of the settlement, Envirotech granted the distributor a Stipulated Judgment which was not to be filed of record so long as no default existed. On May 3, 2004, the distributor claimed a breach and filed the Stipulated Judgment. Management believes no default existed to warrant the filing of the judgment. With the filing of the Bankruptcy Petition by Envirotech (see below), this action was stayed. However, with the dismissal of the Chapter 11 Proceedings on February 28, 2006, this judgment is once again a claim against the assets of Envirotech, subject, however, to the claims and rights of the Senior Secured Creditor.

Seitz Suit. In 2002, Envirotech was named as a Defendant in a law suit filed in the U.S. District Court for the Southern District of Texas, Houston, Texas (Civil Action No. H-02-4782, David Seitz and Microtherm, Inc., vs. Envirotech Systems Worldwide, Inc., and Envirotech of Texas, Inc. (the “Seitz Suit”). The Company is not affiliated with Envirotech of Texas, Inc. The suit alleges that Envirotech has infringed upon patent rights of others and seeks damages and an order to cease and desist. Management believes the suit is without merit. The suit was stayed pending the disposition of the Chapter 11 Bankruptcy Petition filed by Envirotech in August 2004. On September 30, 2005, however, the Bankruptcy Court allowed the plaintiff to re-open the Seitz Suit and he has done so. The suit is in the discovery stage and the Company is vigorously engaged in the process. On December 5, 2005, the Houston Court issued an injunction against Envirotech and its affiliated entities, including Skye, enjoining them from further marketing, advertising or offering for sale, or accepting any orders for (i) the Envirotech ESI 2000 heater, (ii) any other heater, regardless of its model, using parts of the Model ESI 2000 heater, and (iii) any other heater, regardless of model number, utilizing in whole any part any technology embodied in the Model ESI 2000 heater. The Company does not consider this preliminary injunction detrimental to its ongoing business activities, as it had already discontinued production of the alleged offending product. Trial in the Seitz Suit has been scheduled for February 2007. At a hearing on May 18, 2006, the Court directed that discovery be expanded to include the technology and products of Skye, including, specifically the *FORTIS*™ and *Paradigm*™ technologies. Envirotech and Skye intend to aggressively pursue this litigation to conclusion. On July 26, 2006 Envirotech retained the Dallas, TX firm Hemingway, Hansen, LLP to continue the defense and prosecution of this litigation. Envirotech continues to aggressively defend the Seitz suit.

Unpaid Legal Fees. Subsequent to December 31, 2003, Envirotech has been named in five separate lawsuits for unpaid legal and consulting fees totaling $280,000. These include the Myers and Jenkins Suit and the Sensor Technologies Suit discussed below. On May 3, 2004, Envirotech settled one of these suits claiming fees of $112,500. In connection with that settlement, Envirotech reimbursed the plaintiff for alleged out-of-pocket expenses and the Company issued 10,000 shares of common stock, restricted under SEC Rule 144, to the plaintiff on the basis of a loan from the Company to Envirotech. The settlement, and any settlements of the other suits, will be reflected as a charge in the year of the settlement. In two of the other three suits judgments have been granted in the aggregate amount of approximately $155,500, both of which were stayed by the bankruptcy filing discussed above. The fourth suit is on behalf of a law firm that served as a contract arbitrator in Envirotech’s dispute with the Distributor noted above. With the dismissal of the Chapter 11 proceedings, the Company has received notice from the plaintiff that it intends to resume the suit, which seeks approximately $3,500 in fees.

Myers and Jenkins Suit. On May 24, 2006, Envirotech was served with a Motion for Entry of Default in connection with an action filed in Arizona Superior Court, case number CV-2006-003671 by Envirotech's prior legal counsel, Myers and Jenkins. The motion seeks judgment for the payment of the principal sum of $103,830, together with interest and costs. Envirotech has not defended the action.

Sensor Technologies Suit. On May 24, 2006, Envirotech was served with an Application for Entry of Default in connection with an action filed in the Arizona Superior Court, case number CV-2006-0060632, by Sensor Technologies & Systems, Inc., an engineering firm that provided engineering consulting services in connection with Envirotech's ESI-2000 product. The application seeks judgment for the payment of $72,391, together with interest and costs. Envirotech has not defended the action.

ITEM 1. LEGAL PROCEEDINGS - continued

Bankruptcy Proceedings. On August 6, 2004, Envirotech filed a Voluntary Petition for protection under Chapter 11 of the United States Bankruptcy Code in Phoenix, Arizona. The filing of this Petition with the Bankruptcy Court stayed all existing litigation, judgments and efforts to collect on the judgments. Envirotech was acquired by the Company in November 2003 in a stock-for-stock transaction and has been held and operated by the Company as an operating subsidiary. With the exception of a guarantee to one critical supplier in the current amount of approximately $42,500, Skye has not assumed any liability for the obligations of Envirotech. As of the date of the filing of the Chapter 11 Bankruptcy Petition, Envirotech had liabilities of approximately $1.6 million. Several creditors, not related to the supply of parts or the assembly of products, have obtained judgments against Envirotech and an action was pending in the U.S. District Court, Southern District of Texas, alleging patent infringement (see above). All claims of creditors, including the above-mentioned judgments, and efforts to collect same, together with the litigation pending in the U.S. District Court in Houston, were stayed during the pendency of the Bankruptcy Proceedings. Envirotech filed a Disclosure Statement and Plan of Reorganization on November 7, 2004 and the Court approved its request to submit the plan to the creditors for approval. The Plan, however, did not receive approval of the Court and Envirotech subsequently filed a Motion to Dismiss the Chapter 11 proceedings which was granted, with prejudice, on February 28, 2006. As a result of this dismissal, all claims and judgments of creditors of Envirotech may be renewed.

Shareholder Inspection Claim. In April 2006 a shareholder purporting to have obtained consent from at least 15% of the Company's shareholders filed a lawsuit in the United States District Court for the District of Nevada (Case No. 2:06-CV-0541-RLH-GWF) seeking inspection of the Company's books and records pursuant to Nevada corporate law. The Court denied plaintiff's initial request. The Company has asserted several counterclaims against the plaintiff for tortious conduct and for abuse of the legal process in connection with the lawsuit. The matter is currently pending.

Shareholder Derivative Action. In May 2006 a small group of dissident shareholders (including the plaintiff from the Shareholder Inspection Claim) filed a lawsuit in the United States District Court for the District of Arizona (Case No. CV06-1291-PHX-ROS) as a derivative action seeking injunctive and declaratory relief. The Company was named as a nominal defendant and there are no claims for monetary damages against the Company. The primary claims involve the prior issuance of the Company's common stock to former consultants to the Company, as well as prior issuances of stock to certain members of current management. Among other things the plaintiffs seek to prevent these individuals from using their stock and related voting rights to solicit proxies and notice shareholder meetings, and have demanded that they return the shares to the Company. The parties have entered into a "standstill" arrangement in which the parties agreed to refrain from using their stock and voting rights in connection with proxy solicitations, shareholder consents, and the noticing of special shareholder meetings. The matter is currently pending. In addition to the foregoing claims, three of the defendants have demanded that the Company defend and indemnify them from the plaintiffs' claims. The Company is currently contemplating filing counter-claims against certain of the plaintiffs in the action.

Delisting. Because the Company has been unable to file this report on a timely basis, including the grace period permitted by the NASD Over the Counter Bulletin Board ("OTCBB"), it has been delisted from the OTCBB. As a result, the Company's securities now trade on the pink sheets. There is no assurance that the Company will be admitted to trade again on the OTCBB. Due to past delinquencies in its filings, the Company may be restricted from applying for listing on the OTCBB for at least a year.

Berry-Shino Claim. The Company has on several occasions during the past three years utilized the services of Berry-Shino Securities, Inc., Scottsdale, Arizona, in raising various forms of financing to further its business plan and operations. In the course of each of these engagements, the Company has paid Berry-Shino various fees and expenses and has issued a certain number of shares of its Common Stock to Berry-Shino. The Company has recently received correspondence from Berry-Shino stating that it believes it is entitled to be issued an additional 456,500 shares of Common Stock as additional consideration for its services. The Company is currently reviewing of validity of the

entitlement.

Except as noted above, to the best knowledge of the officers and directors of the Company, neither the Company nor its subsidiaries, nor any of their respective officers or directors is a party to any material legal proceeding or litigation.

ITEM 2. CHANGES IN SECURITIES

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

(a) During the year ended December 31, 2000, the Company issued five convertible notes payable, totaling $100,000, which matured in March 2001. These notes bear interest at the rate of 12.5% per annum. Each note is subject to automatic conversion at the maturity date. One of these notes, with a principal amount of $30,000, was converted in November 2006. As of the date of this filing, the remaining four notes, totaling $70,000, have not yet been converted and are in default.

(b) Between January 2004 and January 2005, the Company issued forty notes in connection with bridge loans made through private placements. The notes bear interest at 10%, interest payable quarterly, principal and interest convertible into one common share for each outstanding $1.00 of principal and interest. Of these notes, thirty-six have been either repaid or converted at December 31, 2005. Of the remaining four notes, three were converted in April 2006. The sole remaining note, in the principal amount of $15,000 has not been converted or repaid and is in default.

(c) Envirotech has five notes with an aggregate principal amount of $833,240, that are in default, as follows:

Demand Note with Attorneys, 6% Interest, All Assets of Subsidiary, Envirotech, pledged as Collateral.	194,895
Demand Note with Former Distributor of Subsidiary, Envirotech, in Settlement and Repurchase of Distributorship Territory, 7% Interest.	519,074
Demand Note Made by Subsidiary, Envirotech, 10% Interest, Payable Monthly.	11,880
Demand Note Made by Subsidiary, Envirotech, 6% Interest.	35,000
Demand Note Made by Subsidiary, Envirotech.	72,391

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

On October 21, 2005, through a written consent without a meeting, a majority of the shareholders approved a change in the name of Tankless Systems Worldwide, Inc. to SKYE International, Inc.

In March 2006, the Company was served with a demand by Danial DeSade, acting on behalf of himself and certain other shareholders, purporting to represent shareholders of record holding in excess of 15% of the outstanding shares of the Company (collectively, the "Demand Shareholders"). The Demand Shareholders had signed authorizations giving Mr. DeSade the ostensible authority to demand that the Company permit an inspection of its books and records pursuant to relevant provisions of Nevada law. The Company's Board of Directors denied such demand and took the position that the actions of Mr. DeSade, specifically, the solicitation of proxies, were in contravention of Federal Securities laws, and further, that the demand itself could not be supported under applicable Nevada law. Subsequently, in April 2006, Mr. DeSade, representing the Demand Shareholders, filed a petition in the U.S. District Court for the District of Nevada, case number 2:06-cv-00541-RLH-GWE, seeking an inspection of the Company's financial and other records pursuant to Nevada corporate law. The Company believes the request was not properly made and contested that request. The complaint was dismissed on May 22, 2006, but the plaintiffs were granted leave to re-file the complaint if certain technical deficiencies were corrected.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS - Continued

On April 20, 2006, the President of the Company, acting pursuant to Article II section 2 of the Company's By-laws, having received a demand of shareholders holding in excess of 15% of the issued and outstanding shares of the Registrant, called a Special Meeting of the common shareholders of the company that was to be held on May 31, 2006. The purpose of the special meeting was to:

- To elect directors of Skye to hold office until the succeeding Annual General Meeting of Shareholders
- To transact such other business as may properly come before the Meeting or any adjournment or adjournments thereof.

At its meeting on May 11, 2006, the Board of Directors postponed the special shareholders' meeting until a future date to be established after the Company had brought its SEC filings current. The Board did not evaluate whether the meeting was duly called, or whether the shareholder demand was in compliance with Federal Securities laws.

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

(a) Exhibits

31.1 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certification Pursuant to U.S.C. 18 Section 1350

SIGNATURES

In accordance with Section 13 of the Exchange Act, the Company has caused this report to be signed on its behalf by the undersigned, hereunto duly authorized

SKYE INTERNATIONAL, INC.

Date: November 17, 2006

/s/ Ronald O. Abernathy
Ronald O. Abernathy
Title: Chief Executive Officer (Interim) and
Chief Accounting Officer (Interim)