

EARTHSHELL CORP  
Form 10-Q  
August 14, 2001

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

**FORM 10-Q**

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

For the Quarterly Period Ended June 30, 2001

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

For the Transition Period From \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 333-13287

**EARTHSHELL CORPORATION**

(Exact name of registrant as specified in its charter)

**Deleware**

(State or other jurisdiction of  
incorporation or organization)

**77-0322379**

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

**800 Miramonte Drive, Santa Barbara, California 93109**

(Address of principal executive office) (Zip Code)

Registrant's telephone number, including area code: (805) 897-2248

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 such filing requirements for the past 90 days. Yes  No

The number of shares outstanding of the registrant's common stock as of August 14, 2001 is 114,169,194.

**EARTHSHELL CORPORATION  
FORM 10-Q  
For the Quarter Ended June 30, 2001  
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(unaudited).....

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**EARTHSHELL CORPORATION  
(A Development Stage Enterprise)  
BALANCE SHEETS**

	June 30 2001 (unaudited)
	-----
<b>ASSETS</b>	
<b>CURRENT ASSETS:</b>	
Cash and cash equivalents.....	\$4,783,828
Prepaid expenses and other current assets.....	514,637
	-----
Total current assets.....	5,298,465
RESTRICTED CASH.....	3,500,000
PROPERTY AND EQUIPMENT, NET.....	35,399,813
INVESTMENT IN JOINT VENTURE.....	378,428
	-----
<b>TOTAL</b> .....	<b>\$44,576,706</b>
	=====
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>	
<b>CURRENT LIABILITIES:</b>	
Accounts payable and accrued expenses.....	\$4,086,453
Trade payable to majority stockholder.....	-
	-----
Total current liabilities.....	4,086,453
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COMMITMENTS AND CONTINGENCIES

**STOCKHOLDERS' EQUITY:**

Preferred Stock, \$.01 par value, 10,000,000 shares authorized; 9,170,000 Series A shares designated; no shares issued and outstanding as of June 30, 2001 and December 31, 2000.....	-
Common stock, \$.01 par value, 200,000,000 shares authorized; 111,919,194 and 104,502,335 shares issued and outstanding as of June 30, 2001 and December 31, 2000.....	1,119,192
Additional paid-in common capital.....	250,817,966
Deficit accumulated during the development stage.....	(211,446,905)
	-----
Total stockholders' equity.....	40,490,253
	-----
<b>TOTAL.....</b>	<b>\$44,576,706</b>
	=====

See notes to financial statements.

**EARTHSHELL CORPORATION**  
**(A Development Stage Enterprise)**  
**STATEMENTS OF OPERATIONS**  
**(Unaudited)**

	For the Three Months Ended June 30,		For the Six Months Ended June
	2001	2000	2001
	-----	-----	-----
Expenses:			
Related party research and development.....	\$367,694	\$2,486,429	\$691,142
Other research and development.....	4,007,152	4,908,675	8,430,443
Related party general and administrative ...expenses.....	-	36,134	-
Other general and administrative expenses...	3,893,262	2,238,128	6,078,168
Depreciation and amortization.....	1,225,267	1,427,842	2,510,449
Related party patent expenses.....	-	126,383	-
	-----	-----	-----
Total expenses.....	9,493,375	11,223,591	17,710,202
Interest income.....	(85,071)	(333,228)	(204,382)
Related party interest expense.....	-	-	-
Other interest expense.....	-	-	-
	-----	-----	-----

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Loss Before Income Taxes.....	9,408,304	10,890,363	17,505,820
Income Taxes.....	-	-	-
Net Loss.....	9,408,304	10,890,363	17,505,820
Preferred Dividends .....	-	-	-
Net Loss Available To Common Stockholders.....	\$9,408,304	\$10,890,363	\$17,505,820
Basic And Diluted Loss Per Common Share.....	\$0.08	\$0.11	\$0.16
Weighted Average Number Of Common Shares.....	111,009,853	100,381,321	109,007,431

See notes to financial statements.

**EARTHSHELL CORPORATION**  
**(A Development Stage Enterprise)**  
**STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)**  
**(Unaudited)**

	Cumulative Convertible Preferred Stock Series A		Additional Paid-In Preferred Capital	Common Stock		Additi Paid- Commo Capit
	Shares	Amount		Shares	Amount	
ISSUANCE OF COMMON STOCK AT INCEPTION.....	-	-	-	82,530,000	\$3,150	\$6,8
Sale of preferred stock, net	6,988,850	\$267	\$24,472,734	-	-	-
Net loss.....	-	-	-	-	-	-
BALANCE, DECEMBER 31, 1993	6,988,850	267	24,472,734	82,530,000	3,150	6,8
Net loss.....	-	-	-	-	-	-
BALANCE, DECEMBER 31, 1994	6,988,850	267	24,472,734	82,530,000	3,150	6,8
Contribution to equity.....	-	-	-	-	-	1,117,7
Net loss.....	-	-	-	-	-	-
BALANCE, DECEMBER 31, 1995	6,988,850	267	24,472,734	82,530,000	3,150	1,124,5
Contribution to equity.....	-	-	-	-	-	650,0
Issuance of stock warrants..	-	-	-	-	-	246,2
Net loss.....	-	-	-	-	-	-
BALANCE, DECEMBER 31, 1996	6,988,850	267	24,472,734	82,530,000	3,150	2,020,8
Compensation related to stock options and warrant	-	-	-	-	-	3,156,6
Net loss.....	-	-	-	-	-	-
BALANCE, DECEMBER 31, 1997	6,988,850	267	24,472,734	82,530,000	3,150	5,177,5
262 to 1 stock split.....	-	69,621	(69,621)	-	822,150	(822,15
Conversion of preferred stock to common stock....	(6,988,850)	(69,888)	(24,403,113)	6,988,850	69,888	24,403,1

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Issuance of common stock....	-	-	-	10,526,316	105,263	205,883,4
Preferred stock dividends...	-	-	-	-	-	(9,926,7
Net loss.....	-	-	-	-	-	-
<hr/>						
BALANCE, DECEMBER 31, 1998	-	-	-	100,045,166	1,000,451	224,715,2
Net loss.....	-	-	-	-	-	-
<hr/>						
BALANCE, DECEMBER 31, 1999	-	-	-	100,045,166	1,000,451	224,715,2
Net Loss.....	-	-	-	-	-	-
Issuance of common stock....	-	-	-	4,457,169	44,572	10,477,2
<hr/>						
BALANCE, DECEMBER 31, 2000	-	-	-	104,502,335	1,045,023	235,192,4
Net Loss.....	-	-	-	-	-	-
Issuance of common stock....	-	-	-	7,416,859	74,169	15,625,4
<hr/>						
BALANCE, JUNE 30, 2001	-	-	-	111,919,194	\$1,119,192	\$250,817,9
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See notes to financial statements.

**EARTHSHELL CORPORATION**  
**(A Development Stage Enterprise)**  
**STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

For the  
Six Months Ended  
June 30,

	2001	2000
<hr/>		
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss.....	\$(17,505,820)	\$(20,055,931)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization.....	2,510,449	2,850,096
Issuance of stock options to director, consultant and officer	-	-
Issuance of stock grants to director, consultant and officer	515,398	-
Amortization of debt issue costs.....	-	-
Loss on sale or disposal of property and equipment.....	-	194,937
Loss from investment in joint venture.....	45,000	103,598
Net Loss on Sale of Investments.....	-	-
Accretion of Discounts on Investments.....	-	-
Changes in operating assets and liabilities:		
Prepaid expenses and other current assets.....	(21,748)	(158,588)
Accounts payable and accrued expenses.....	(1,588,118)	(978,015)
Trade payable to majority stockholder.....	(266,312)	(875,882)
Net cash used in operating activities.....	(16,311,151)	(18,919,785)
<hr/>		
CASH FLOWS FROM INVESTING ACTIVITIES:		
Sale (purchase) of short-term investments.....	-	8,970,638
Purchase of restricted time deposit.....	-	-
Proceeds from sales and redemptions of investments.....	-	-

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Proceeds from sale of property and equipment.....	-	-
Investment in joint venture.....	-	-
Purchase of property and equipment.....	(1,644,615)	(3,764,414)
	<u>-----</u>	<u>-----</u>
Net (cash used) provided by investing activities.....	(1,644,615)	5,224,224
	<u>-----</u>	<u>-----</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of notes payable to stockholders.....	-	-
Proceeds from drawings on line of credit with bank.....	-	-
Proceeds from issuance of common stock.....	14,947,940	3,615,929
Common stock issuance costs.....	-	-
Preferred dividends paid.....	-	-
Proceeds from issuance of preferred stock.....	-	-
Preferred stock issuance costs.....	-	-
Repayment of line of credit with bank.....	-	-
Repayment of note payable.....	-	-
	<u>-----</u>	<u>-----</u>
Net cash provided by financing activities.....	14,947,940	3,615,929
	<u>-----</u>	<u>-----</u>
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS.....	(3,007,826)	(10,079,633)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD.....	7,791,654	26,412,553
	<u>-----</u>	<u>-----</u>
CASH AND CASH EQUIVALENTS, END OF PERIOD.....	\$4,783,828	\$16,332,920
	<u>=====</u>	<u>=====</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for:		
Income taxes.....	-	800
Interest.....	-	-
Warrants issued with debt.....	-	-
Transfer of property from EKI.....	-	-
Conversion of preferred stock to common stock.....	-	-
Tax Liability related to stock grants.....	\$236,326	-

See notes to financial statements.

**EARTHSHELL CORPORATION**

**NOTES TO FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2001

**Presentation of Financial Information**

The foregoing interim financial information is unaudited and has been prepared from the books and records of EarthShell Corporation (the Company). In the opinion of management, the financial information reflects all adjustments necessary for a fair presentation of the financial condition, results of operations and cash flows of the Company in conformity with generally accepted accounting principles. All such adjustments were of a normal recurring nature for interim financial reporting.

The accompanying unaudited financial statements and these notes do not include certain information and footnote disclosures required by generally accepted accounting principles which were included in the Company's financial statements for the year ended December 31, 2000. The

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information included in this Form 10-Q should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and financial statements and notes thereto for the year ended December 31, 2000 included in the Company's Annual Report on Form 10-K.

Basic and diluted loss per common share is calculated based on the weighted average shares outstanding of 111,009,853 and 109,007,431 for the three and six months ended June 30, 2001, respectively and 100,381,321 and 100,213,243 for the three and six months ended June 30, 2000. Basic and diluted per share calculation is the same because common stock equivalents are anti-dilutive. Incremental dilutive shares which would be issuable using the treasury stock method would be 382,237 and 43,761 at June 30, 2001 and 2000, respectively.

### Related Party Transactions

For the three months ended June 30, 2001 and 2000, the Company paid or accrued \$367,694 and \$2,486,429 respectively, and \$691,142 and \$4,470,852 for the six months ended June 30, 2001 and 2000, respectively for services performed by EKI under the Amended and Restated Technical Services Agreement as amended October 1, 1997, between the Company and EKI. On January 1, 2001 the Company directly hired the EKI personnel critical to the Company's future development programs and since that time has significantly reduced the use of EKI technical services and related expenses. The related party expenses for 2001 are attributable to research and development related to sandwich wraps and films being performed for the Company by an affiliate of EKI.

Effective January 1, 2001 the Company assumed direct responsibility for managing the patent portfolio underlying its license from EKI and pays such patent expenses directly. For the three and six months ended June 30, 2000, the Company paid or accrued \$126,383 and \$269,773 respectively to EKI for patent costs under the Amended and Restated Agreement for Allocation of Patent Costs effective October 1, 1997.

## EARTHSHELL CORPORATION

### NOTES TO FINANCIAL STATEMENTS (Unaudited) - continued JUNE 30, 2001

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#### Property and Equipment

At June 30, 2001, property and equipment consisted of the following:

Commercial Manufacturing Equipment: Construction in progress, at the Owings Mills Maryland plant of Sweetheart Company.....	\$35,4
Product Development Center:	
Equipment.....	3,7
Construction in progress.....	8,9
Leasehold improvements.....	5
	13,3
Office equipment and furniture.....	7
Less: accumulated depreciation and amortization.....	(14,2
	-----
Property and equipment - net.....	\$35,=====

#### Contingencies

On August 2, 1999, Novamont S.p.A., an Italian company specializing in the manufacture of a biodegradable plastic resin and products, filed a complaint in the United States District Court for the Northern District of Illinois alleging four counts of infringement of three patents. On August 3, 2001 the Company entered into a Settlement Agreement with Novamont wherein the lawsuit by Novamont was dismissed with no material adverse financial effect on the Company, and the Company's rights to manufacture and distribute the foodservice disposable through its operating partners are fully protected and expanded to include the application of Novamont technology.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Information contained in this Quarterly Report on Form 10-Q including Management's Discussion and Analysis of Financial Condition and Results of Operations contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, as amended. These statements may be identified by the use of forward-looking terminology such as may, will, expect, anticipate, estimate, or continue, or the negative thereof or other comparable terminology. Any one factor or combination of factors could cause the Company's actual operating performance or financial results to differ substantially from those anticipated by management that are described herein. Factors influencing the Company's operating performance and financial results include, but are not limited to, changes in the general economy, the availability of financing, governmental regulations concerning, but not limited to, environmental issues, and other risks and unforeseen circumstances affecting the Company's business and should be read in conjunction with other risk factors discussed in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000.

### Overview of Operations

The Company was organized in November 1992 as a Delaware corporation and is a development stage company engaged in the commercialization of a proprietary composite material, designed with the environment in mind, for the manufacture of disposable packaging for the foodservice industry, such as hinged-lid containers, plates, bowls, sandwich wraps, and cups. The Company has an exclusive, worldwide, royalty-free license from EKI to use and license the EKI technology to manufacture and sell disposable, single-use containers for packaging or serving food or beverages intended for consumption within a short period of time (EARTHSHELL Products). The Company does not have the right to use the EKI technology for other purposes. The Company licenses or joint ventures with existing manufacturers of foodservice disposables to manufacture and distribute EARTHSHELL Products. The Company expects to derive revenues primarily from license royalties and profit distributions from joint ventures that are licensed to manufacture EARTHSHELL Products.

The Company has experienced aggregate net losses of approximately \$211 million from its inception through June 30, 2001 and expects to continue to incur operating losses until its products are more broadly used and have achieved greater market acceptance and market penetration. EARTHSHELL Products are being sold through or in cooperation with its operating partners and these sales are being booked according to the terms of the respective operating agreement. For example, under the terms of its agreement with Sweetheart Cup Company, sales of the Company's clamshells for the Big Mac® sandwich are recorded on Sweetheart's books as revenue, and are credited to the Company as an offset to the cost of start-up manufacturing operations. Successful future operations will depend upon the ability of the Company, its licensees and joint venture partners to commercialize multiple EARTHSHELL Products.

### Results of Operations

#### Comparison of the Three and Six Months Ended June 30, 2001, to the Three and Six Months June 30, 2000.

**Total Research and Development Expenses** Total research and development expenditures for the development of EarthShell Products decreased \$4.3 million to \$9.1 million from \$13.4 million for the six months ended June 30, 2001 compared to the six months ended June 30, 2000, and decreased \$3.0 million to \$4.4 million from \$7.4 million for the three months ended June 30, 2001 compared to the three months ended June 30, 2000. Approximately \$2.5 million of the cost reduction is directly related to reducing the operating costs of the Owings Mills facility related to the continued development and production of the EarthShell Big Mac® sandwich container, and approximately \$0.8 million from a reduction in other research and development efforts, and approximately \$1.0 million of the decrease results from a non-recurring abandonment charge taken during the six months ended June 30, 2000.

**Total General and Administrative Expenses** Total general and administrative expenses increased \$1.8 million to \$6.1 million from \$4.3 million for the six months ended June 30, 2001 compared to the six months ended June 30, 2000, respectively, and increased \$1.6 million to \$3.9 million from \$2.3 million for the three months ended June 30, 2001 compared to June 30, 2000, respectively. Approximately \$0.7 million of the increase is a non cash charge relating to various issuance of stock grants during the quarter ended June 30, 2001. Approximately \$0.3 million of the increase results from re-classification to general and administrative expense of certain personnel changes related to technical personnel, and \$0.6 million of the increase from legal expense related to the settlement of the lawsuit with Novamont, and the direct management of the patent portfolio effective January 1, 2001.

**Depreciation and Amortization Expense** Depreciation and amortization expense decreased \$0.4 million to \$2.5 million from \$2.9 million for the six months ended June 30, 2001 compared with the six months ended June 30, 2000.

**Related Party Patent Expenses** Legal fees reimbursed to EKI under the Amended and Restated Agreement for Allocation of Patent Costs with EKI decreased \$0.3 million to \$0 million from \$0.3 million for the six months ended June 30, 2001 compared with the six months ended June 30, 2000. Beginning January 1, 2001 the Company assumed direct responsibility for managing and paying for the maintenance of the patent portfolio underlying the license with EKI, and accordingly these costs are now being recorded within general and administrative expense for the Company. Legal fees for patent expense are no longer reimbursed to EKI as they were in fiscal periods prior to 2001.

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**Interest Income** Interest Income decreased \$0.6 million to \$0.2 million from \$0.8 million for the six months ended June 30, 2001 compared to the six months ended June 30, 2000 due to reduced cash balances on hand.

**Net Loss** The Company's net loss decreased \$2.5 million to \$17.5 million from \$20.0 million for the six months ended June 30, 2001 compared to the six months ended June 30, 2000, and decreased \$1.5 million to \$9.4 million from \$10.9 million for the three months ended June 30, 2001 compared to the three months ended June 30, 2000 as a result of the foregoing factors.

### **Liquidity and Capital Resources at June 30, 2001**

**Cash Flow** The Company's principal use of cash for the six months ended June 30, 2001 was to fund operations, including the continued development and purchase of equipment to facilitate the development of manufacturing capacity for EARTHSHELL Products. Net cash used in operations was \$16.3 million for the six months ended June 30, 2001 down from \$18.9 million for the six months ended June 30, 2000. Net cash (used in) and provided by investing activities was (\$1.6) million and \$5.2 million for the six months ended June 30, 2001 and 2000, respectively. Net cash provided by financing activities was \$14.9 million and \$3.6 million for the six months ended June 30, 2001 and 2000, respectively. As of June 30, 2001 the Company had cash totaling \$4.8 million.

**Capital Requirements** The Company expects to spend approximately \$10.0 million in capital expenditures in the year 2001 related to developing the manufacturing facilities and prototypes for the line of EarthShell Products. The Company paid or accrued approximately \$1.6 million in capital expenditures for the first six months ended June 30, 2001. The Company spent approximately \$6.6 million in capital expenditures for the year ended December 31, 2000.

**Sources of Capital** As part of the Company's initial public offering on March 27, 1998, the Company issued 10,526,316 shares of common stock, for which it received net proceeds of \$206 million. The Company has signed an agreement with Acqua Wellington North American Equities Fund, LTD (Acqua Wellington), pursuant to which the Company may, from time to time and in its sole discretion present Acqua Wellington with draw-down notices requiring Acqua Wellington to purchase up to \$2,500,000 of the Company's common stock in respect of each draw-down notice. The Company issues and sells the shares to Acqua Wellington at a per share price equal to the average price of the Company's common stock over a period of time after the draw-down notice less a discount of 5%. In addition, the agreement gives Acqua Wellington the option to purchase an additional \$2.5 million of the Company's common stock per month, subject to certain conditions.

The common stock purchase agreement with Acqua Wellington provides that the Company generally may not request draw-downs unless the Company's common stock is trading at \$3.00 per share or more. As an alternative, Acqua Wellington has purchased and continues to purchase shares from the Company from time-to-time at negotiated prices.

During the six months ended June 30, 2001 the Company issued approximately 7.1 million shares of common stock to Acqua Wellington and received net proceeds from such issuance of approximately \$14.9 million. As of June 30, 2001 up to \$35.0 million remains available to the Company under the equity drawn-down facility with Acqua Wellington, with \$17.5 million available at the Company's request, and \$17.5 million at Acqua Wellington's option.

As the Company accomplishes its core goals, it continues discussions with certain financing institutions to secure additional sources of long term funding. The Company believes that its existing cash, the financing provided through the Acqua Wellington equity draw-down facility, as well as new sources, will enable it to continue funding its operations, including the Owings Mills facility, as well as continue with its next generation development of EarthShell Products over the remainder of the fiscal year. The Company cannot assure, however, that commitments can be obtained on favorable terms, if at all.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Not applicable

### *Part II. Other Information*

#### **Item 1. Legal Proceedings**

On August 2, 1999, Novamont S.p.A., an Italian company specializing in the manufacture of a biodegradable plastic resin and products, filed a complaint in the United States District Court for the Northern District of Illinois alleging four counts of infringement of three patents. On August 3, 2001 the Company entered into a Settlement Agreement with Novamont wherein the lawsuit by Novamont was dismissed with no material adverse financial effect on the Company, and the Company's rights to manufacture and distribute the foodservice disposable through its operating partners are fully protected and expanded to include the application of Novamont technology.

**Item 2. Changes in Securities**

Not Applicable

**Item 3. Defaults Upon Senior Securities**

Not applicable

**Item 4. Submission of Matters to a Vote of Security Holders**

The Annual Meeting of Stockholders of the Company was held on May 8th, 2001, at which time Essam Khashoggi, Simon K. Hodson, John Daoud, Layla Khashoggi, Howard J. Marsh, Lynn Scarlett, Michael S. Noling were elected as the Board of Directors.

**Item 5. Other Information**

Not applicable

**Item 6. Exhibits and Reports on Form 8-K**

- 10.48 Settlement Agreement with Novamont dated August 3, 2001
- 10.49 Amendment to Common Stock Purchase Agreement dated March 28, 2001

The Company filed no reports on Form 8-K during the quarter ended June 30, 2001.

*Signature*

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.

EarthShell Corporation

Date: August 14, 2001

By: /s/ D. SCOTT HOUSTON

-----  
D. Scott Houston  
Chief Financial Officer

(Principal Financial and Accounting Officer  
and Duly Authorized Officer)