AMERICAN AMMUNITION INC/FL
Form 10QSB
August 16, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

Form 10-QSB

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(Mark one)

[X] Quarterly Report under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2004

[X] Transition Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from ______________ to _____________

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Commission File No.: 000-32379

American Ammunition, Inc.
(Name of small business registrant in its charter)

| | |
|---|---|
| California | 91-2021594 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 3545 NW 71st Street<br>Miami, FL | 33147 |
| (Address of principal executive offices) | (Zip Code) |

Registrant's telephone number: (305) 835-7400

Securities registered under Section 12(b) of the Exchange Act:

| Title of each class | Name of each exchange on which registered |
|---|---|
| None | |

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

Common Stock, $0.001 par value
(Title of class)

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

State the number of shares outstanding of each of the issuer's classes of common equity as of the latest practicable date: July 28, 2004: 74,656,926

Transitional Small Business Disclosure Format (check one): YES [_] NO [X]

American Ammunition, Inc.

Form 10-QSB for the Quarter ended June 30, 2004

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Part I
Item 1 - Financial Statements

American Ammunition, Inc. and Subsidiaries
Consolidated Balance Sheets
June 30, 2004 and 2003

(Unaudited)

| | June 30, 2004 | J |
|---|---|---|
| **ASSETS** | | |
| Current Assets | | |
| Cash on hand and in bank | $ 439,037 | $ |
| Accounts receivable - trade, net of allowance for doubtful accounts of $-0- and $-0-, respectively | 37,073 | |
| Inventory | 1,020,460 | |
| Prepaid expenses | 36,760 | |
| Total Current Assets | 1,533,330 | |
| Property and Equipment - at cost or contributed value | | |
| Manufacturing equipment | 7,446,870 | |
| Office furniture and fixtures | 82,719 | |
| Leasehold improvements | 187,397 | |
| | 7,716,986 | |
| Accumulated depreciation | (4,417,688) | |
| Net Property and Equipment | 3,299,298 | |
| Other Assets | | |
| Deposits and other | 83,660 | |
| Total Other Assets | 83,660 | |
| TOTAL ASSETS | $ 4,916,288 | $ |

- Continued -

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

American Ammunition, Inc. and Subsidiaries
Consolidated Balance Sheets - Continued
June 30, 2004 and 2003

(Unaudited)

| | June 30, 2004 | J |
|---|---|---|
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current Liabilities | | |
| Current maturities of leases payable | $ 2,606 | $ |
| Customer deposits | 4,100 | |
| Accounts payable - trade | 218,116 | |
| Accrued dividends payable | 12,221 | |
| Total Current Liabilities | 237,043 | |
| Long-Term Liabilities | | |
| Capital leases payable | - | |
| Total Liabilities | 237,043 | |
| Commitments and Contingencies | | |
| Convertible Debenture | 266,365 | |
| Mandatory Convertible Preferred Stock net of Beneficial Conversion Discount Feature 103,700 and 123,700 shares issued and outstanding | 518,500 | |
| Stockholders' Equity | | |
| Preferred stock - $0.001 par value 20,000,000 shares authorized. | | |
| 1,795,320 shares allocated to Series A | - | |
| 1,000,000 shares allocated to Series B | - | |
| Common stock - $0.001 par value. 300,000,000 shares authorized. 75,656,926 and 59,806,008 shares issued and outstanding | 73,657 | |
| Additional paid-in capital | 23,089,172 | |
| Accumulated deficit | (18,993,449) | |
| | 4,169,380 | |
| Stock subscription receivable | (275,000) | |
| Total Stockholders' Equity | 3,894,380 | |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $ 4,916,288 | $ |

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


American Ammunition, Inc. and Subsidiaries
Consolidated Statements of Operations and Comprehensive Income (Loss)
Six and Three months ended June 30, 2004 and 2003

(Unaudited)

| | Six months ended June 30, 2004 | Six months ended June 30, 2003 | Three months ended June 30, 2004 | T J |
|---|---|---|---|---|
| Revenues | $ 850,292 | $ 897,988 | $ 568,785 | $ |
| Cost of Sales | | | | |
| Materials, Direct Labor and other direct costs | 1,602,707 | 1,099,140 | 1,070,662 | |
| Depreciation | 347,511 | 329,169 | 174,423 | |
| Total Cost of Sales | 1,950,218 | 1,428,309 | 1,245,085 | |
| Gross Profit | (1,099,926) | (530,321) | (676,300) | |
| Operating Expenses | | | | |
| Research and development expenses | 6,474 | 324 | 6,474 | |
| Marketing and promotion expenses | 254,054 | 13,515 | 130,875 | |
| Other operating expenses | 595,092 | 458,472 | 304,425 | |
| Interest expense | 767 | 16,545 | 507 | |
| Depreciation expense | 3,787 | 2,258 | 1,893 | |
| Compensation expense related to common stock issuances at less than "fair value" | 356,000 | 354,304 | 35 000 | |
| Total Operating Expenses | 1,243,993 | 845,418 | 479,174 | |
| Loss from Operations | (2,343,919) | (1,375,739) | (1,155,474) | |
| Other Income (Expense) | | | | |
| Interest and other income | 254 | 2,594 | 167 | |
| Amortization of Beneficial Conversion Feature Discount on Preferred Stock | - | (30,948) | - | |
| Income (Loss) before Income Taxes | (2,343,665) | (1,404,093) | (1,155,307) | |

| | | | | |
|---|---|---|---|---|
| Provision for Income Taxes | - | - | - | |
| Net Income (Loss) | (2,343,665) | (1,404,093) | (1,155,307) | |
| Other Comprehensive Income | - | - | - | |
| Comprehensive Income (Loss) | $ (2,343,665) | $ (1,404,093) | $ (1,155,307) | $ |
| Loss per weighted-average share of common stock outstanding, computed on net loss - basic and fully diluted | $ (0.03) | $ (0.02) | $ (0.02) | $ |
| Weighted-average number of common shares outstanding | 69,458,597 | 57,972,390 | 71,148,043 | |

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



American Ammunition, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Six months ended June 30, 2004 and 2003

(Unaudited)

| | Six months ended June 30, 2004 | J |
|---|---|---|
| Cash flows from operating activities | | |
| Net loss for the year | $ (2,343,665) | |
| Adjustments to reconcile net loss to net cash provided by operating activities | | |
| Depreciation and amortization | 351,298 | |
| Bad debt expense | 27,819 | |
| Amortization of Beneficial Conversion Feature Discount on Preferred Stock | - | |
| Compensation expense related to common stock issuances at less than "fair value" | 356,000 | |
| (Increase) Decrease in | | |
| Accounts receivable | 455,943 | |
| Inventory | 92,296 | |
| Prepaid expenses, deposits and other | (2,172) | |
| Increase (Decrease) in | | |
| Accounts payable - trade | 89,252 | |
| Other accrued expenses | - | |
| Customer deposits | - | |
| Net cash used in operating activities | (973,229) | |

| | |
|---|---|
| Cash flows from investing activities | |
| Purchase of property and equipment | (338,170) |
| Net cash used in investing activities | (338,170) |
| Cash flows from financing activities | |
| Principal paid on long-term debt | - |
| Principal paid on long-term capital leases | (5,235) |
| Cash paid to obtain capital | - |
| Cash received on convertible debenture | - |
| Cash received on sale of convertible preferred stock | - |
| Cash received on sale of common stock | 1,250,000 |
| Net cash provided by financing activities | 1,244,765 |
| Increase (Decrease) in Cash | (66,634) |
| Cash at beginning of year | 505,671 |
| Cash at end of year | $ 439,037 |

- Continued -

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

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American Ammunition, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Six months ended June 30, 2004 and 2003

(Unaudited)

| | Six months ended June 30, 2004 |
|---|---|
| Supplemental disclosure of interest and income taxes paid | |
| Interest paid for the period | $ 767 |
| Income taxes paid for the period | $ - |

Supplemental disclosure of non-cash

| | | |
|---|---|---|
| investing and financing activities | | |
| Conversion of debt and accrued interest payable to a shareholder into common stock | $ 125,000 | $ |
| Common stock issued in payment for costs of raising capital | $ 36,000 | $ |
| Common stock issued in payment of accrued dividends on Preferred Stock - Series A and Series B | $ 19,540 | $ |

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



American Ammunition, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

Note A - Organization and Description of Business

American Ammunition, Inc. (AAI or Company) was incorporated on February 1, 2000 in the State of California as FirsTelevision.com. AAI subsequently changed its corporate name to FBI Fresh Burgers International which unsuccessfully marketed a business plan concept of a national "fast food" restaurant chain.

On September 29, 2001, the Company, F&F Equipment, Inc. (F&F) and the individual shareholders of F&F entered into an "Agreement For The Exchange Of Common Stock" (Exchange Agreement) whereby the shareholders of F&F exchanged 100.0% of the issued and outstanding stock of F&F for 21,000,000 post-forward split shares of restricted, unregistered common stock of the Company. F&F Equipment, Inc. then became a wholly-owned subsidiary of the Company.

F&F Equipment, Inc.(Company) was incorporated on October 4, 1983 under the laws of the State of Florida. The Company was formed to engage principally in the "import, export, retail & wholesale of firearms equipment, ammunition & other devices and for the purpose of transacting any and/or all lawful business." The Company conducts its business operations under the assumed name of "American Ammunition".

In June 2002, American Ammunition, Inc. formed a wholly owned subsidiary, Industrial Plating Enterprise Co. (IPE), which started production on June 14, 2002. IPE is a fully licensed and approved state of the art electrochemical metallization facility for processing the Company's line of projectiles as well as other products and services while employing environmentally sound water conservation and proven waste treatment techniques. The facility meets or exceeds all current environmental requirements and enjoys the "conditionally exempt small quantity generator" status for State and Federal regulations.

Note B - Preparation of Financial Statements

The acquisition of F&F Equipment, Inc., on September 29, 2001, by the Company effected a change in control and was accounted for as a "reverse acquisition" whereby F&F Equipment, Inc. was the accounting acquiror for financial statement purposes. Accordingly, the historical financial statements of the Company are those of F&F Equipment, Inc. from it's inception and those of the consolidated entity subsequent to the September 29, 2001 transaction date.

The Company and its subsidiaries follow the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America and have adopted a year-end of December 31 for all entities.

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

Management further acknowledges that it is solely responsible for adopting sound accounting practices, establishing and maintaining a system of internal accounting control and preventing and detecting fraud. The Company's system of internal accounting control is designed to assure, among other items, that 1) recorded transactions are valid; 2) valid transactions are recorded; and 3) transactions are recorded in the proper period in a timely manner to produce financial statements which present fairly the financial condition, results of operations and cash flows of the Company for the respective periods being presented

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American Ammunition, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

Note B - Preparation of Financial Statements - Continued

For segment reporting purposes, the Company operated in only one industry segment during the periods represented in the accompanying financial statements and makes all operating decisions and allocates resources based on the best benefit to the Company as a whole.

During interim periods, the Company follows the accounting policies set forth in its annual audited financial statements filed with the U. S. Securities and Exchange Commission on its Annual Report on Form 10-KSB for the year ended December 31, 2003. The information presented within these interim financial statements may not include all disclosures required by accounting principles generally accepted in the United States of America and the users of financial information provided for interim periods should refer to the annual financial information and footnotes when reviewing the interim financial results presented herein.

In the opinion of management, the accompanying interim financial statements, prepared in accordance with the U. S. Securities and Exchange Commission's instructions for Form 10-QSB, are unaudited and contain all material adjustments, consisting only of normal recurring adjustments necessary to present fairly the financial condition, results of operations and cash flows of the Company for the respective interim periods presented. The current period results of operations are not necessarily indicative of results which ultimately will be reported for the full fiscal year ending December 31, 2004.

The accompanying consolidated financial statements contain the accounts of American Ammunition, Inc. and its wholly-owned subsidiaries, F&F Equipment, Inc. and Industrial Plating Enterprise Co. All significant intercompany transactions have been eliminated. The consolidated entities are collectively referred to as "Company".

Note C - Summary of Significant Accounting Policies

1. Cash and cash equivalents

   For Statement of Cash Flows purposes, the Company considers all cash on hand and in banks, including accounts in book overdraft positions, certificates of deposit and other highly-liquid investments with maturities of three months or less, when purchased, to be cash and cash equivalents.

   Cash overdraft positions may occur from time to time due to the timing of making bank deposits and releasing checks, in accordance with the Company's cash management policies.

2. Accounts receivable and Revenue Recognition

   In the normal course of business, the Company extends unsecured credit to virtually all of its customers which are located throughout the United States. Because of the credit risk involved, management has provided an allowance for doubtful accounts which reflects its opinion of amounts which will eventually become uncollectible. In the event of complete non-performance, the maximum exposure to the Company is the recorded amount of trade accounts receivable shown on the balance sheet at the date of non-performance.

   The Company ships all product on an FOB-Plant basis. Accordingly, revenue is recognized by the Company at the point at which an order is shipped at a fixed price, collection is reasonably assured, the Company has no remaining performance obligations and no right of return by the purchaser exists.

Note C - Summary of Significant Accounting Policies - Continued

3. Inventory

Inventory consists of raw materials, work-in-process and finished goods related to the production and sale of small arms ammunition. Inventory is valued at the lower of cost or market using the first-in, first-out method.

4. Property, plant and equipment

Property and equipment are recorded at historical cost. These costs are depreciated over the estimated useful lives of the individual assets using the straight-line method, generally three to ten years.

Gains and losses from disposition of property and equipment are recognized as incurred and are included in operations.

5. Income Taxes

The Company uses the asset and liability method of accounting for income taxes. At June 30, 2004 and 2003, the deferred tax asset and deferred tax liability accounts, as recorded when material to the financial statements, are entirely the result of temporary differences. Temporary differences represent differences in the recognition of assets and liabilities for tax and financial reporting purposes, primarily accumulated depreciation and amortization, allowance for doubtful accounts and vacation accruals.

As of June 30, 2004 and 2003, the deferred tax asset related to the Company's net operating loss carryforward is fully reserved. If these carryforwards are not utilized, they will begin to expire in 2005.

6. Earnings (loss) per share

Basic earnings (loss) per share is computed by dividing the net income (loss) available to common shareholders by the weighted-average number of common shares outstanding during the respective period presented in our accompanying financial statements. Fully diluted earnings (loss) per share is computed similar to basic income (loss) per share except that the denominator is increased to include the number of common stock equivalents (primarily outstanding options and warrants). Common stock equivalents represent the dilutive effect of the assumed exercise of the outstanding stock options and warrants, using the treasury stock method, at either the beginning of the respective period presented or the date of issuance, whichever is later, and only if the common stock equivalents are considered dilutive based upon the Company's net income (loss) position at the calculation date.

At June 30, 2004 and 2003, the Company had no common stock equivalents outstanding.

7. Advertising costs

The Company does not conduct any direct response advertising activities. For non-direct response advertising, the Company charges the costs of these efforts to operations at the first time the related advertising is published.

American Ammunition, Inc. and Subsidiaries

Notes to Consolidated Financial Statements - Continued

Note D - Fair Value of Financial Instruments

The carrying amount of cash, accounts receivable, accounts payable and notes payable, as applicable, approximates fair value due to the short term nature of these items and/or the current interest rates payable in relation to current market conditions.

Interest rate risk is the risk that the Company's earnings are subject to fluctuations in interest rates on either investments or on debt and is fully dependent upon the volatility of these rates. The Company does not use derivative instruments to moderate its exposure to interest rate risk, if any.

Financial risk is the risk that the Company's earnings are subject to fluctuations in interest rates or foreign exchange rates and are fully dependent upon the volatility of these rates. The company does not use derivative instruments to moderate its exposure to financial risk, if any.

Note E - Concentrations of Credit Risk

The Company maintains its cash accounts in a financial institution subject to insurance coverage issued by the Federal Deposit Insurance Corporation (FDIC). Under FDIC rules, the separate companies are each entitled to aggregate coverage of $100,000 per account type per separate legal entity per financial institution. During the years ended December 31, 2003 and 2002 and each of the six months ended June 30, 2004 and 2003, respectively, the various operating companies had deposits in a financial institution with credit risk exposures in excess of statutory FDIC coverage. The Company has incurred no losses as a result of any of these unsecured situations.

Note F - Inventory

As of June 30, 2004 and 2003, inventory consisted of the following components:

| | June 30, 2004 | June 30, 2003 |
|---|---|---|
| Raw materials | $ 121,795 | $ 152,770 |
| Work in process | 562,094 | 149,467 |
| Finished goods | 336,571 | 156,919 |
| Totals | $ 1,020,460 | $ 459,156 |

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American Ammunition, Inc. and Subsidiaries

Notes to Consolidated Financial Statements - Continued

Note G - Property and Equipment

Property and equipment consist of the following components:

| | June 30, 2004 | June 30, 2003 | Estimated useful life |
|---|---|---|---|
| Manufacturing equipment | $ 7,446,870 | $ 6,865,916 | 3-10 years |
| Office furniture and fixtures | 82,719 | 62,893 | 3- 7 years |
| Leasehold improvements | 187,397 | 190,028 | 8-20 years |
| | 7,716,986 | 7,118,837 | |
| Accumulated depreciation | (4,417,688) | (3,724,728) | |
| Net property and equipment | $3,299,298 | $3,394,109 | |

Total depreciation expense charged to operations for the six months ended June 30, 2004 and 2003 was approximately $351,298 and $331,427. respectively.

Included in the amounts reflected in the accompanying balance sheet are the following fixed assets on long-term capital leases:

| | June 30, 2004 | June 30, 2003 |
|---|---|---|
| Manufacturing and processing equipment | $ 153,400 | $ 153,400 |
| Less accumulated depreciation | (91,211) | (62,189) |
| | $ 62,189 | $ 91,211 |

Note H - Working Capital Advance

On March 13, 2003, La Jolla Cove Investors, Inc., the holder of the Company's convertible debenture, advanced the Company an additional $200,000 for working capital purposes. At La Jolla Cove's sole discretion, the $200,000 could be allocated in any proportion to a) an increase in the principal amount of the debenture and/or b) a prepayment for a future warrant exercise. During the 2nd quarter of 2003, La Jolla elected to add this balance to the principal balance on the convertible debenture.

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American Ammunition, Inc. and Subsidiaries

Notes to Consolidated Financial Statements - Continued

Note I- Capital Leases Payable

Capital leases payable consist of the following as of June 30, 2004 and 2003, respectively:

| | June 30, 2004 |
|---|---|
| Three capital leases, respectively, payable to various equipment financing companies. Interest, at March 31, 2002, ranging between 11.37% and 14.05%. Payable in aggregate monthly installments of approximately $935, including accrued interest. Final maturities occur between September 2004 and December 2004. Collateralized the underlying leased manufacturing equipment. | $ 2,606 |
| Less current maturities | (2,606) |
| Long-term portion | $ - |

Future maturities of capital leases payable are as follows:

| Year ending December 31 | Amount |
|---|---|
| 2004 | $ 2,606 |

Note I - Long-Term Debt Payable to a Bank

On June 28, 2001, the Company executed a $950,000 note payable to a financial institution. This note bore interest at the Wall Street Journal published prime rate plus 2.0%.

During Calendar 2002, the Company made five (5) lump-sum principal reductions aggregating $500,000 to the outstanding balance on this note. As of December 31, 2002, the Company owed $450,000 on this note. Upon each lump-sum payment, the Company executed a modification to the payment terms on the note.

During Calendar 2003, the Company made two (2) lump-sum principal reductions aggregating $450,000 to the outstanding balance on this note. As of March 31, 2003, this note was retired in full.

Note K - Convertible Debenture

On October 4, 2002, the Company issued an 8.0% Convertible Debenture (Debenture) in the face amount of $250,000 and a Warrant which requires the Holder to purchase shares of common stock equal to ten (10) times the number of shares of common stock issued to the Holder on conversion of the Debenture. In no event shall the number of shares issued under the Warrant exceed 30,000,000.

During the second quarter of Calendar 2003, the Holder made additional cash advances to the Company totaling $350,000 which were applied to the then outstanding principal balance on the Debenture.





Note K - Convertible Debenture - Continued

The Debenture bears interest at 8.0% and matures on October 4, 2004. The full principal amount of the Debenture is due upon default, as defined in the Debenture agreement. The Debenture interest is payable monthly in arrears commencing on November 15, 2002.

At June 30, 2004 and 2003, respectively, the outstanding balance on the

Debenture was approximately $266,365 and $524,865.

In December 2002, the Company and the Debenture Holder amended the above-referenced debenture and warrants as follows:

The number of common shares into which the debenture may be converted is equal to the dollar amount of the debenture being converted multiplied by eleven, minus the product of the conversion price, multiplied by ten times the dollar amount of the debenture being converted, divided by the conversion price. The conversion price is obtained by multiplying the average of the five (5) lowest Volume Weighted Average Prices (VWAP) during the 20 trading days prior to the date of conversion by the Discount Multiplier of 80%.

The warrants are exercisable at $1.00 per share for up to 2,500,000 shares. The warrant holder is obligated to exercise the warrant concurrently with the conversion of the debenture for a number of shares equal to ten times the dollar amount of the debenture being converted.

The Company was obligated to file a Registration Statement under the Securities Act of 1933 to register the underlying conversion shares on either Form SB-2 or S-3. This Registration Statement was declared effective by the U. S. Securities and Exchange Commission on May 14, 2003.

The Debenture Holder has contractually committed to convert not less than 5.0% and not more than 10.0% of the original face value of the Debenture monthly beginning the month after the effective date of the Registration Statement and the Holder is required to concurrently exercise warrants and purchase shares of common stock equal to ten (10) times the number of shares of common stock issued to the Holder upon the respective mandatory conversion of the Debenture.

The Holder has further contractually agreed to restrict its ability to convert the Debenture or exercise their warrants and receive shares of the Company's common stock such that the number of shares held by the Holder and its affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of common stock of the Company.

In the event an election to convert is made and the volume weighted average price of the Company's common stock is below $0.30 per share, the Company shall have the right to prepay any portion of the outstanding Debenture that was elected to be converted, plus any accrued and unpaid interest, at 125.0%.

Due to the contractually agreed mandatory conversion of this Debenture, the Company has reflected this transaction in its balance sheet as a "mezzanine" level debt obligation on its balance sheet, between "Total Liabilities" and "Stockholders' Equity". Upon the respective mandatory conversion, the Company will relieve the respective portion of the Debenture and the any related accrued, but unpaid interest, and credit this amount to the respective "common stock" and "additional paid-in capital" accounts in the stockholder's equity section for the par value and excess amount over the par value of the respective shares issued.

American Ammunition, Inc. and Subsidiaries

Notes to Consolidated Financial Statements - Continued

Note K - Convertible Debenture - Continued

As the warrant is non-detachable from the Debenture and requires simultaneous exercise upon conversion of the Debenture, no value was assigned to the issued warrant. Upon exercise of the warrant, the Company will record the issuance of the underlying shares as a new issuance of common stock on the date of each respective exercise.

On various dates through June 30, 2004, the Debenture Holder elected to convert an aggregate $333,635, through 29 separate transactions, in outstanding Debenture principal into restricted, unregistered common stock. This election caused the Company to issue 8,711,753 shares of restricted, unregistered common stock to the Debenture Holder. Additionally, pursuant to the contract terms, the Debenture Holder concurrently exercised a portion of the outstanding Warrant to purchase 3,336,350 shares of the Company's restricted, unregistered common stock for gross proceeds of $3,336,350.

As of June 30, 2004, pursuant to the conversion terms of the Debenture, the Debenture Holder is in arrears in the contractually obligated conversions, and accordingly, the related mandatory warrant exercise.

Note L - Preferred Stock Transactions

Preferred stock consists of the following as of June 30, 2004 and 2003, respectively:

| | June 30, 2004 | | June 30, 2003 | |
|---|---|---|---|---|
| | # shares | value | # shares | value |
| Series A Cumulative Convertible Stock | 12,000 | $ 60,000 | 36,000 | $160,000 |
| Series B Cumulative Convertible Stock | 91,700 | 458,500 | 91,700 | 458,500 |
| | 103,700 | 518,500 | 127,700 | 618,500 |
| Beneficial Conversion Feature Discount | | - | | (62,730) |
| | | $518,500 | | $555,770 |

In September, October and November 2001, the Company sold an aggregate 222,600 shares of $5.00 Series A Convertible Preferred Stock (Series A Preferred Stock) for total proceeds of approximately $1,113,000 through a Private Placement Memorandum. The Series A Convertible Preferred Stock provides for cumulative dividends at a rate of 8.0% per year, payable quarterly, in cash or shares of the Company's common stock at the Company's election. Each share of Series A Preferred Stock is convertible into 11 shares of the Company's common stock initially at any time after 6 months of the date of issue and prior to the notice of redemption at the option of the holder, subject to adjustments for customary anti-dilution events. In December 2001, at the request of the holders of the Series A Preferred Stock, the Company and the individual holders modified the holding period for conversion to allow for conversion in December 2001.

In September 2001, the Company's principal stockholder converted approximately

$4,007,327 of unsecured debt and approximately $3,546,273 of cumulative and unpaid accrued interest into 1,510,710 shares of Series A Preferred Stock.

In September 2001, a creditor of the Company agreed to convert approximately $10,000 of trade accounts payable into 2,000 shares of Series A Preferred Stock.

In December 2001, concurrent with a modification in the holding period prior to conversion, certain holders of the Series A Preferred Stock orally notified the Company of their intent to exercise the conversion features on 1,749,720 issued and outstanding shares of Series A Preferred Stock into 19,246,920 shares of common stock prior to December 31, 2001. Due to the timing of the requisite documentation, the clerical activities related to this conversion were not completed until February 2002.





Note L - Preferred Stock Transactions - Continued

In conjunction with the Series A Preferred Stock, certain shares were sold after the Company's common stock was approved for trading by the National Association of Securities Dealers on the OTC Bulletin Board in October 2001. The shares of Series A Preferred Stock sold subsequent to this date had an equivalent per share value of common stock below the ending quoted market price of the Company's common stock on their respective issue dates. This difference created a Beneficial Conversion Feature Discount of approximately $1,207,993. This discount was then amortized over the unexpired time period between the date of issue of the eligible shares and the eligible conversion date, as amended. All of the shares sold subsequent to the initial trading date were converted in December 2001 and, accordingly, the approximate $1,207,993 in Beneficial Conversion Feature Discount was fully amortized to operations.

In December 2002, a holder of 5,000 shares of Series A Preferred Stock exercised his conversion rights and converted these shares of Series A Preferred Stock into 55,000 shares of restricted, unregistered common stock.

In January 2003, three separate holders of 9,000 shares of Series A Preferred Stock exercised their conversion rights and converted these shares of Series A Preferred stock into 99,000 shares of restricted, unregistered common stock.

In May 2003, the Company sold an aggregate 91,700 shares of $5.00 Series B Convertible Preferred Stock (Series B Preferred Stock) for total proceeds of approximately $458,500 through a separate Private Placement Memorandum. The Series B Convertible Preferred Stock provides for cumulative dividends at a rate of 8.0% per year, payable quarterly, in cash or shares of the Company's common stock at the Company's election. Each share of Series B Preferred Stock is convertible into 11 shares of the Company's common stock initially at any time after 6 months of the date of issue and prior to the notice of redemption at the option of the holder, subject to adjustments for customary anti-dilution events.

Note M - Common Stock Transactions

In January 2003, the Company issued an aggregate 937,568 shares of restricted, unregistered common stock for cash proceeds of approximately $324,182. These sales were made at a price of either $0.23 or $0.36 per share, which was in excess of the discounted "fair value" of the Company's common stock based on the quoted closing price of the Company's common stock on the date of the respective transaction. The proceeds of this transaction were used for operating working capital. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction.

In February 2003, the Company issued 384,615 shares of restricted, unregistered common stock for cash proceeds of approximately $100,000. These sales were made at a price of $0.26 per share, which was in excess of the discounted "fair value" of the Company's common stock based on the quoted closing price of the Company's common stock on the date of the respective transaction. The proceeds of this transaction were used to reduce the Company's outstanding long-term debt. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction.

In March 2003, the Company issued 972,222 shares of restricted, unregistered common stock for cash proceeds of approximately $350,000. These sales were made at a price of $0.36 per share, which was in excess of the discounted "fair value" of the Company's common stock based on the quoted closing price of the Company's common stock on the date of the respective transaction. The proceeds of this transaction were used to reduce the Company's outstanding long-term debt. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction.





Note M - Common Stock Transactions - Continued

In March 2003, the Company issued an aggregate 966,608 shares of restricted, unregistered common stock to the Holder of the Company's 8.0% Convertible Debenture upon notice of conversion of $35,000 of outstanding principal and exercise of a portion of the outstanding warrant to purchase 350,000 shares of common stock. This transaction was valued at $385,000, or approximately $0.40 per share, which was in excess of the discounted "fair value" of the Company's common stock based on the quoted closing price of the Company's common stock on the date of the respective transaction. The cash proceeds of this transaction were used to provide working capital and support operations.

In May 2003, the Company issued 1,967 shares of restricted, unregistered common stock in payment of approximately $1,200 in accrued dividends payable on the Company's outstanding Series A Preferred Stock for the quarter ended March 31, 2003. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction.

During the period from July 1, 2003 through September 30, 2003, the Company issued an aggregate 2,902,129 shares of common stock, in 15 separate transactions, in exchange for the redemption of approximately $93,500 in outstanding debenture balance and approximately $935,000 in cash from the exercise of the affiliated warrant. Where the closing price of the Company's common stock was in excess of the respective price per share on the respective transaction date, the Company recognized a charge to operations for "compensation expense related to common stock issuances at less than "fair value". The cumulative effect of transactions where the transaction price, as established in the Debenture Agreement, was less than the closing price on the date of the respective transactions resulted in a cumulative charge to operations of approximately $317,539 during this time period.

In October 2003, in a separate transaction, the Company sold 2,200,000 shares of restricted, unregistered common stock to the Debenture Holder for cash proceeds of approximately $400,000, or approximately $0.18 per share, which was in excess of the discounted "fair value" of the Company's common stock based on the quoted closing price of the Company's common stock on the date of the respective transaction. The cash proceeds of this transaction were used to provide working capital and support operations.

In October 2003, the Company issued an aggregate 1,659,847 shares of common stock, in 3 separate transactions, in exchange for the redemption of approximately $40,000 in outstanding debenture balance and approximately $400,000 in cash from the exercise of the affiliated warrant. Where the closing price of the Company's common stock was in excess of the respective price per share on the respective transaction date, the Company recognized a charge to operations for "compensation expense related to common stock issuances at less than "fair value". The cumulative effect of transactions where the transaction price, as established in the Debenture Agreement, was less than the closing price on the date of the respective transactions resulted in a cumulative charge to operations of approximately $146,189 during this time period.

In October 2003, the Company issued an aggregate 37,866 shares of restricted, unregistered common stock in payment of approximately $16,710 in accrued dividends payable on the Company's outstanding Series A and Series B Preferred Stock for the quarters ended June 30, 2003 and September 30, 2003, collectively. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction.

In January 2004, the Company issued 38,038 shares of restricted, unregistered common stock in payment of approximately $10,000 in accrued dividends payable on the Company's outstanding Series A and Series B Preferred Stock for the quarter ended December 31, 2003. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction.

Note M - Common Stock Transactions - Continued

During the period from January 1, 2004 through March 31, 2004, the Company issued an aggregate 2,400,000 shares of common stock, in two (2) separate transactions, in exchange for the redemption of approximately $50,000 in outstanding debenture balance and approximately $500,000 in cash from the exercise of the affiliated warrant. Where the closing price of the Company's common stock was in excess of the respective price per share on the respective transaction date, the Company recognized a charge to operations for "compensation expense related to common stock issuances at less than "fair value". The cumulative effect of transactions where the transaction price, as established in the Debenture Agreement, was less than the closing price on the date of the respective transactions resulted in a cumulative charge to operations of approximately $321,000 during this time period.

In May 2004, the Company issued 25,260 shares of restricted, unregistered common stock in payment of approximately $9,170 in accrued dividends payable on the Company's outstanding Series B Preferred Stock for the quarter ended March 31, 2004. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction.

During the period from April 1, 2004 through June 30, 2004, the Company issued an aggregate 3,000,000 shares of common stock, in three (3) separate transactions, in exchange for the redemption of approximately $75,000 in outstanding debenture balance and approximately $750,000 in cash from the exercise of the affiliated warrant. Where the closing price of the Company's common stock was in excess of the respective price per share on the respective transaction date, the Company recognized a charge to operations for "compensation expense related to common stock issuances at less than "fair value". The cumulative effect of transactions where the transaction price, as established in the Debenture Agreement, was less than the closing price on the date of the respective transactions resulted in a cumulative charge to operations of approximately $35,000 during this time period. Additionally, on June 29, 2004, the Company issued an additional 1,000,000 shares of common stock in advance of the exercise of a $25,000 redemption on the outstanding debenture payable and a $250,000 cash payment on the exercise of the affiliated warrant, which was received in July 2004.

On May 26, 2004, the Company issued 300,000 shares of restricted, unregistered common stock to two separate corporations in payment and full satisfaction of all amounts due for fees and/or commissions due in conjunction with the Company's convertible debenture financing transaction. This transaction was valued at approximately $36,000, which approximated the "fair value" of the underlying securities given in payment and the related charges for the services provided. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction.

Note N - Rental Commitments

The Company leases its corporate office and manufacturing facility from its controlling stockholder under a long- term operating lease agreement. The lease requires a monthly payment of approximately $5,410, including applicable sales taxes. The Company is responsible for all utilities and maintenance expenses. The lease expires on July 31, 2004 and contains a clause that upon expiration, the Company and the controlling shareholder shall renegotiate the annual rental amount. Total rent expense under this lease was approximately $67,075 and $54,100, respectively, for each of the years ended December 31, 2003 and 2002.

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American Ammunition, Inc. and Subsidiaries

Notes to Consolidated Financial Statements - Continued

Note N - Rental Commitments - Continued

The Company's subsidiary, IPE, leases it's manufacturing facility from an unrelated third-party under a long-term operating lease agreement. This lease is for a period of five (5) years and requires graduated monthly payments, changing on the lease anniversary date, ranging from approximately $1,751 to $1,914, plus the applicable sales taxes. The Company is responsible for all utilities and maintenance expenses. The lease expires on February 28, 2007 and may be renewed for an additional five (5) year term at a rental rate of approximately $1,971, plus applicable sales taxes for the first renewal year and 3.0% increase on each succeeding anniversary date. Total rent expense under this lease was approximately $20,752 and $16,622, respectively, for each of the years ended December 31, 2003 and 2002.

In May 2004, the Company entered into a long-term lease agreement for a warehouse facility adjacent to the Company's primary office and manufacturing facility. This lease is for a period of two (2) years and requires payments of approximately $6,206 per month for the first 12 months and approximately $6,393 for the second 12 months, plus applicable sales taxes. The Company is responsible for all utilities and maintenance expenses. This lease expires on May 31, 2006. Further, the Company is responsible for any incremental real estate taxes and property insurance in excess of the amounts incurred by the landlord for the calendar year immediately preceding the execution of the lease.

Future minimum rental payments on the above leases are as follows:

| Year ended December 31, | Amount |
|---|---|
| 2004 | $ 104,196 |
| 2005 | 99,348 |
| 2006 | 56,242 |
| 2007 | 4,076 |
| Totals | $ 263,862 |

Note O - Income Taxes

The components of income tax (benefit) expense for the six months ended June 30, 2004 and 2003, respectively, are as follows:

| | Six months ended June 30, 2004 | Six months ended June 30, 2003 |
|---|---|---|
| Federal: | | |
| Current | $ - | $ - |
| Deferred | - | - |
| | - | - |
| State: | | |
| Current | - | - |
| Deferred | - | - |
| | - | - |
| Total | $ - | $ - |



American Ammunition, Inc. and Subsidiaries

Notes to Consolidated Financial Statements - Continued

Note O - Income Taxes - Continued

As of December 31, 2003, the Company has a net operating loss carryforward of approximately $8,500,000 to offset future taxable income. Subject to current regulations, components of this carryforward began to expire in 2003. The amount and availability of the net operating loss carryforwards may be subject to limitations set forth by the Internal Revenue Code. Factors such as the number of shares ultimately issued within a three year look-back period; whether there is a deemed more than 50 percent change in control; the applicable long-term tax exempt bond rate; continuity of historical business; and subsequent income of the Company all enter into the annual computation of allowable annual utilization of the carryforwards.

The Company's income tax expense (benefit) for the six months ended June 30, 2004 and 2003, respectively, differed from the statutory federal rate of 34 percent as follows:

| | Six months ended June 30, 2004 | Six months ended June 30, 2003 |
|---|---|---|
| Statutory rate applied to loss before income taxes | $ (797,000) | $ (477,000) |
| Increase (decrease) in income taxes resulting from: | | |
| State income taxes | - | - |

| | | |
|---|---|---|
| Other, including reserve for deferred tax asset | 797,000 | 477,000 |
| Income tax expense | $ - | $ - |

Temporary differences, consisting primarily of statutory differences in the depreciable lives for property and equipment, between the financial statement carrying amounts and tax bases of assets and liabilities give rise to deferred tax assets and liabilities as of December 31, 2003 and 2002, respectively:

| | December 31, 2003 | December 31, 2002 |
|---|---|---|
| Deferred tax assets - long-term | | |
| Net operating loss carryforwards | $ 2,900,000 | $ 2,244,000 |
| Deferred tax liabilities - long-term | | |
| Statutory depreciation differences | (250,000) | (250,000) |
| | 2,650,000 | 1,994,000 |
| Less valuation allowance | (2,650,000) | (1,994,000) |
| Net Deferred Tax Asset | $ - | $ - |

During the years ended December 31, 2003 and 2002, respectively, the valuation allowance increased by approximately $656,000 and $629,000.

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Item 2 - Management's Discussion and Analysis or Plan of Operation

(1) Caution Regarding Forward-Looking Information

Certain statements contained in this Quarterly Report including, without limitation, statements containing the words "believes", "anticipates", "expects" and words of similar import, constitute forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements.

Such factors include, among others, the following: international, national and local general economic and market conditions: demographic changes; the ability of the Company to sustain, manage or forecast its growth; the ability of the Company to successfully make and integrate acquisitions; raw material costs and availability; new product development and introduction; existing government regulations and changes in, or the failure to comply with, government regulations; adverse publicity; competition; the loss of significant customers or suppliers; fluctuations and difficulty in forecasting operating results; changes in business strategy or development plans; business disruptions; the ability to attract and retain qualified personnel; the ability to protect technology; and other factors referenced in this and previous filings.

Given these uncertainties, readers of this Quarterly Report and investors are cautioned not to place undue reliance on such forward-looking statements. The Company disclaims any obligation to update any such factors or to publicly announce the result of any revisions to any of the forward-looking statements contained herein to reflect future events or developments.

Overview

We were incorporated on February 1, 2000 in the State of California as FirsTelevision.com. We subsequently changed our corporate name to FBI Fresh Burgers International which unsuccessfully marketed a business plan concept of a national "fast food" restaurant chain.

American Ammunition, Inc. is a holding company with two operating subsidiaries: F&F Equipment, Inc. and Industrial Plating Enterprise Co.

F&F Equipment, Inc. was incorporated on October 4, 1983 under the laws of the State of Florida. The company was formed to engage principally in the "import, export, retail & wholesale of firearms equipment, ammunition & other devices and for the purpose of transacting any and/or all lawful business." F&F conducts its business operations under the assumed name of "American Ammunition."

In June 2002, American Ammunition, Inc. formed a wholly owned subsidiary, Industrial Plating Enterprise Co., which started production on June 14, 2002. Industrial Plating is a fully licensed and approved electrochemical metallization facility with significant capacity for processing our line of projectiles as well as other products and services while employing environmentally sound water conservation and proven waste treatment techniques.

During the third quarter of 2003, the Company's operations experienced the negative impact of a lower than anticipated or budgeted purchases by Elliot Brothers, a significant customer.

However, during this same time period, the Company has entered into a strategic alliance with Israel Military Industries (IMI), an entity owned by the State of Israel, for the cross-production and sale of various small arms ammunition. This alliance is anticipated to greatly expand the Company's catalog of products and assist in utilizing existing production capacity.

In prior periods, the Company executed a private labeling agreement with Century International Arms, Inc. (Century). Under this agreement, the Company was to produce it's standard catalog of small arms ammunition plus one specialty small arms cartridge to Century's specifications for packaging in Century's designated labeling. This agreement required no modifications to the Company's production line and did not require the addition of supplemental personnel or equipment. The Company made an initial shipment under this agreement to Century during December 2003. Virtually immediately, the Company began to experience problems with Century regarding Century's compliance with their performance criteria under this agreement. During the first quarter of 2004, Century defaulted on certain agreed-upon payment schedules on merchandise sold during December 2003. In repayment of the outstanding trade debt, the Company accepted unscheduled product returns as payment of the trade debt. As a result of these issues, the Company recognized a charge to operations of approximately $28,000 on it's business activity with Century. The returned merchandise was repackaged and is resalable by the Company to other customers. As of June 30, 2004, the Company has cancelled this agreement, and is contemplating litigation against Century for breach of contractual obligations under this agreement.

Additionally, the Company has been awarded three (3) separate contracts from various departments of the U. S. Government. Each contract is for an initial term of one year (commencing between April 24, 2003 and September 30, 2003) with four (4) successive individual one-year extension options. The contracts are summarized as follows:

Contract 1: U. S. Department of State. Minimum annual volume of approximately 100,000 rounds of military grade small arms ammunition. Maximum annual volume of approximately 5,000,000 rounds. Maximum volume may be increased at the discretion of the Contracting Officer and respective utilization requirements. The Company has received firm orders for 2,265,000 rounds of ammunition under this contract and has approximately 1,265,000 rounds ready for shipment. The ammunition under this contract will be subject to the strategic alliance with Israel Military Industries (IWI).

Contract 2: U. S. Department of Energy. This contract covers seven (7) separate products in the Company's standard catalog of products. The U. S. Department of Energy is obligated to purchase an aggregate of 4,549,000 rounds of ammunition under this contract. Through March 31, 2004, the Company has not shipped any product under this contract.

Contract 3: U. S. Department of Homeland Security. This contract covers four (4) separate products being introduced to the Company's catalog through the strategic alliance with IMI and requires no modifications to the Company's production facilities or additions to the labor force. The minimum annual volume is 1,000 rounds of each product and a maximum annual volume of 9,600,000 rounds of two (2) products and 36,000,000 of the remaining two (2) products. The Company has shipped all first article samples, as defined in the contract, and has received favorable feedback on a 20,000 round shipment during the first quarter of 2004. Full scale shipments are anticipated to commence during the second quarter of 2004.

During the first quarter of 2004 and subsequent thereto, the Company remains in negotiation for the issuance of purchase orders against these contracts and continues to prepare bids on other contracts from these and other U. S. Governmental agencies.

During the first quarter of 2004, the Company commenced a direct solicitation program for it's "dealer direct" sales program. As this endeavor has received a very positive initial response from the qualified retail resellers of the Company's product, the announcement of this program had a significantly detrimental impact on the Company's relationship with wholesale distributors and, accordingly, had a significant negative impact on first quarter 2004 sales. The Company continues to experience increases in customer demand, order size and reorder quantities in this program by smaller "single store" owner/operators of retail outlets selling the Company's products. It is anticipated that the overall Calendar 2004 sales volume through the "dealer direct" program may well equal or exceed the sales volumes generated by wholesale distributors in prior years.

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Results of Operations

Six months ended June 30, 2004 compared with the six months ended June 30, 2003.

During the six and three months ended June 30, 2004, we experienced net revenues of approximately $850,000 and $569,000, respectively, as compared to approximately $898,000 and $290,000 for the same respective periods of 2003.

During the first quarter of 2004, the Company commenced a direct solicitation program for it's "dealer direct" sales program. As this endeavor has received a very positive initial response from the qualified retail resellers of the Company's product, the announcement of this program had a significantly detrimental impact on the Company's relationship with wholesale distributors and, accordingly, had a significant negative impact on first quarter 2004 sales. The Company continues to experience increases in customer demand, order size and reorder quantities in this program by smaller "single store" owner/operators of retail outlets selling the Company's products. It is anticipated that the overall Calendar 2004 sales volume through the "dealer direct" program may well equal or exceed the sales volumes generated by wholesale distributors in prior years.

We experienced costs of goods sold of approximately $1,950,218 for the six months ended June 30, 2004 as compared to approximately $1,428,000 for the six months ended June 30, 2003. Included in these amounts are approximately $348,000 and $329,000, respectively, for depreciation expense on manufacturing equipment and leasehold improvements on our production facility.

Management is of the opinion that the production labor force is stable and able to maintain a constant standard of quality for future periods. We experience variable costs in the area of material consumption and direct labor.

These depreciation levels are anticipated to remain fairly constant as compared to the first quarter of 2004. Management has placed on order, and placed initial deposits on, new manufacturing equipment to automate the product packaging process and to add new quality assurance equipment on the production line. These commitments aggregate approximately $260,000, of which the majority has been expended through June 30, 2004. Management, at this time, does not anticipate any further significant capital equipment acquisitions. Further, the addition of the Industrial Plating Enterprise Co. equipment during 2003 allows us to produce certain components which were previously outsourced to unrelated third parties.

For the six months ended June 30, 2004 and 2003, respectively, we have generated a negative gross profit of approximately $(1,100,000), or (129.36%), and approximately $(530,000), or (59.06%).

Our research during the second quarter of 2004 has revealed that the various governmental agencies which have issued purchase contracts to us either purchased large quantities during the last 60 days of the Federal Government's year ended September 30, 2003 or are experiencing transitional purchasing problems or issues surrounding the reorganization of various agencies into the Department of Homeland Security, with the related issues of Congressional appropriations for funding the necessary expenditures of these reorganized agencies. We continue to anticipate that with the fulfillment of the government contracts discussed above, continued retail consumer demand for our product line, lower production costs being experienced from internally generated plating activities and adequate liquidity, we will be able to generate a positive gross profit in future periods. Further, based on production cost information developed during the 4th quarter of 2002 and further refined during 2003, management has developed a new model for the pricing of its products to its customers. It is anticipated that this model will allow management to better manage expense levels, control labor costs and maximize revenue opportunities.

We had minimal costs allocated to research and development expenses during either of the quarters ended June 30, 2004 and 2003.

During the six months of 2004, we expended approximately $254,000 in advertising and marketing expenses, principally in developing and promoting our retail dealer direct program. We anticipate to continue our marketing



efforts in this area in future periods; however, the volume and frequency of our expenditures may fluctuate as management allocates available capital to these efforts.

Other general and administrative expenses increased by approximately $137,000 from approximately $595,000 for the six months ended June 30, 2004 as compared to approximately $458,000 for the six months ended June 30, 2003. These increases are not identifiable by one specific area; however, relate to general corporate expenses, office and administrative wages and salaries and other related office overhead.

Included in our results of operations for the first six months of 2004 are certain non-cash expenditure charges to operations of approximately $356,000 for compensation expense related to common stock issuances at less than "fair value". The calculation of these charges result from our issuing common stock for either cash or services at valuations below the closing quoted market price of our common stock (as discounted, as applicable) and either the cash received or the value of the services provided to us by third parties. During Calendar 2003, we experienced a charge of approximately $94,000 for the amortization of the Beneficial Conversion Feature Discount on our Preferred Stock. This charge results from the difference between the closing quoted market price on our common stock and the equivalent converted price of our Mandatory Convertible Preferred Stock which was sold and converted during 2003.

We recognized a net loss of approximately $(2,344,000) and $(1,404,000) for the respective three month periods ended March 31,2004 and 2003, respectively, or $(0.03) and $(0.02) per share.

Liquidity And Capital Resources

As of June 30, 2004, December 31, 2003 and June 30, 2003, respectively, we had working capital of approximately $1,296,287, $2,000,000 and $1,148,995. Our working capital position continues to fluctuate based on collections on our trade accounts receivable and investments from the mandatory exercise of our outstanding warrant related to our convertible debenture. Further, we anticipate that we have sufficient inventory levels to support our retail dealer direct program and our existing and anticipated U. S. Government contracts.

We have used cash in operating activities of approximately $(973,000) and $(911,000) during the quarters ended March 31, 2004 and 2003, respectively.

The most significant use of cash in operations during the six months ended June 30, 2004 was for the support of our operations where our costs, expenses and overhead was in excess of the sales volume that we generated, including increased advertising and marketing expenses to institute our new retail dealer direct program.

We anticipate that our improved liquidity position will continue to improve as management is of the opinion that the production capacity is in place to support all existing orders and accept existing inquiries which have previously been denied due to the lack of production capacity and liquidity.

During the six months ended June 30, 2004 and 2003, respectively, we added approximately $338,000 and $29,000 in new equipment. Depending on future demand for our products, we may develop plans to increase our production capacity by an additional 50% to 100%, as influenced by the availability of manufacturing equipment on the open market and product sales demand. Management is of the opinion that sufficient demand will be present, as supported by new product development and increased product marketing efforts, to justify this expansion. However, we may not be able to obtain additional funding or, that such funding, if available, will be obtained on terms favorable to or affordable by us.

Convertible Debenture

On October 4, 2002, we signed a Securities Purchase Agreement with La Jolla Cove Investors, Inc. (La Jolla) for the sale of a $250,000 8% convertible debenture and a warrant to purchase up 30,000,000 shares of our common stock. The debenture bears interest at 8% and matures two years from the date of issuance.



In December 2002, the Company and La Jolla, the Debenture and/or Warrant Holder, amended the above-referenced debenture and warrants as follows:

> The number of common shares into which the debenture may be converted is equal to the dollar amount of the debenture being converted multiplied by eleven, minus the product of the conversion price, multiplied by ten times the dollar amount of the debenture being converted, divided by the conversion price. The conversion price is obtained by multiplying the average of the five (5) lowest Volume Weighted Average Prices (VWAP) during the 20 trading days prior to the date of conversion by the Discount

Multiplier of 80%.

The warrants are exercisable at $1.00 per share for up to 2,500,000 shares. The Warrant Holder is obligated to exercise the warrant concurrently with the conversion of the debenture for a number of shares equal to ten times the dollar amount of the debenture being converted.

We were obligated to file a Registration Statement under the Securities Act of 1933 to register the underlying conversion shares on either Form SB-2 or S-3 and have said Registration Statement effective no later than 120 days after October 4, 2002. Our Registration Statement on Form SB-2 was deemed effective by the U. S. Securities and Exchange Commission on May 14, 2003 at 1:00 pm EDT.

La Jolla has contractually committed to convert not less than 5.0% and not more than 10.0% of the original face value of the Debenture monthly beginning the month after the effective date of the Registration Statement and is required to concurrently exercise warrants and purchase shares of common stock equal to ten (10) times the number of shares of common stock issued to La Jolla upon the respective mandatory conversion of the Debenture.

La Jolla has further contractually agreed to restrict its ability to convert the Debenture or exercise their warrants and receive shares of our common stock such that the number of shares held them or their affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of our common stock.

In the event an election to convert is made and the volume weighted average price of our common stock is below $0.30 per share, we have the right to prepay any portion of the outstanding Debenture that was elected to be converted, plus any accrued and unpaid interest, at 125.0%.

La Jolla could have demanded repayment of the Debenture of 125.0% of the face amount outstanding, plus all accrued and unpaid interest, in cash at any time prior to May 14, 2003, the date that underlying Registration Statement under the Securities Act of 1933 was declared effective by the U. S. Securities and Exchange Commission, within 3 business days of such demand. If the repayment was accelerated, we were obligated to issue La Jolla 25,000 shares of common stock and $10,000 cash for each 30 day period, or portion thereof, during which the face amount, including interest thereon, remains unpaid with the cash payment to increase to $15,000 for each 30 day period the balance remains unpaid after the initial 90 day period.

If La Jolla does not elect to accelerate the Debenture, the Company shall immediately issue and pay La Jolla 25,000 shares of common stock and $10,000 cash for each 30 day period, or portion thereof, during which the face amount, including interest thereon, remains unpaid with the cash payment to increase to $15,000 for each 30 day period the balance remains unpaid after the initial 90 day period.

Due to the contractually agreed mandatory conversion of this Debenture, we have reflected this transaction in our balance sheet as a "mezzanine" level debt obligation on its balance sheet, between "Total Liabilities" and "Stockholders' Equity". Upon the respective mandatory conversion, we will relieve the respective portion of the Debenture and the any related accrued, but unpaid interest, and credit this amount to the respective "common stock" and "additional paid-in capital" accounts in the stockholder's equity section for the par value and excess amount over the par value of the respective shares issued.

As the warrant is non-detachable from the Debenture and requires simultaneous exercise upon conversion of the Debenture, no value was assigned to the issued warrant. Upon exercise of the warrant, the Company will record the issuance of the underlying shares as a new issuance of common stock on the date of each respective exercise.



Concurrent with the execution of the Debenture agreement, we executed an engagement letter with La Jolla's counsel for legal representation with regard to the preparation of the Registration Statement under the Securities Act of 1933 on Form SB-2.

On March 13, 2003 and May 6, 2003, La Jolla Cove Investors, Inc., the holder of the Company's convertible debenture, advanced the Company an additional $200,000 and $150,000, respectively, for working capital purposes. During the second quarter of 2003, La Jolla elected to allocate the entire $350,000 in additional funding to the principal balance of the convertible debenture.

On various dates between May 7, 2003 and June 30, 2003, La Jolla elected to convert an aggregate $75,135, through six (6) separate transactions, in outstanding Debenture principal into restricted, unregistered common stock. This election caused the Company to issue 1,334,777 shares of restricted, unregistered common stock to the Debenture Holder. Additionally, pursuant to the contract terms, the Debenture Holder concurrently exercised a portion of the outstanding Warrant to purchase 751,350 shares of the Company's restricted, unregistered common stock for gross proceeds of $751,350.

During the period from July 1, 2003 through September 30, 2003, the Company issued an aggregate 2,902,129 shares of common stock, in 15 separate transactions, to La Jolla in exchange for the redemption of approximately $93,500 in outstanding debenture balance and approximately $935,000 in cash from the exercise of the affiliated warrant. Where the closing price of the Company's common stock was in excess of the respective price per share on the respective transaction date, the Company recognized a charge to operations for "compensation expense related to common stock issuances at less than "fair value". The cumulative effect of transactions where the transaction price, as established in the Debenture Agreement, was less than the closing price on the date of the respective transactions resulted in a cumulative charge to operations of approximately $317,539 during this time period.

In October 2003, the Company issued an aggregate 1,659,847 shares of common stock, in 3 separate transactions, in exchange for the redemption of approximately $40,000 in outstanding debenture balance and approximately $400,000 in cash from the exercise of the affiliated warrant. Where the closing price of the Company's common stock was in excess of the respective price per share on the respective transaction date, the Company recognized a charge to operations for "compensation expense related to common stock issuances at less than "fair value". The cumulative effect of transactions where the transaction price, as established in the Debenture Agreement, was less than the closing price on the date of the respective transactions resulted in a cumulative charge to operations of approximately $146,189 during this time period.

During the period from January 1, 2004 through March 31, 2004, the Company issued an aggregate 2,400,000 shares of common stock, in two (2) separate transactions, in exchange for the redemption of approximately $50,000 in outstanding debenture balance and approximately $500,000 in cash from the exercise of the affiliated warrant. Where the closing price of the Company's common stock was in excess of the respective price per share on the respective transaction date, the Company recognized a charge to operations for "compensation expense related to common stock issuances at less than "fair value". The cumulative effect of transactions where the transaction price, as established in the Debenture Agreement, was less than the closing price on the date of the respective transactions resulted in a cumulative charge to operations of approximately $321,000 during this time period.

During the period from April 1, 2004 through June 30, 2004, the Company issued an aggregate 3,000,000 shares of common stock, in three (3) separate transactions, in exchange for the redemption of approximately $75,000 in outstanding debenture balance and approximately $750,000 in cash from the exercise of the affiliated warrant. Where the closing price of the Company's common stock was in excess of the respective price per share on the respective transaction date, the Company recognized a charge to operations for "compensation expense related to common stock issuances at less than "fair value". The cumulative effect of transactions where the transaction price, as established in the Debenture Agreement, was less than the closing price on the date of the respective transactions resulted in a cumulative charge to operations of approximately $35,000 during this time period. Additionally, on June 29, 2004, the Company issued an additional 1,000,000 shares of common stock in advance



of the exercise of a $25,000 redemption on the outstanding debenture payable and a $250,000 cash payment on the exercise of the affiliated warrant, which was received in July 2004.

Research and Development

Depending on the demand for new product lines and the refinement of our production processes under our production agreement with Israel Military Industries (IMI), an entity owned by the State of Israel, for the cross-production and sale of various small arms ammunition, we may or may not incur increased spending on research and development activities during Calendar 2004.

Further, additional ammunition calibers and/or projectiles may be developed by us depending upon market research, acceptance in the marketplace of existing products and production capabilities. At this time, there are no definitive plans for the further introduction of other new products into the marketplace.

Item 3 - Controls and Procedures

As required by Rule 13a-15 under the Exchange Act, within the 90 days prior to the filing date of this report, the Company carried out an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures. This evaluation was carried out under the supervision and with the participation of the Company's President, Chief Executive and Chief Financial Officer. Based upon that evaluation, the Company's President, Chief Executive and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective. There have been no significant changes in the Company's internal controls or in other factors, which could significantly affect internal controls subsequent to the date the Company carried out its evaluation.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in Company reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in Company reports filed under the Exchange Act is accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer as appropriate, to allow timely decisions regarding required disclosure.

Part II - Other Information

Item 1 - Legal Proceedings

None

Item 2 - Changes in Securities

In May 2004, the Company issued 25,260 shares of restricted, unregistered common stock in payment of approximately $9,170 in accrued dividends payable on the Company's outstanding Series B Preferred Stock for the quarter ended March 31, 2004. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction.

During the period from April 1, 2004 through June 30, 2004, the Company issued an aggregate 3,000,000 shares of common stock, in three (3) separate transactions, to La Jolla Cove Investors, Inc. in exchange for the redemption of approximately $75,000 in outstanding debenture balance and approximately $750,000 in cash from the exercise of the affiliated warrant. Where the closing price of the Company's common stock was in excess of the respective price per share on the respective transaction date, the Company recognized a charge to operations for "compensation expense related to common stock issuances at less than "fair value". The cumulative effect of transactions where the transaction price, as established in the Debenture Agreement, was



less than the closing price on the date of the respective transactions resulted in a cumulative charge to operations of approximately $35,000 during this time period. Additionally, on June 29, 2004, the Company issued an additional 1,000,000 shares of common stock in advance of the exercise of a $25,000 redemption on the outstanding debenture payable and a $250,000 cash payment on the exercise of the affiliated warrant, which was received in July 2004.

On May 26, 2004, the Company issued 270,000 shares of restricted, unregistered common stock to Alliance Financial, LLC of Snowmass, Colorado and 30,000 shares of restricted, unregistered common stock to TN Capital Equities, Ltd. of New York, New York in payment and full satisfaction of all amounts due for fees and/or commissions due in conjunction with the Company's convertible debenture financing transaction. This transaction was valued at approximately $36,000, which approximated the "fair value" of the underlying securities given in payment and the related charges for the services provided. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction.

Item 3 - Defaults on Senior Securities

None

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

(a) The exhibits required to be filed herewith by Item 601 of Regulation S-B, as described in the following index of exhibits, are incorporated herein by reference, as follows:

| Exhibit No. | | Description |
| --- | --- | --- |
| 31.1 | * | Certification pursuant to Section 302 of Sarbanes-Oxley Act of 2002. |
| 32.1 | * | Certification pursuant to Section 906 of Sarbanes-Oxley Act of 2002. |

* Filed herewith

(b) Reports on Form 8-K

None

SIGNATURES

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

American Ammunition, Inc.

Date: August 16, 2004

By: /s/ Andres F. Fernandez

Andres F. Fernandez
President, Chief Executive Officer
Chief Financial Officer and Director