N-VIRO INTERNATIONAL CORP
Form 10-Q
May 20, 2003

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

FORM 10-Q

(MARK ONE)
X QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D)
OF THE SECURITIES EXCHANGE ACT OF 1934.
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2003
OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D)
OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM ____________ TO ____________

COMMISSION FILE NUMBER: 0-21802

N-VIRO INTERNATIONAL CORPORATION
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	34-1741211
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(IRS EMPLOYER IDENTIFICATION NO.)

3450 W. CENTRAL AVENUE, SUITE 328 TOLEDO, OHIO	43606
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	(ZIP CODE)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (419) 535-6374

Indicate by check mark 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 the filing requirements for at least the past 90 days. Yes X No.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12-2). Yes No X

As of May 12, 2003, 2,577,433 shares of N-Viro International Corporation $ .01 par value common stock were outstanding.

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

N-VIRO INTERNATIONAL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended March 31 2003	2002
Revenues	$1,245,269	$1,417,779
Cost of revenues	913,397	947,866
Gross Profit	331,872	469,913
Operating expenses:		
Selling, general and administrative	451,256	469,750
Patent litigation expense	-	545
	451,256	470,295
Operating loss	(119,384)	(382)
Nonoperating income (expense):		
Interest and dividend income	2,396	6,474
Interest expense	(22,329)	(6,684)
Income from equity investment in joint venture	1,804	24,646
	(18,129)	24,436
Income (loss) before income taxes	(137,513)	24,054
Federal and state income taxes	-	-
Net income (loss)	$(137,513)	$ 24,054
Basic and diluted earnings (loss) per share	$ (0.05)	$ 0.01
Weighted average common shares outstanding	2,577,433	2,577,433

See Notes to Consolidated Financial Statements

N-VIRO INTERNATIONAL CORPORATION

CONSOLIDATED BALANCE SHEETS

	'March 31, 2003 (Unaudited)	'December 2002 (Aud
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents:		
Unrestricted	$ 13,698	$ 4
Restricted	-	400
Receivables:		
Trade, net of allowance of $40,000 in 2003 and 2002	977,305	659
Notes and other	10,358	16
Prepaid expenses and other assets	201,664	137
Inventory - stated at lower of cost or market	117,440	117
Total current assets	1,320,465	1,335
Property and Equipment	527,877	559
Investment in Florida N-Viro, L.P.	492,387	490
Intangible and Other Assets	1,617,244	1,641
	$ 3,957,973	$ 4,027
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Current maturities of long-term debt	$ 335,771	$ 392
Line-of-credit	341,172	656
Accounts payable	1,242,289	957
Accrued liabilities	437,275	370
Total current liabilities	2,356,507	2,376
Long-term debt, less current maturities	514,259	426
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Common stock, $.01 par value; authorized 7,000,000 shares; issued 2,700,933 shares	27,010	27
Additional paid-in capital	13,495,602	13,495
Retained earnings (deficit)	(11,750,515)	(11,613
	1,772,097	1,909
Less treasury stock, at cost, 123,500 shares	684,890	684
Total stockholders' equity	1,087,207	1,224
	$ 3,957,973	$ 4,027

See Notes to Consolidated Financial Statements

N-VIRO INTERNATIONAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months Ended March 31, 2003	2002
NET CASH USED BY OPERATING ACTIVITIES.	$(102,845)	$(27,581)
CASH FLOWS FROM INVESTING ACTIVITIES		
Collections on notes receivable.	6,000	3,279
Advances to related party - net.	-	(800)
Purchases of property and equipment.	(870)	(14,933)
Expenditures for intangible assets	(9,820)	(23,938)
Net cash used in investing activities.	(4,690)	(36,392)
CASH FLOWS FROM FINANCING ACTIVITIES		
Reductions to restricted cash and cash equivalents	400,000	-
Net borrowings (payments) on line-of-credit. . . .	(314,915)	80,000
Borrowings under long-term obligations	336,003	71,811
Principal payments on long-term obligations. . . .	(304,790)	(76,591)
Net cash provided by financing activities.	116,298	75,220
NET INCREASE IN CASH AND CASH EQUIVALENTS.	8,763	11,247
CASH AND CASH EQUIVALENTS BEGINNING.	4,935	45,427
CASH AND CASH EQUIVALENTS ENDING	$ 13,698	$ 56,674
Supplemental disclosure of cash flows information:		
Cash paid during the three months ended for interest	$ 22,827	$ 8,522

Non-cash investing and financing activities:

During the three months ending March 31, 2003, the Company paid $22,827 in interest.

During the three months ended March 31, 2003, the Company issued stock warrants with a fair value of $30,000 as part of debt refinancing.

See Notes to Consolidated Financial Statements

N-VIRO INTERNATIONAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. ORGANIZATION AND BASIS OF PRESENTATION

The accompanying consolidated financial statements of N-Viro International Corporation (the "Company") are unaudited but, in management's opinion, reflect all adjustments (including normal recurring accruals) necessary to present fairly such information for the period and at the dates indicated. The results of operations for the three months ended March 31, 2003 may not be indicative of the results of operations for the year ended December 31, 2003. Since the accompanying consolidated financial statements have been prepared in accordance with Article 10 of Regulation S-X, they do not contain all information and footnotes normally contained in annual consolidated financial statements; accordingly, they should be read in conjunction with the consolidated financial statements and notes thereto appearing in the Company's Form 10-K for the period ending December 31, 2002.

The financial statements are consolidated as of March 31, 2003 and December 31, 2002 for the Company. Adjustments have been made to eliminate all intercompany transactions.

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The following are certain significant estimates and assumptions made in preparation of the financial statements:

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. The Company has in the past and continues to sustain net and operating losses. In addition, the Company has used substantial amounts of working capital in its operations which has reduced the Company's liquidity to a low level. These matters raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments relating to the recoverability and classification of recorded assets or the amounts and classification of liabilities that may result from the outcome of these uncertainties.

Non-domestic license and territory fees - The Company does not recognize revenue on any non-domestic license or territory fee contracts until the cash is received, assuming all other tests of revenue recognition are met. Canada is excluded from this definition of non-domestic.

Allowance for Doubtful Accounts - The Company estimates losses for uncollectible accounts based on the aging of the accounts receivable and the evaluation of the likelihood of success in collecting the receivable.

Property and Equipment/Long-Lived Assets - Property and equipment is reviewed for impairment pursuant to the provisions of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." The carrying amount of an asset (group) is considered impaired if it exceeds the sum of our estimate of the undiscounted future cash flows expected to result from the use and eventual disposition of the asset (group), excluding interest charges.

Equity Method Investment - The Company accounts for its investments in joint ventures under the equity method. The Company periodically evaluates the recoverability of its equity investments in accordance with APB No. 18, "The Equity Method of Accounting for Investments in Common Stock." If circumstances were to arise where a loss would be considered other than temporary, the Company would record a write-down of excess investment cost. Management has determined that no write-down was required at March 31, 2003.

Intangible Assets - Intangible assets deemed to have indefinite lives are tested for impairment by comparing the fair value with its carrying value. Significant estimates used in the determination of fair value include estimates of future cash flows. As required under current accounting standards, the Company tests for impairment when events and circumstances indicate that the assets might be impaired and the carrying value of those assets may not be recoverable.

Fair Value of Financial Instruments - The carrying amounts of cash and cash equivalents, receivables, accounts payable and accrued liabilities approximate their fair values because of the short-term nature of these instruments. Management believes the carrying amounts of the current and long-term debt approximate their fair value based on interest rates for the same or similar debt offered to the Company having the same or similar terms and maturities.

Income Taxes - The Company assumes the deductibility of certain costs in income tax filings and estimates the recovery of deferred income tax assets.

2. RELATED PARTY TRANSACTIONS

The Company has an unsecured receivable from a related party, N-Viro Energy Systems, Inc., a corporation of which Mr. J. Patrick Nicholson is the controlling stockholder, of $24,606 at March 31, 2003. The amount due from the related party has been deemed to be noncurrent by management in the accompanying balance sheets. No additional advances were made to the related party during the quarter ended March 31, 2003.

3. LONG-TERM DEBT

During the three months ended March 31, 2003, the Company closed on an $845,000 credit facility with a local bank. This senior debt credit facility is comprised of a $295,000 four year term note at 7.5% and a line of credit up to $550,000 at Prime plus 1 1/2% and secured by a first lien on all assets of the Company. The Company will use the funds to refinance existing debt and to provide working capital. Previously, the Company had a $750,000 line of credit with another financial institution, secured by a $400,000 restricted Certificate of Deposit, required and held by this financial institution. Effectively, the former line of credit provided only $350,000 of additional working capital. The effective increase in the line will provide the Company with additional working capital, and the debt refinance will provide lower cost and longer term debt, improving cash flow. To secure the credit facility, the Company was required by the financial institution to obtain Additional Collateral of $100,000 from a real estate mortgage from a third party. Messrs. J. Patrick Nicholson, the Chairman of the Board and Consultant to the Company; Michael G. Nicholson, the Company's Chief Operating Officer and a Director; Robert F. Nicholson, a Company employee, and Timothy J. Nicholson, a Company employee, ("the Nicholsons") collectively provided the $100,000 Additional Collateral. In exchange for their commitment, the Company has agreed to provide the Nicholsons the following: (1)

an annual fee in an amount equal to two percent (2%) of the aggregate value of the Mortgage or Mortgages encumbering the Additional Collateral, which fee originally shall be $2,000 per annum; (2) interest at an annual rate of 5% of the aggregate value of the Mortgage or Mortgages encumbering the Additional Collateral beginning on the first anniversary date of the closing of the Credit Facility, and (3) grant, jointly, a warrant to acquire in the aggregate, 50,000 shares of the Company's voting common stock at a purchase price of $0.90 per share, which was the closing market price of the Company's common stock on the prior business day to the closing of the Credit Facility. In addition, the Company granted to the Nicholsons a lien upon the Company's inventory and accounts receivable. This lien is subordinated to both existing liens on the Company's assets and all liens granted by the Company in favor of the financial institution providing the Credit Facility. The value of the warrants is estimated to be $30,000 based upon a calculation using the Black-Scholes pricing model. In estimating the value of the warrants, the following assumptions were used: no assumed dividend rate; risk-free interest rate of 2.05% on expected life of 3 years; and expected price volatility of 108%. The fair value is being amortized over the 4-year life of the guarantee.

4. CONTINGENCIES

Prior to May 9, 2002, the Company's shares of voting, common stock were traded on the SmallCap Market of the National Association of Securities Dealers Automated Quotation System ("NASDAQ"). On Thursday, May 9, 2002, the Company received notice from the NASD that the Company's shares of voting, common stock would be de-listed effective with the open of business on May 10, 2002. In July, 2002 the Company decided not to pursue further appeal of the NASD's decision to de-list its voting common stock. Currently, the Company's shares of common stock are traded on the Over-The-Counter ("OTC") market. The Company does not believe that the delisting of its common stock from the Nasdaq SmallCap Market has or will have a material adverse effect on the financial condition or results of operations of the Company. The delisting of the Company's common stock from NASDAQ, however, may have had a material adverse effect on the marketability of the Company's shares, as shares traded on the OTC market generally experience lower trading value than those traded on the organized exchanges.

The Company leases its executive and administrative offices in Toledo, Ohio. The Company believes its relationship with its lessor is satisfactory. The total minimum annual rental commitment through 2006 is approximately $56,000 each year. The total rental expense included in the statements of operations for the three months ended March 31, 2003 and 2002 is approximately $14,000 and $15,600, respectively. The Company also leases various equipment on a month-to-month basis.

During 1999, the Company entered into employment and consulting agreements with two officers of the Company. One employment agreement expired in July 2002 and the other will expire in June 2004. Future compensation amounts are to be determined annually by the Board. In addition, one of the agreements provides for payment of life insurance premiums and the provision of health insurance coverage to the officer and his spouse for their lives. The present value of estimated costs related to the provisions of this agreement totaled approximately $135,800 at March 31, 2003. The cost was recognized over the term of the employment agreement. The Company charged $1,524 in payments against the liability for the three months ended March 31, 2003. The consulting agreements begin upon termination of the respective employment agreements and extend through July 2015 and June 2014, respectively. The agreements require the officers to provide minimum future services to be eligible for compensation.

5. NEW ACCOUNTING STANDARDS

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 142, "Goodwill and Other Intangible Assets." Under SFAS No. 142, goodwill and intangible assets deemed to have indefinite lives are no longer amortized but are subject to periodic impairment tests. Other intangible assets continue to be amortized over their useful lives. SFAS No. 142 was adopted by the Company in 2002.

In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations," which is effective the first quarter of fiscal year 2003. SFAS 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement cost.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets," which was adopted by the Company in 2002. SFAS No. 144 supercedes SFAS No. 121 and modifies and expands the financial accounting and reporting for the impairment or disposal of long-lived assets other than goodwill.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections." Provisions of SFAS No. 145 become effective in 2002 and 2003. Under SFAS No. 145, gains and losses from the extinguishment of debt should be classified as extraordinary items only if they meet the criteria of Accounting Principles Board Opinion No. 30. SFAS No. 145 also addresses financial accounting and reporting for capital leases that are modified in such a way as to give rise to a new agreement classified as an operating lease.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," which is effective for exit or disposal activities initiated after December 31, 2002. SFAS No. 146 nullifies Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." Under SFAS No. 146, a liability is required to be recognized for costs, including certain lease termination costs and employee termination benefits, associated with an exit or disposal activity when the liability is incurred. SFAS No. 146 applies to costs associated with an exit activity that does not involve an entity newly acquired in a business combination or with a retirement or disposal activity covered by SFAS Nos. 143 and 144.

In November 2002, the FASB issued FIN 45, which expands previously issued accounting guidance and disclosure requirements for certain guarantees. FIN 45 requires the recognition of an initial liability for the fair value of an obligation assumed by issuing a guarantee. The provision for initial recognition and measurement of the liability will be applied on a prospective basis to guarantees issued or modified after December 31, 2002.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based, Compensation - Transition and Disclosure," that amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition to the fair value method of accounting for stock-based employee compensation. SFAS No. 148 also amends the disclosure provisions of SFAS No. 123 and APB Opinion No. 28, "Interim Financial Reporting," to require disclosure in the summary of significant accounting policies of the effects of an entity's accounting policy with respect to stock-based employee compensation on reported net income and earnings per share in annual and interim financial statements. The Statement does not amend SFAS No. 123 to require companies to account for employee stock options using the fair value method. The Statement is effective for fiscal years beginning after December 15, 2002.

The adoption of the new standards did not, or is not expected to, materially affect the Company's financial position and results of operations.

6. SEGMENT INFORMATION

EARNINGS VARIATION DUE TO BUSINESS CYCLES AND SEASONAL FACTORS. The Company's operating results can experience quarterly or annual variations due to business cycles, seasonality and other factors. The market price for its common stock may decrease if its operating results do not meet the expectations of the market.

For the first quarter of 2003, approximately 40% of the Company's revenue is from management operations, 57% from other domestic operations, 2% from research and development grants and the remaining 1% from foreign operations. Sales of the N-Viro technology are affected by general fluctuations in the business cycles in the United States and worldwide, instability of economic conditions (such as the current conditions in the Asia Pacific region and Latin America) and interest rates, as well as other factors. In addition, operating results of some of the Company's business segments are influenced, along with other factors such as interest rates, by particular business cycles and seasonality.

COMPETITION. The Company does business in a highly competitive market and has fewer resources than most of its competitors. Businesses in this market compete within and outside the United States principally on the basis of price, product quality, custom design, technical support, reputation, equipment financing assistance and reliability. Competitive pressures and other factors could cause the Company to lose market share or could result in decreases in prices, either of which could have a material adverse effect on its financial position and results of operations.

RISKS OF DOING BUSINESS IN OTHER COUNTRIES. The Company conducts business in markets outside the United States, and expects to continue to do so. In addition to the risk of currency fluctuations, the risks associated with conducting business outside the United States include: social, political and economic instability; slower payment of invoices; underdeveloped infrastructure; underdeveloped legal systems; and nationalization. The Company has not entered into any currency swap agreements which may reduce these risks. The Company may enter into such agreements in the future if it is deemed necessary to do so. Current economic and political conditions in the Asia Pacific and Middle East regions have affected the Company outlook for potential revenue there. The Company cannot predict the full impact of this economic instability, but it could have a material adverse effect on revenues and profits.

The Company has determined that its reportable segments are those that are based on the Company's method of internal reporting, which segregates its business by product category and service lines. The Company's reportable segments are as follows:

Management Operations - The Company provides employee and management services to operate the Toledo Wastewater Treatment Facility.

Other Domestic Operations - Sales of territory or site licenses and royalty fees to use N-Viro technology in the United States.

Foreign Operations - Sale of territory or site licenses and royalty fees to use N-Viro technology in foreign operations.

Research and Development - The Company contracts with Federal and State agencies to perform or assist in research and development on the Company's technology.

The accounting policies of the segments are the same as the Company's significant accounting policies. Fixed assets generating specific revenue are identified with their respective segments and are accounted for as such in the internal accounting records. All other assets, including cash and other current assets and all long-term assets, other than fixed assets, are identified with the Corporate segment. The Company allocates a total of approximately 6% of its labor cost contained in selling, general, and administrative expenses to the segments, to reflect the indirect cost of maintaining these segments. All of the net nonoperating income (expense) are non-apportionable and not allocated to a specific segment. The Company accounts for and analyzes the operating data for its segments generally by geographic location, with the exception of the Management Operations and Research and Development segments. These segments represent both a significant amount of business generated as well as a specific location and unique type of revenue.

The next two segments are divided between domestic and foreign sources, as these segments differ in terms of environmental and municipal legal issues, nature of the waste disposal infrastructure, political climate, and availability of funds for investing in the Company's technology. These factors have not changed significantly over the past several years and are not expected to change in the near term.

The Research and Development segment accounts for approximately 2% of the total year-to-date revenue of the Company, and is unlike any other revenue in that it is generated as a result of a specific project to conduct initial or additional ongoing research into the Company's emerging technologies.

The table below presents information about the segment profits and segment identifiable assets used by the chief operating decision makers of the Company for the quarters ended March 31, 2003 and 2002 (dollars in thousands):

	Management Operations	Other Domestic Operations	Foreign Operations	Research & Development	Total
			2003		
Revenues.	$ 503	$ 707	$ 12	$ 23	$1,245
Cost of revenues. .	347	542	-	24	913
Segment profits . .	156	165	12	(1)	332
Identifiable assets	366	101	-	-	467
Depreciation. . . .	14	11	-	-	25
			2002		
Revenues.	$ 519	$ 784	$ 13	$ 102	$1,418
Cost of revenues. .	383	463	1	101	948
Segment profits . .	136	321	12	1	470
Identifiable assets	303	83	-	49	435
Depreciation. . . .	8	10	-	2	20

A reconciliation of total segment revenues, cost of revenues, and segment profits to consolidated revenues, cost of revenues, and segment information to the consolidated financial statements for the quarters ended March 31, 2003 and 2002 is as follows (dollars in thousands):

	2003	2002
Segment profits:		
Segment profits for reportable segments. . . .	$ 332	$ 470
Corporate selling, general and administrative expenses and research and development costs. .	(451)	(470)
Other income (expense)	(19)	24
Consolidated earnings before taxes	$ (138)	$ 24
Identifiable assets:		
Identifiable assets for reportable segments. .	$ 467	$ 435
Corporate property and equipment	61	145
Current assets not allocated to segments . . .	1,330	1,680
Intangible and other assets not allocated to segments	2,334	2,505
Consolidated eliminations.	(234)	(234)
Consolidated assets.	$3,958	$4,531
Depreciation and amortization:		
Depreciation for reportable segments	$ 25	$ 20
Corporate depreciation and amortization. . . .	42	40
Consolidated depreciation and amortization . .	$ 67	$ 60

7. INVESTMENT IN FLORIDA N-VIRO, L. P.

Florida N-Viro, L.P. was formed in January 1996 pursuant to a joint venture agreement between the Company and VFL Technology Corporation. The Company owns a 47.5% interest in the joint venture.

Condensed financial information of the partnership for the quarters ended March 31, 2003 and 2002 is as follows:

	Quarter Ended March 31,	
	2003	2002
Net sales	$905,532	$962,073
Gross profit.	61,100	107,456
Income from continuing operations	3,797	51,887

Net income.	3,797	51,887

8. STOCK OPTIONS

The Company accounts for stock-based compensation issued to its employees and directors in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." Accordingly, no compensation cost has been recognized for the stock option plans, as all options granted under the plans have an exercise price equal to the market value of the underlying common stock on the date of the grant. The fair value of options granted was determined using the Black-Scholes option pricing model.

The following table illustrates the effect on net income (loss) and net income (loss) per share if the Company had applied the fair value recognition provisions of FASB Statement No. 123, "Accounting for Stock-based Compensation" to stock-based employee compensation:

	Three Months Ended March 3	
	2003	2002
Net income (loss), as reported	$ (137,513)	$ 24,054
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects.	(18,621)	(65,287)
Pro forma net income (loss).	(156,134)	(41,233)
Earnings (loss) per share:		
Basic and diluted - as reported.	$ (0.05)	$ 0.01
Basic and diluted - pro-forma.	$ (0.06)	$ (0.02)

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

OVERVIEW

The Company was incorporated in April, 1993, and became a public company on October 12, 1993. The Company's business strategy is to market the N-Viro Process, which produces an "exceptional quality" sludge product as defined in the Section 503 Sludge Regulations under the Clean Water Act of 1987, with multiple commercial uses. To date, the Company's revenues primarily have been derived from the licensing of the N-Viro Process to treat and recycle wastewater sludge generated by municipal wastewater treatment plants and from the sale to licensees of the alkaline admixture used in the N-Viro Process. The Company has also operated N-Viro facilities for third parties on a start-up basis and currently operates one N-Viro facility on a contract management basis.

Total revenues were $1,245,000 for the quarter ended March 31, 2003 compared to $1,418,000 for the same period of 2002. The net decrease in revenue is due primarily to a decrease in facility management fees, one-time licenses and research and development revenue. The Company's cost of revenues decreased to $913,000 in 2003 from $948,000 for the same period in 2002, and the gross profit percentage decreased to 27% from 33% for the quarters ended March 31, 2003 and 2002. This decrease in gross profit percentage is primarily due to the decreased share of one-time license revenue in the first quarter of 2003 compared to 2002, and increased costs associated with the sale of alkaline admixture and the Company's soil blending operation for the same period. Operating expenses decreased for the comparative period, while the Company's share of the income of a joint venture, the Company's interest in Florida N-Viro, L.P., decreased for the same period of 2003. These changes collectively resulted in a net loss of approximately $138,000 for the quarter ended March 31, 2003 compared to net income of $24,000 for the same period in 2002.

COMPARISON OF THREE MONTHS ENDED MARCH 31, 2003 WITH THREE MONTHS ENDED MARCH 31, 2002

Overall revenue decreased $173,000, or 12%, to $1,245,000 for the quarter ended March 31, 2003 from $1,418,000 for the quarter ended March 31, 2002. The net decrease in revenue was due primarily to the following:

a) Sales of alkaline admixture decreased $6,000 from the same period ended in 2002;

b) Revenue from the service fees for the management of alkaline admixture increased $34,000 from the same period ended in 2002;

c) The Company's processing revenue, including facility management revenue, showed a net decrease of $50,000 over the same period ended in 2002;

d) Miscellaneous revenues increased $16,000 from the same period ended in 2002;

e) Licensing of the N-Viro Process, including territory fees, earned the Company $-0- for the period, a decrease of $92,000 from 2002; and,

f) Research and development revenue decreased $75,000 from the same period ended in 2002.

Gross profit decreased $138,000, or 29%, to $332,000 for the three months ended March 31, 2003 from $470,000 for the three months ended March 31, 2002. This decrease in gross profit was primarily due to the decrease in one-time license fee and facility management revenue, in addition to an increase in the cost of supplying alkaline admixture to all domestic facilities and cost of the Company's soil blending operation. The gross profit margin decreased to 27% from 33%, and was primarily due to the decreased one-time license revenue in the first quarter of 2003 compared to 2002 and increased costs associated with the sale of alkaline admixture and the Company's soil blending operation for the same period.

Operating expenses decreased $19,000, or 4%, to $451,000 for the three months ended March 31, 2003 from $470,000 for the three months ended March 31, 2002. The decrease was primarily due to a decrease of $49,000 in personnel-related and selling costs, partially offset by an increase in outside professional fees of $30,000.

As a result of the foregoing factors, the Company recorded an operating loss of $119,000 for the three months ended March 31, 2003 compared to an operating loss of $400 for the three months ended March 31, 2002, an increase in the loss of approximately $119,000.

Net nonoperating expense decreased by $43,000 to a net nonoperating expense of $18,000 for the three months ended March 31, 2003 from net nonoperating income of $25,000 for the three months ended March 31, 2002. The decrease was primarily due to an increase in interest expense of $16,000 and a decrease of $23,000 in the equity of a joint venture, to $2,000 in 2003 from $25,000 in 2002.

The Company recorded a net loss of $138,000 for the three months ended March 31, 2003 compared to net income of $24,000 for the same period ended in 2002, a decrease in net profit of approximately $162,000.

For the three months ended March 31, 2003 and 2002, the Company has not fully recognized the tax benefit of the losses incurred in prior periods. Accordingly, the effective tax rate for each period was zero.

LIQUIDITY AND CAPITAL RESOURCES

The Company had a working capital deficit of $1,026,000 at March 31, 2003, compared to a working capital deficit of $1,040,000 at December 31, 2002, an increase in working capital of $14,000. Current assets at March 31, 2003 included cash and investments of $15,000, which is a decrease of $391,000 from December 31, 2002. This decrease in cash and investments was the result of the Company closing on an $845,000 credit facility with a local bank, and redeeming its $400,000 certificate of deposit in the transaction. The increase in working capital was principally due to the credit facility obtained which assisted in refinancing existing short-term debt to long-term, but offset by the operating loss for the three month period.

In the first quarter of 2003 the Company's cash flow generated from operations was a deficit of $103,000, a decrease of approximately $75,000 from 2002. No unusual cash transactions were recorded in the first quarter of 2003 that affected cash flow from operations.

In February 2003 the Company closed on an $845,000 credit facility with a local bank. This senior debt credit facility is comprised of a $295,000 four year term note at 7.5% and a line of credit up to $550,000 at Prime plus 1 1/2% and secured by a first lien on all assets of the Company. The Company will use the funds to refinance existing debt and to provide working capital. Previously, the Company had a $750,000 line of credit with another financial institution, secured by a $400,000 restricted Certificate of Deposit, required and held by this financial institution. Effectively, the former line of credit provided only $350,000 of additional working capital. The effective increase in the line will provide the Company with additional working capital, and the debt refinance will provide lower cost and longer term debt, improving cash flow. To secure the credit facility, the Company was required by the financial institution to obtain Additional Collateral of $100,000 from a real estate mortgage from a third party. Messrs. J. Patrick Nicholson, the Chairman of the Board and Consultant to the Company; Michael G. Nicholson, the Company's Chief Operating Officer and a Director; Robert F. Nicholson, a Company employee, and Timothy J. Nicholson, a Company employee, ("the Nicholsons") collectively provided the $100,000 Additional Collateral. In exchange for their commitment, the Company has agreed to provide the Nicholsons the following: (1) an annual fee in an amount equal to two percent (2%) of the aggregate value of the Mortgage or Mortgages encumbering the Additional Collateral, which fee originally shall be $2,000.00 per annum; (2) interest at an annual rate of 5% of the aggregate value of the Mortgage or Mortgages encumbering the Additional Collateral beginning on the first anniversary date of the closing of the Credit Facility, and (3) grant, jointly, a warrant to acquire in the aggregate, 50,000 shares of the Company's voting common stock at a purchase price of $0.90 per share, which was the closing market price of the Company's common stock on the prior business day to the closing of the Credit Facility. In addition, the Company granted to the Nicholsons a lien upon the Company's inventory and accounts receivable. This lien is subordinated to both existing liens on the Company's assets and all liens granted by the Company in favor of the financial institution providing the Credit Facility.

The normal collection period for accounts receivable are approximately 45-60 days for the majority of customers. This is a result of the nature of the license contracts, type of customer and the amount of time required to obtain the information to prepare the billing. The Company did not change its reserve for bad debts during the first quarter of 2003.

The Company is currently actively pursuing sale of its investment in Florida N-Viro, LP, which may provide, in management's opinion, additional funds to finance the Company's cash requirements. Because these efforts are still in progress, there can be no assurance the Company will successfully complete these negotiations.

The Company paid certain amounts due to Hydropress Environmental Services, Inc. ("Hydropress") under a Settlement Agreement dated December 14, 2001 and pursuant to the terms of a promissory note (the "Hydropress Note"). The original principal amount of the Hydropress Note was $204,587, was non-interest bearing and matured on October 15, 2002 with a balloon payment of $144,587. At September 30, 2002, the outstanding principal balance on the Hydropress Note was $144,587, which was paid in full to Hydropress in October 2002. In conjunction with the final discharge of the Hydropress Note, the Company arranged an unsecured loan from a third-party licensee for $144,587, with monthly payments of $13,966 due for one year through October 15, 2003. At March 31, 2003, the outstanding principal balance on the note was $89,190.

The Company is currently working with the investment banking firm of Laux & Company of Medina, Ohio, with respect to a proposal to obtain up to $1.25 million in equity financing. The Company hopes to sell up to 500,000 shares of preferred stock at a price per share of $2.50. The specific terms and conditions applicable to the preferred shares will be determined once Laux & Company has identified a potential purchaser. There can be no assurance that the Company will be successful in finding a buyer for the preferred stock or in selling these shares. If the shares are sold, the proceeds from the offering will be used to supplement the Company's working capital.

Also, the Company has gone forward on contracts with two investment banking firms with respect to a proposal to obtain up to $800,000 of mezzanine debt financing. The specific terms and conditions applicable to the debt will be determined once either firm has identified a potential debtor. There can be no assurance that the Company will be successful in finding a lender for the financing. If the financing is obtained, the proceeds from the offering will be used to supplement the Company's working capital.

The Company is currently in discussions with several companies in the cement and fuel industries for the development and commercialization of the patented N-Viro fuel technology. Because these discussions are still in progress, there can be no assurance they will be successful.

The Company continues to focus on the development of regional biosolids processing facilities. Currently the Company is in negotiations with several privatization firms to permit and develop independent, regional facilities.

The Company expects continued improvements in operating results for 2003 as a result of maintaining lower administrative costs, along with realized and expected new sources of revenue. Additionally, market developments and ongoing discussions with companies in the cement, fuel and wastewater industries could provide enhanced liquidity and positively impact 2003 operations.

Current market trends and Company business development provide significant basis for the Company's optimistic outlook for 2003 and beyond. The national public attack on Class B levels of sludge treatment is rapidly moving the market to Class A technologies, of which the Company's patented N-Viro processes are very cost competitive, and well established in the market place. The development and patenting of new technologies for animal manure treatment, bio-fuel and nematode control have the potential to expand the Company's revenue base over the next five years and beyond.

RISK FACTORS

THE COMPANY'S LICENSEES ARE SUBJECT TO EXTENSIVE AND INCREASINGLY STRICT FEDERAL, STATE AND LOCAL ENVIRONMENTAL REGULATION AND PERMITTING

The Company's licensees and their operations are subject to increasingly strict environmental laws and regulations, including laws and regulations governing the emission, discharge, disposal and transportation of certain substances and related odor. Wastewater treatment plants and other plants at which our biosolids products or processes may be implemented are usually required to have permits, registrations and/or approvals from state and/or local governments for the operation of such facilities. Some of our licensee's facilities require air, wastewater, storm water, biosolids processing, use or siting permits, registrations or approvals. These licensees may not be able to maintain or renew their current permits or registrations or to obtain new permits or registrations. The process of obtaining a required permit or registration can be lengthy and expensive. They may not be able to meet applicable regulatory or permit requirements, and therefore may be subject to related legal or judicial proceedings that could have a materially adverse effect on our income derived from these licensees.

Any of the permits, registrations or approvals noted above, or related applications may be subject to denial, revocation or modification, or challenge by a third party, under various circumstances. In addition, if new environmental legislation or regulations are enacted or existing legislation or regulations are amended or are enforced differently, these licensees may be required to obtain additional, or modify existing, operating permits, registrations or approvals.

Maintaining, modifying or renewing current permits or registrations or obtaining new permits or registrations after new environmental legislation or regulations are enacted or existing legislation or regulations are amended or enforced differently may be subject to public opposition or challenge. Much of this public opposition and challenge, as well as related complaints, relates to odor issues, even when our licensees are in compliance with odor requirements and even though the licensee has worked hard to minimize odor from their operations. Public misperceptions about the business and any related odor could influence the governmental process for issuing such permits or registrations or for responding to any such public opposition or challenge. Community groups could pressure local municipalities or state governments to implement laws and regulations which could increase our licensee's costs of its operations that in turn could have a material and adverse effect on the Company's business and financial condition.

THE ABILITY TO GROW MAY BE LIMITED BY COMPETITION

The Company provides a variety of technology and services relating to the treatment of wastewater residuals. The Company is in direct and indirect competition with other businesses that provide some or all of the same services including regional residuals management companies and national and international water and wastewater operations/privatization companies, technology suppliers, municipal solid waste companies and farming operations. Some of these competitors are larger and have greater capital resources.

The Company derives a substantial portion of revenue from services provided under municipal contracts, and many of these are subject to competitive bidding. The Company also intends to bid on additional municipal contracts, however, and may not be the successful bidder. In addition, some of its contracts will expire in the future and those contracts may be renewed on less attractive terms. If the Company is not able to replace revenues from contracts lost through competitive bidding or from the renegotiation of existing contracts with other revenues within a reasonable time period, the lost revenue could have a material and adverse effect on its business, financial condition and results of operation.

THE COMPANY'S CUSTOMER CONTRACTS MAY BE TERMINATED PRIOR TO THE EXPIRATION OF THEIR TERM.

A substantial portion of the Company's revenue is derived from services provided under contracts and agreements with existing licensees. Some of these contracts, especially those contracts with large municipalities, provide for termination of the contract by the customer after giving relative short notice (in some cases as little as ten days). In addition, some of these contracts contain liquidated damages clauses, which may or may not be enforceable in the event of early termination of the contracts. If one or more of these contracts are terminated prior to the expiration of its term, and we are not able to replace revenues from the terminated contract or receive liquidated damages pursuant to the terms of the contract, the lost revenue could have a material and adverse effect on our business and financial condition.

A SIGNIFICANT AMOUNT OF THE COMPANY'S BUSINESS COMES FROM A LIMITED NUMBER OF CUSTOMERS AND OUR REVENUE AND PROFITS COULD DECREASE SIGNIFICANTLY IF WE LOST ONE OR MORE OF THEM AS CUSTOMERS.

The Company's business depends on provision of services to a limited number of customers. One or more of these customers may stop contracting for services from us or may substantially reduce the amount of services we provide them. Any cancellation, deferral or significant reduction in the services we provide these principal customers or a significant number of smaller customers could seriously harm our business and financial condition. For the quarter ended March 31, 2003, our single largest customer accounted for approximately 40 percent of our revenues and our top three customers accounted for approximately 69 percent of our revenues.

THE COMPANY IS AFFECTED BY UNUSUALLY ADVERSE WEATHER CONDITIONS

The Company's business is adversely affected by unusual weather conditions and unseasonably heavy rainfall which can temporarily reduce the availability of land application sites in close proximity to our operations. In addition, revenues and operational results are adversely affected during months of inclement weather which limits the level of land application that can be performed. Long periods of adverse weather could have a material negative effect on the Company's business and financial condition.

FUEL COST VARIATION COULD AFFECT OPERATING RESULTS AND EXPENSES

The price and supply of fuel is unpredictable and fluctuates based on events outside our control, including demand for oil and gas, actions by OPEC and other oil and gas producers, and war in oil producing countries. Because fuel is needed for the trucks that purchase the processing materials and supplies for our customers, price escalations or reductions in the supply of fuel could increase operating expenses and have a negative impact on the results of operations. The Company is not always able to pass through all or part of the increased fuel costs due to the terms of certain customers' contracts and the inability to negotiate such pass through costs in a timely manner.

THE COMPANY IS DEPENDENT ON THE MEMBERS OF ITS MANAGEMENT TEAM

The Company is highly dependent on the services of its management team, the loss of any of whom may have a material adverse effect on its business and financial condition.

The Company has entered into employment agreements with certain members of its management team, which contain non-compete and other provisions. The laws of each state differ concerning the enforceability of non-competition agreements. The Company cannot predict with certainty whether or not a court will enforce a non-compete covenant in any given situation based on the facts and circumstances at that time. If one of its key executive officers were to leave and the courts refused to enforce the non-compete covenant, the Company might be subject to increased competition, which could have a material and adverse effect on its business and financial condition.

THE COMPANY'S INTELLECTUAL PROPERTY MAY BE MISAPPROPRIATED OR SUBJECT TO CLAIMS OF INFRINGEMENT

The Company attempts to protect our intellectual property rights through a combination of patent, trademark, and trade secret laws, as well as licensing agreements. The Company's failure to obtain or maintain adequate protection of our intellectual property rights for any reason could have a material adverse effect on our business and financial condition.

The Company's competitors, many of whom have substantially greater resources and have made substantial investments in competing technologies, may have applied for or obtained, or may in the future apply for and obtain, patents that will prevent, limit or otherwise interfere with the Company's ability to offer services. The Company has not conducted an independent review of patents issued to third parties.

The Company also relies on unpatented proprietary technology. It is possible that others will independently develop the same or similar technology or otherwise obtain access to its unpatented technology. If the Company is unable to maintain the proprietary nature of our technologies, it could be materially adversely affected.

The Company cautions that words used in this document such as "expects," "anticipates," "believes," "may," and "optimistic," as well as similar words and expressions used herein, identify and refer to statements describing events that may or may not occur in the future. These forward-looking statements and the matters to which they refer are subject to considerable uncertainty that may cause actual results to be materially different from those described herein. Some, but not all, of the factors that could cause actual results to be different than those anticipated or predicted by the Company include: (i) a deterioration in economic conditions in general; (ii) a decrease in demand for the Company's products or services in particular; (iii) the Company's loss of a key employee or employees; (iv) regulatory changes, including changes in environmental regulations, that may have an adverse affect on the demand for the Company's products or services; (v) increases in the Company's operating expenses resulting from increased costs of labor and/or consulting services; and (vi) a failure to collect upon or otherwise secure the benefits of existing contractual commitments with third parties, including customers of the Company. For example, while the Company anticipates obtaining the permits and approvals necessary for the Bio-Fuel pilot program to commence operations in 2003, such program may not begin until 2004 or ever. Delay or cancellation with respect to this project could result from (1) a failure to achieve acceptable air quality levels in preliminary testing, (2) costs associated with the use of Bio-Fuel significantly exceeding current estimates, or (3) competing technologies rendering the Bio-Fuel process less attractive.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

None.

ITEM 4. CONTROLS AND PROCEDURES

Within 90 days prior to the date of filing this Annual Report on Form 10-Q, an evaluation was performed under the supervision and with the participation of our management, including the chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective as of March 31, 2003, and the evaluation date. There have been no significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to the date of our evaluation.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

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

None

ITEM 5. OTHER INFORMATION

CHANGES IN REGISTRANT'S BOARD OF DIRECTORS

On February 13, 2003, Wallace G. (Jack) Irmscher resigned as a Class III member of the Board of Directors of the Company, effective at the end of the Board meeting held that day.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:
Exhibit 99.1 - Certification(s) Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K:

The Company filed a report on Form 8-K dated February 26, 2003, to disclose the closing on an $845,000 credit facility.

The Company filed a report on Form 8-K dated March 4, 2003, to announce the date of the 2003 Annual Stockholders Meeting.

N-VIRO INTERNATIONAL CORPORATION

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

N-VIRO INTERNATIONAL CORPORATION

Date: May 20, 2003
/s/ Terry J. Logan

Terry J. Logan
Chief Executive Officer and President
(Principal Executive Officer)

Date: May 20, 2003
/s/ James K. McHugh

James K. McHugh
Chief Financial Officer,
Secretary and Treasurer
(Principal Financial &
Accounting Officer)

N-Viro International Corporation
Certifications

I, Terry J. Logan, President and Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of N-Viro International Corporation;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in the Report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as

of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within the 90 days prior to the filing date of this quarterly report (the "Evaluation Date");

c. presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function);

a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 20, 2003

/s/ Terry J. Logan

President and Chief Executive Officer

N-Viro International Corporation
Certifications

I, James K. McHugh, Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of N-Viro International Corporation;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in the Report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as

of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within the 90 days prior to the filing date of this quarterly report (the "Evaluation Date");

c. presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function);

a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 20, 2003

/s/ James K. McHugh

Chief Financial Officer