

CHROMATICS COLOR SCIENCES INTERNATIONAL INC

Form 10-Q

May 21, 2001

1

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2001

OR

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

For the transition period from _____ to _____

Commission file number 0-21168

CHROMATICS COLOR SCIENCES INTERNATIONAL, INC.

(Exact Name of Registrant as Specified in Its Charter)

New York

13-3253392

(State or Other Jurisdiction (I.R.S. Employer Identification Number)
of Incorporation or Organization)

5 East 80th Street, New York, New York 10021

(Address of principal executive offices)

(212) 717-6544

(Registrant's Telephone Number, Including Area Code)

(Former Name, Former Address and Former Fiscal Year,
if Changed Since Last Report)

Indicate by check whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by the court. Yes [] No [] N/A

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of May 1, 2001: 19,033,308

PART I -- FINANCIAL INFORMATION

Item 1. Financial Statements

CHROMATICS COLOR SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS

| | March 31, 2001 | December 31, 2000 |
|---|----------------------|--------------------------|
| | ----- (unaudited) | ----- (Notes 1 and 3) |
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and equivalents | \$ 6,700 | \$ 1,379,000 |
| Accounts receivable | 72,900 | 72,900 |
| Inventories | 717,400 | 747,100 |
| Prepaid expenses and other current assets | 402,500 | 296,900 |
| | ----- | ----- |
| Total Current Assets | 1,199,500 | 2,495,900 |
| PROPERTY AND EQUIPMENT - NET | 223,400 | 244,100 |
| SOFTWARE DEVELOPMENT COSTS - NET | 209,100 | 261,400 |
| PATENT COSTS - NET | 556,000 | 581,100 |
| NET ASSETS OF DISCONTINUED OPERATIONS | -- | 1,000,000 |
| OTHER ASSETS | 331,700 | 331,700 |
| | ----- | ----- |
| | \$ 2,519,700 | \$ 4,914,200 |
| | ===== | ===== |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable and accrued expenses: | | |
| Attorneys and accountants | \$ 876,400 | \$ 458,900 |
| Consultants | 237,300 | 141,700 |
| Trade and other | 1,383,800 | 260,100 |
| | ----- | ----- |
| Total Current Liabilities | 2,497,500 | 860,700 |
| | ----- | ----- |
| LONG TERM DEBT: | | |
| Amount payable for purchase of Gordon | 653,000 | 653,000 |

COMMITMENTS AND CONTINGENCIES

REDEEMABLE PREFERRED STOCK:

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| | | |
|--|--------------|--------------|
| Class A, Par Value \$.01 per share: | | |
| Authorized - 1,400,000 shares | | |
| Issued and outstanding - 1,380,000 | | |
| shares at par value and redemption value | 13,800 | 13,800 |
| SHAREHOLDERS' EQUITY (DEFICIENCY) | | |
| Preferred Stock | 11,788,800 | 11,510,800 |
| Common Stock, par value \$.001 per share: | | |
| Authorized - 50,000,000 shares | | |
| Issued and outstanding - 19,033,308 (2001) | | |
| and 19,033,308 (2000) shares | 19,100 | 19,100 |
| Capital in excess of par value | 45,656,400 | 45,934,400 |
| Accumulated deficit | (58,108,900) | (54,077,600) |
| | ----- | ----- |
| Total Shareholders' Equity (Deficiency) | (644,600) | 3,386,700 |
| | ----- | ----- |
| | \$ 2,519,700 | \$ 4,914,200 |
| | ===== | ===== |

See accompanying notes to consolidated financial statements

CHROMATICS COLOR SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

| | Three Months Ended March 31, | |
|--|------------------------------|-----------|
| | 2001 | 2000 |
| | ----- | ----- |
| Revenues: | | |
| Sales | \$ -- | \$ 38,700 |
| | ----- | ----- |
| COSTS AND EXPENSES: | | |
| Cost of sales | -- | 20,800 |
| Sales, marketing and trade show costs | 243,800 | 637,400 |
| Medical regulatory expenses | 276,400 | 196,400 |
| Research and development | 305,100 | 294,700 |
| Patent application costs | 136,000 | 56,100 |
| Compensation costs relating to options granted to consultants (non cash) | -- | 240,000 |
| Provision for Estimated Payments for terminated Employees | 1,000,000 | -- |
| General and administrative: | | |
| Compensation - Officers and employees | 271,100 | 228,400 |
| Consultants | 133,200 | 116,000 |
| Legal fees | 154,400 | 187,400 |
| Accounting fees | 40,000 | 69,900 |
| Rent and storage | 92,400 | 78,100 |
| Insurance | 72,500 | 77,700 |

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| | | |
|---|-----------------------|-----------------------|
| Repairs and maintenance | 20,900 | 47,500 |
| Depreciation and amortization | 126,000 | 171,400 |
| Payroll taxes | 27,300 | 20,400 |
| Stock administrative fees | 29,700 | 29,300 |
| Public relations | 39,500 | 59,900 |
| Other | 65,800 | 84,200 |
| | <u>3,034,100</u> | <u>2,615,600</u> |
| OPERATING LOSS | <u>(3,034,100)</u> | <u>(2,576,900)</u> |
| OTHER INCOME (EXPENSE): | | |
| Interest income | 2,800 | 44,800 |
| Interest expense and non-cash financing costs including \$715,000 in non-cash OID costs in 2000 | -- | (896,600) |
| | <u>2,800</u> | <u>(851,800)</u> |
| LOSS FROM CONTINUING OPERATIONS | (3,031,300) | (3,428,700) |
| LOSS FROM DISCONTINUED OPERATIONS (Note 3) | (1,000,000) | -- |
| NET LOSS | <u>\$ (4,031,300)</u> | <u>\$ (3,428,700)</u> |
| NET LOSS TO COMMON STOCKHOLDERS: | | |
| LOSS FROM CONTINUING OPERATIONS | \$ (3,031,300) | \$ (3,428,700) |
| DEEMED DIVIDEND FOR CLASS B, SERIES 2 AND 3 CONVERTIBLE PREFERRED STOCK | 278,000 | 703,000 |
| LOSS FROM CONTINUING OPERATIONS TO COMMON STOCKHOLDERS | <u>(3,309,300)</u> | <u>(4,131,700)</u> |
| LOSS FROM DISCONTINUED OPERATIONS (Note 3) | (1,000,000) | - |
| NET LOSS TO COMMON STOCKHOLDERS | <u>\$ (4,309,300)</u> | <u>\$ (4,131,700)</u> |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING | | |
| | <u>19,033,308</u> | <u>15,630,412</u> |
| BASIC AND DILUTED LOSS PER SHARE: | | |
| LOSS FROM CONTINUING OPERATIONS | \$ (0.18) | \$ (0.26) |
| LOSS FROM DISCONTINUED OPERATIONS | (0.05) | -- |
| NET LOSS TO COMMON STOCKHOLDERS | <u>\$ (0.23)</u> | <u>\$ (0.26)</u> |

See accompanying notes to consolidated financial statements

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CHROMATICS COLOR SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY (DEFICIENCY)
(UNAUDITED)

| | Preferred Stock | Common Stock | | Capi Excess Va |
|--|--------------------|------------------------------------|-----------|----------------------|
| | | Number of Shares Outstanding | Par Value | |
| Balances, December 31, 2000 | \$ 11,510,800 | 19,033,308 | \$ 19,100 | \$ 45 |
| Three Months Ended March 31, 2001: | | | | |
| Net Loss | - | | - | |
| Deemed dividend on Class B, convertible preferred stock | 278,000 | | | |
| Balances, March 31, 2001 | \$ 11,788,800 | 19,033,308 | \$ 19,100 | \$ 45 |

See accompanying notes to consolidated financial statements

CHROMATICS COLOR SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

| | Three Months Ended March 31, | |
|---|------------------------------|----------------|
| | 2001 | 2000 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Loss from continuing operations | \$ (3,031,300) | \$ (3,428,700) |
| Loss from discontinued operations | (1,000,000) | -- |
| Adjustments to reconcile net loss to net cash flows from operating activities: | | |
| Non-cash impairment charge and net change in net assets of discontinued operations | 1,000,000 | -- |
| Depreciation and amortization | 126,000 | 171,400 |
| Compensation cost relating to options granted to consultants | -- | 240,000 |
| Non-cash interest and financing costs | -- | 715,000 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | -- | 776,700 |

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| | | |
|--|-------------|--------------|
| Inventories | 29,700 | (60,900) |
| Prepaid expenses and other assets | (130,600) | 15,300 |
| Accrued interest on senior convertible debentures | -- | 175,000 |
| Accounts payable and accrued expenses | 1,636,800 | (88,500) |
| | ----- | ----- |
| Net cash flows from operating activities | (1,369,400) | (1,484,700) |
| | ----- | ----- |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Capitalized patent costs | -- | (151,300) |
| Purchase of property and equipment | (2,900) | (53,300) |
| | ----- | ----- |
| Net cash flows from investing activities | (2,900) | (204,600) |
| | ----- | ----- |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from issuance of common stock, net of related costs | -- | 295,200 |
| Proceeds (payments) of amounts payable to related party | -- | (11,400) |
| Net proceeds from the issuance of preferred stock and warrants, net of costs | -- | 3,610,000 |
| | ----- | ----- |
| Net cash flows from financing activities | -- | 3,893,800 |
| | ----- | ----- |
| NET CHANGE IN CASH AND EQUIVALENTS | (1,372,300) | 2,204,500 |
| | | |
| CASH AND EQUIVALENTS, BEGINNING OF PERIOD | 1,379,000 | 2,790,400 |
| | ----- | ----- |
| CASH AND EQUIVALENTS, END OF PERIOD | \$ 6,700 | \$ 4,994,900 |
| | ===== | ===== |
| SUPPLEMENTAL CASH FLOW INFORMATION | | |
| Interest Paid | \$ -- | \$ 6,600 |
| | ===== | ===== |

See accompanying notes to consolidated financial statements

CHROMATICS COLOR SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Basis of Presentation:

Nature of Report - The consolidated balance sheet at the end of the preceding fiscal year has been derived from the audited consolidated balance sheet contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000 and is presented for comparative purposes. All other financial statements are unaudited. In the opinion of management, all adjustments, which include only normal recurring adjustments necessary to present fairly the financial position, results of operations and changes in cash flows, for all periods presented have been made. The results of operations for interim periods are not necessarily indicative of the operating results for the full year.

Footnotes - Certain footnote disclosures normally included in financial

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statements prepared in accordance with generally accepted accounting principles have been omitted in accordance with the published rules and regulations of the Securities and Exchange Commission. These consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000.

Note 2 - Commitments and Contingencies:

Business Risks - Since its formation in 1984, the Company has been principally engaged in color science technology research and development and licensing activities, seeking mass market applications for its proprietary technology and instrumentation. The Company's business encompasses all of the risks inherent in the establishment of a new business enterprise, including a limited operating history with significant competition possessing substantially greater resources. Current and future operations also depend upon the continued employment of certain key executives, the ability to further commercialize its proprietary technology and products and the Company's ability to obtain sufficient revenues and outside financing.

Operating Difficulties - Since 1989, the Company has incurred losses from operations and net cash outflows from operations. The Company expects to license its patents and proprietary technology, sell its equipment and market its related services and products to ultimately overcome these difficulties.

Although the Company has taken steps to substantially reduce personnel and ongoing operating expenses, the Company expects that it will continue to incur costs in connection with the required research and development on its new LED instrument and technology, complete filings, administration and maintenance for certain intellectual properties and regulatory requirements; supply updated products and sales support to its medical distributor; complete FDA filings for upgrades to its medical products, and explore the possibility of either renegotiating its current distribution agreement for its medical products or selling the exclusive rights to its medical products and technology. There can be no assurance the Company will not continue to incur such losses or will ever generate revenues at levels sufficient to support profitable operations.

The Company anticipates that it will continue to incur net losses for the foreseeable future as expenses are incurred in implementing its long-term business plan.

The Company is currently taking steps to improve operating results and has initiated a plan to significantly reduce operating costs. The Company is experiencing a major liquidity crisis and requires an immediate infusion of cash to continue operations. The Company is seeking additional capital to facilitate short-term liquidity and is currently reviewing various financing proposals. If the Company is unable to obtain such short-term financing, or sell its assets to obtain a cash infusion, it may be forced to seek protection from its creditors in bankruptcy.

Even if the Company is successful in obtaining this short-term cash infusion, the Company will require additional future financing to execute its business plan. If the Company is not able to attract additional future financing, generate significant revenue from operations and/or successfully market its products and technologies, it may have to significantly curtail and/or cease operations and be forced to seek protection from its creditors in bankruptcy.

Legal Proceedings - On January 16, 2001, a lawsuit was commenced against the Company and Darby Macfarlane in the federal district court for the Southern District of New York entitled Richard Sommers and Linda Sommers v. Chromatics Color Sciences International, Inc. and Darby S. Macfarlane. The plaintiffs allege that certain statements purportedly made by or on behalf of the Company

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concerning the Company's success, the extent of use of the ColorMate (Registered Trademark) System and the Company's cash flow constituted violations of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 promulgated thereunder and Section 12(a)(2) of the Securities Act of 1933 as well as common law claims alleging fraudulent misrepresentation, concealment and nondisclosure and seek unspecified damages in an amount to be proven at trial. On March 1, 2001, the defendants moved to dismiss the complaint for failure to state a claim upon which relief can be granted, for failure to plead fraud with requisite particularity and for failure to comply with the statutory requirements for federal securities fraud claims. No decision has been rendered by the court on this motion. The defendants believe that the allegations of the complaint are without merit and intend to vigorously defend this action.

Note 3 - Discontinued Operations:

On June 2, 2000, the Company purchased Gordon Laboratories, Inc. ("Gordon"). Due to the recent financial results of Gordon and CCSI's inability to continue funding Gordon, the Company has decided to attempt to sell Gordon. The Company is currently evaluating proposals related to the sale of Gordon. Accordingly, results of this operation have been classified as discontinued, and prior periods have been restated. The net assets of Gordon have been written - down to zero at March 31, 2001, since the Company cannot predict the ultimate recoverability of the net assets of Gordon through a sale.

Net sales and loss from the discontinued operation are as follows:

| | Three months ended March 31, 2001 |
|--------------------------------------|-----------------------------------|
| Net Sales | \$ 1,167,000 |
| Loss from discontinued operation | \$ 451,000 |
| Impairment cost | \$ 549,000 |
| Net Loss from discontinued operation | \$ 1,000,000 |

Assets and liabilities from the discontinued operation are as follows:

| | March 31, 2001 | December 31, 2000 |
|--------------------------------------|----------------|-------------------|
| Current assets | \$ 1,883,000 | \$ 1,821,500 |
| Property and equipment/other assets | \$ 2,597,000 | \$ 3,261,100 |
| Current liabilities | \$ 4,480,000 | \$ 4,082,600 |
| Long-term liabilities | \$ 0 | \$ 0 |
| Net assets of discontinued operation | \$ 0 | \$ 1,000,000 |

Note 4 - Subsequent issuance of Common Stock:

In connection with an "adjustable warrant" issued to a private investor in 2000, the Company is obligated to issue approximately 936,000 shares of its common stock to such investor as a result of the first adjustment of such adjustable warrant which occurred on March 31, 2001. The common shares are expected to be issued in May 2001.

Note 5 - Employee termination payments

Since March 2001, the Company has terminated many of its employees or has been

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unable to pay many of its existing employees. Some of these employees have employment contracts that provide for severance and other payments upon the termination of employment or breach in such contracts. Accordingly, the Company has recorded a \$1,000,000 provision for the estimated exposure to these employees for additional amounts due to them as of March 31, 2001.

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

RESULTS OF OPERATIONS

The Company incurred losses from continuing operations of \$3,031,300 and \$3,428,700 for the three months ended March 31, 2001 and 2000, respectively. Loss per share from continuing operations was (\$.18) for 2001 and (\$.26) for 2000.

The Company incurred losses from Discontinued Operations of \$1,000,000 or (\$.05) per share in 2001 due to the decision to dispose of the Gordon operation (See Note 3).

Sales, marketing and trade show costs were \$243,800 for the three months ended March 31, 2001 as compared to \$637,400 in the prior period as the Company has substantially reduced its medical sales force in 2001. Medical regulatory expenses were \$276,400 for the three months ended March 31, 2001 as compared to \$196,400 in the prior period due to FDA filing costs for upgrades to medical products and other regulatory requirements.

Research and development costs were \$305,100 for the three months ended March 31, 2001 as compared to \$294,700 in the prior period. The increase in the current period is primarily a result of the continuing implementation of the Company's long-term business plan to seek commercial applications of its intellectual properties and technologies.

The Company recorded a provision for estimated payments for terminated employees of \$1,000,000.

Compensation - Officers and employees were \$271,100 for the three months ended March 31, 2001 as compared to \$228,400 in the prior period. The increase in these costs is a result of the addition of executive and senior level personnel to implement the Company's business plan.

Total General and administrative costs were \$1,072,800 for the three months ended March 31, 2001 as compared to \$1,170,200 in the prior period. The decrease is primarily a result of cost reductions initiated by the Company in the last few weeks of the current period.

Interest and non-cash financing costs were \$0 in the three months ended March 31, 2001 as compared to \$896,600 in the prior period. The decrease is due to amortization of original issue discount on senior convertible debentures, which was fully amortized in prior periods.

Deemed dividend on preferred stock was \$278,000 in the three months ended March 31, 2001 as compared to \$703,000 in the prior period. The decrease is due to additional deemed dividend from a new financing in the prior period, which did not occur in the current period.

Although the Company has substantially reduced personnel and ongoing operating expenses, the Company expects that if it is successful in raising the necessary financing to continue operations, it will continue to incur costs in connection with the required research and development on its new LED instrument and technology, complete filings, administration and maintenance for certain

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intellectual properties and regulatory requirements; supply updated products and sales support to its medical distributor; complete FDA filings for upgrades to its medical products, and explore the possibility of either renegotiating its current distribution agreement for its medical products or selling the exclusive rights to its medical products and technology.

The Company anticipates that it will continue to incur net losses for the foreseeable future as expenses are incurred in implementing its long-term business plan.

LIQUIDITY AND CAPITAL RESOURCES

Current Assets were \$1,199,500 at March 31, 2001 as compared to \$2,495,900 at December 31, 2000. This decrease is primarily attributable to a decrease in cash due to the operating losses.

As indicated in the Consolidated Statement of Cash Flows, the Company continues to experience significant negative net cash flows from operating activities. The 2001 net cash outflow from operating activities is primarily attributed to the Company's net loss (partially offset by depreciation and amortization expense and increases in accounts payable).

The Company lacks funds to continue material aspects of its operations and business plan, including funds and necessary personnel to complete research and development on its new LED instrument and technology recently required during its first mass manufacturing process; complete filings, administration and maintenance for certain intellectual properties and regulatory requirements; supply upgraded products and sales support to its medical distributor; and complete FDA regulatory filings for upgrades to its medical products.

The Company's current objective with regard to its medical business is to arrive at acceptable revised terms of the existing agreement with the distributor or to identify a strategic partner in the medical industry to whom the Company could sell, for an up-front fee and ongoing royalty, the exclusive market rights to the ColorMate TLC-BiliTest System.

The Company's subsidiary, Gordon, has a note payable to a finance Company totaling \$2,714,700 at December 31, 2000, which is secured by substantially all of the assets of Gordon. The failure by Gordon to make regularly scheduled payments in 2001, as well as the failure to pay other amounts due constitutes an event of default under the loan agreement. The lender has requested full payment of the loan, which Gordon cannot afford to pay without additional financing. Gordon is currently negotiating with the lender in an attempt to renegotiate the loan. The failure of Gordon to successfully renegotiate this financing could force Gordon to seek protection from its creditors in bankruptcy. The Company is not responsible for payment of this loan.

The Independent Accountants' Report on the December 31, 2000 financial statements indicates the Company has incurred recurring losses for the last several years, including \$19,464,400 in 2000 and has experienced significant problems and delays exploiting its primary technology (medical equipment). In addition, the Company's subsidiary, Gordon, has defaulted on its debt services obligations and the lender has demanded payment of the entire debt, which totaled \$2,714,700 at December 31, 2000. The Independent Accountants' Report states that these matters raise substantial doubt about the Company's ability to continue as a going concern.

The Company is experiencing a major liquidity crisis and requires an immediate infusion of cash to continue operations. In addition, the Company's subsidiary -Gordon, continues to experience cash flow losses. The Company is seeking additional capital to facilitate short-term liquidity and is currently reviewing various financing proposals and has taken steps to significantly reduce costs.

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If the Company is unable to obtain such short-term financing, or sell its assets to obtain a cash infusion, it may be forced to seek protection from its creditors in bankruptcy.

Even if the Company is successful in obtaining this short-term cash infusion, the Company will require additional future financing to execute its business plan. If the Company is not able to attract additional future financing, generate significant revenue from operations and/or successfully market its products and technologies, it may have to significantly curtail and/or cease operations and be forced to seek protection from its creditors in bankruptcy.

The Company is currently negotiating proposals for financing the Company. Such proposals require negotiation of warrants to purchase CCSI's stock and are subject to satisfactory completion of due diligence, negotiation, execution and delivery of definitive agreements by and between the parties, and compliance with NASDAQ listing requirements.

Some of the information presented in or incorporated by reference in this report constitutes "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Although the Company believes that its expectations are based on reasonable assumptions, within the bounds of its knowledge of its business and operations, there can be no assurance that actual results will not differ materially from its expectations. Factors that could cause actual results to differ from expectations include, among other things: (i) the inability of the Company to resolve the current liquidity crisis, (ii) the inability of the Company to secure additional financing, (iii) the failure of the Company to implement its business plan for various applications of its technologies, including medical and industrial technologies, (iv) government regulation and (v) the loss of key personnel.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

No disclosure is required under this Item 3.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On January 16, 2001, a lawsuit was commenced against the Company and Darby Macfarlane in the federal district court for the Southern District of New York entitled Richard Sommers and Linda Sommers v. Chromatics Color Sciences International, Inc. and Darby S. Macfarlane. The plaintiffs allege that certain statements purportedly made by or on behalf of the Company concerning the Company's success, the extent of use of the ColorMate (Registered Trademark) System and the Company's cash flow constituted violations of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 promulgated thereunder and Section 12(a)(2) of the Securities Act of 1933 as well as common law claims alleging fraudulent misrepresentation, concealment and nondisclosure and seek unspecified damages in an amount to be proven at trial. On March 1, 2001, the defendants moved to dismiss the complaint for failure to state a claim upon which relief can be granted, for failure to plead fraud with requisite particularity and for failure to comply with the statutory requirements for federal securities fraud claims. No decision has been rendered by the court on this motion. The defendants believe that the allegations of the complaint are without merit and intend to vigorously defend this action.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.

None.

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ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

The Company's subsidiary, Gordon, has a note payable to a finance Company totaling \$2,714,700 at December 31, 2000, which is secured by substantially all of the assets of Gordon. The failure by Gordon to make regularly scheduled payments in 2001, as well as the failure to pay other amounts due constitutes an event of default under the loan agreement. The lender has requested full payment of the loan, which Gordon cannot afford to pay without additional financing. Gordon is currently negotiating with the lender in an attempt to renegotiate the loan. The failure of Gordon to successfully renegotiate this financing could force Gordon to seek protection from its creditors in bankruptcy. The Company is not responsible for payment of this loan.

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

None.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

Reports on Form 8-K:

None.

SIGNATURES

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

CHROMATICS COLOR SCIENCES INTERNATIONAL, INC.

Date: May 21, 2001

By: /s/ Darby S. Macfarlane

Darby S. Macfarlane
Chairman and Chief Technology Officer

Date: May 21, 2001

By: /s/ Frank Marchese

Frank Marchese
Chief Financial and Principal
Accounting Officer