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WATER CHEF INC
Form 10QSB
November 17, 2004

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

Form 10-QSB

(Mark One)

(X) QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF THE SECURITIES AND EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2004

() TRANSITION REPORT UNDER SECTION 13 OR 15 (d) OF THE EXCHANGE ACT

For the transition period from _____ to _____

Commission file number 001-09478

WATERCHEF, INC.

(Exact name of small business issuer as specified in its charter)

Delaware

86-0515678

(State of other jurisdiction of incorporation or organization)

(IRS Employer Identification No.)

1007 Glen Cove Avenue, Suite 1, Glen Head, New York 11545

(Address of principal executive offices)

516-656-0059

(Issuer's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common stock, as of the last practicable date.

OUTSTANDING AS OF NOVEMBER 2, 2004

| CLASS ----- | Common ----- |
|-----------------------------|-----------------|
| Par value \$0.001 per share | 150,433,227 |

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Transitional Small Business Disclosure Format (Check One) Yes No X

WATERCHEF, INC.

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1

WATERCHEF, INC.
(A Development-Stage Company Commencing January 1, 2002)

CONDENSED BALANCE SHEET

AT SEPTEMBER 30, 2004
(UNAUDITED)

ASSETS

CURRENT ASSETS:

| | | |
|---|----|--------|
| Cash | \$ | 58,945 |
| Prepaid expenses and other current assets | | 21,245 |
| | | ----- |
| TOTAL CURRENT ASSETS | | 80,190 |
| | | ----- |

OTHER ASSETS:

| | | |
|--|--|--------|
| Patents and trademarks - net of accumulated amortization of \$6,480 | | 19,575 |
| Other assets | | 3,162 |
| | | ----- |
| TOTAL OTHER ASSETS | | 22,737 |
| | | ----- |

| | | |
|--------------|----|---------|
| TOTAL ASSETS | \$ | 102,927 |
| | | ===== |

LIABILITIES AND STOCKHOLDERS' DEFICIENCY

CURRENT LIABILITIES:

| | | |
|---|----|-----------|
| Accounts payable | \$ | 239,192 |
| Accrued expenses and other current liabilities | | 986,478 |
| Notes payable (including accrued interest of \$477,865) | | 1,161,087 |
| Accrued dividends payable | | 75,493 |
| | | ----- |
| TOTAL CURRENT LIABILITIES | | 2,462,250 |

LONG-TERM LIABILITIES:

Loans payable to shareholder (including accrued interest

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| | |
|--|--------------|
| of \$99,254) | 472,035 |
| | ----- |
| TOTAL LIABILITIES | 2,934,285 |
| | ----- |
| COMMITMENTS AND CONTINGENCIES | |
| STOCKHOLDERS' DEFICIENCY: | |
| Preferred stock - \$.001 par value; 10,000,000 shares authorized; 679,787 shares issued and outstanding | 680 |
| Common stock - \$.001 par value; 190,000,000 shares authorized; 149,439,630 shares issued and 149,435,230 shares outstanding | 149,440 |
| Additional paid-in capital | 19,983,786 |
| Treasury stock, at cost - 4,400 shares of common stock | (5,768) |
| Accumulated deficit through December 31, 2001 | (14,531,596) |
| Deficit accumulated during development stage | (8,427,900) |
| | ----- |
| TOTAL STOCKHOLDERS' DEFICIENCY | (2,831,358) |
| | ----- |
| TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIENCY | \$ 102,927 |
| | ===== |

See notes to condensed financial statements.

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WATERCHEF, INC.
(A Development-Stage Company Commencing January 1, 2002)

CONDENSED STATEMENTS OF OPERATIONS
(UNAUDITED)

| | For the Three Months Ended September 30, | | For the Nine Mo September |
|---|---|-----------|------------------------------|
| | 2004 | 2003 | 2004 |
| | ----- | ----- | ----- |
| SALES | \$ -- | \$ -- | \$ 56,290 |
| COST OF SALES | 24,000 | 24,000 | 77,250 |
| | ----- | ----- | ----- |
| GROSS (LOSS) PROFIT | (24,000) | (24,000) | (20,960) |
| GENERAL AND ADMINISTRATIVE EXPENSES | 428,357 | 216,094 | 985,037 |
| NON-DILUTION AGREEMENT TERMINATION COST | -- | 1,044,677 | (223,860) |
| INTEREST EXPENSE | 37,557 | 39,807 | 112,671 |
| LOSS ON SETTLEMENT OF DEBT | -- | -- | 2,407,867 |
| | ----- | ----- | ----- |

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| | | | |
|---|--------------|----------------|----------------|
| NET LOSS | (489,914) | (1,324,578) | (3,302,675) |
| DEEMED DIVIDEND ON PREFERRED STOCK | -- | -- | (2,072,296) |
| PREFERRED STOCK DIVIDENDS | (47,398) | (39,912) | (93,570) |
| | (47,398) | (39,912) | (2,165,866) |
| NET LOSS APPLICABLE TO COMMON STOCK | \$ (537,312) | \$ (1,364,490) | \$ (5,468,541) |
| BASIC AND DILUTED LOSS PER COMMON SHARE | \$ (.00) | \$ (.02) | \$ (.05) |
| WEIGHTED AVERAGE COMMON SHARES OUTSTANDING - BASIC AND DILUTED | 142,118,759 | 89,559,886 | 111,529,245 |

See notes to condensed financial statements.

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WATERCHEF, INC.
(A Development-Stage Company Commencing January 1, 2002)

CONDENSED STATEMENTS OF STOCKHOLDERS' DEFICIENCY
(UNAUDITED)

| | Preferred Stock | | Common Stock | |
|---|-----------------|--------|--------------|-----------|
| | Shares | Amount | Shares | Amount |
| For the Nine Months Ended September 30, 2004: | | | | |
| Balance - January 1, 2004 | 887,166 | \$ 887 | 89,564,286 | \$ 89,564 |
| Proceeds from sale of preferred stock | | | | |
| (\$0.80 per share) | 15,625 | 15 | -- | -- |
| (\$2.00 Per share) | 58,334 | 59 | -- | -- |
| (\$2.40 Per share) | 3,860 | 4 | -- | -- |
| (\$2.60 Per share) | 19,231 | 19 | -- | -- |
| (\$2.80 Per share) | 3,000 | 3 | -- | -- |
| (\$4.00 Per share) | 3,984 | 4 | -- | -- |
| (\$4.80 Per share) | 41,668 | 42 | -- | -- |
| Preferred stock issued for services (\$2.00 Per share) | 17,265 | 17 | -- | -- |

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| | | | | |
|---|-----------|--------|-------------|----------------|
| (\$3.20 Per share) | 20,625 | 21 | -- | -- |
| (\$4.00 Per share) | 1,000 | 1 | -- | -- |
| (\$4.27 Per share) | 9,375 | 9 | -- | -- |
| (\$4.80 Per share) | 4,168 | 4 | -- | -- |
| Proceeds from sale of common stock | | | | |
| (\$0.03 Per share) | -- | -- | 450,000 | 450,000 |
| (\$0.07 Per share) | -- | -- | 666,667 | 667,000 |
| (\$0.08 Per share) | -- | -- | 1,082,500 | 1,083,000 |
| (\$0.15 Per share) | -- | -- | 142,428 | 142,500 |
| (\$0.17 Per share) | -- | -- | 200,000 | 200,000 |
| Common stock issued for services | | | | |
| (\$0.05 Per share) | -- | -- | 1,857,133 | 1,857,500 |
| (\$0.15 Per share) | -- | -- | 357,800 | 358,000 |
| Preferred stock dividend | -- | -- | -- | -- |
| Common stock issued for satisfaction of liabilities | | | | |
| (\$0.165 Per share) | -- | -- | 37,786,629 | 37,787,000 |
| Preferred stock converted to common stock | (405,514) | (405) | 17,332,187 | 17,332,500 |
| Net loss | -- | -- | -- | -- |
| Balance - September 30, 2004 | 679,787 | \$ 680 | 149,439,630 | \$ 149,440,000 |

See notes to condensed financial statements.

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WATERCHEF, INC.
(A Development-Stage Company Commencing January 1, 2002)

CONDENSED STATEMENTS OF STOCKHOLDERS' DEFICIENCY
(UNAUDITED)

| | Additional Paid-In Capital | Treasury Stock |
|---|----------------------------------|-------------------|
| | ----- | ----- |
| For the Nine Months Ended September 30, 2004: | | |
| Balance - January 1, 2004 | \$ 13,513,834 | \$ (5,768) |
| Proceeds from sale of preferred stock | | |
| (\$0.80 per share) | 12,485 | -- |
| (\$2.00 Per share) | 116,608 | -- |
| (\$2.40 Per share) | 9,256 | -- |

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| | | |
|--|---------------|------------|
| (\$2.60 Per share) | 49,981 | -- |
| (\$2.80 Per share) | 8,397 | -- |
| (\$4.00 Per share) | 15,925 | -- |
| (\$4.80 Per share) | 199,958 | -- |
| Preferred stock issued for services | | |
| (\$2.00 Per share) | 34,513 | -- |
| (\$3.20 Per share) | 65,979 | -- |
| (\$4.00 Per share) | 3,999 | -- |
| (\$4.27 Per share) | 39,991 | -- |
| (\$4.80 Per share) | 19,996 | -- |
| Proceeds from sale of common stock | | |
| (\$0.03 Per share) | 14,950 | -- |
| (\$0.07 Per share) | 49,333 | -- |
| (\$0.08 Per share) | 85,517 | -- |
| (\$0.15 Per share) | 20,858 | -- |
| (\$0.17 Per share) | 34,400 | -- |
| Common stock issued for services | | |
| (\$0.05 Per share) | 91,000 | -- |
| (\$0.15 Per share) | 53,292 | -- |
| Preferred stock dividend | (75,493) | -- |
| Common stock issued for satisfaction of liabilities (\$0.165 Per share) | 5,635,934 | -- |
| Preferred stock converted to common stock | (16,927) | -- |
| Net loss | -- | -- |
| | ----- | ----- |
| Balance - September 30, 2004 | \$ 19,983,786 | \$ (5,768) |
| | ===== | ===== |

See notes to condensed financial statements.

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WATERCHEF, INC.
(A Development-Stage Company Commencing January 1, 2002)

CONDENSED STATEMENTS OF STOCKHOLDERS' DEFICIENCY
(UNAUDITED)

| | Accumulated Deficit Through December 31, 2001 | Deficit Accumulated During Development Stage | Total Stockholder Deficiency |
|---|---|--|------------------------------------|
| | ----- | ----- | ----- |
| For the Nine Months Ended September 30, 2004: | | | |
| ----- | | | |

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| | | | |
|---|-----------------|----------------|----------------|
| Balance - January 1, 2004 | \$ (14,531,596) | \$ (5,125,225) | \$ (6,058,300) |
| Proceeds from sale of preferred stock | | | |
| (\$0.80 Per share) | -- | -- | 12,500 |
| (\$2.00 Per share) | -- | -- | 116,666 |
| (\$2.40 Per share) | -- | -- | 9,260 |
| (\$2.60 Per share) | -- | -- | 50,000 |
| (\$2.80 Per share) | -- | -- | 8,400 |
| (\$4.00 Per share) | -- | -- | 15,920 |
| (\$4.80 Per share) | -- | -- | 200,000 |
| Preferred stock issued for services | | | |
| (\$2.00 Per share) | -- | -- | 34,530 |
| (\$3.20 Per share) | -- | -- | 66,000 |
| (\$4.00 Per share) | -- | -- | 4,000 |
| (\$4.27 Per share) | -- | -- | 40,000 |
| (\$4.80 Per share) | -- | -- | 20,000 |
| Proceeds from sale of common stock | | | |
| (\$0.03 Per share) | -- | -- | 15,400 |
| (\$0.07 Per share) | -- | -- | 50,000 |
| (\$0.08 Per share) | -- | -- | 86,600 |
| (\$0.15 Per share) | -- | -- | 21,000 |
| (\$0.17 Per share) | -- | -- | 34,600 |
| Common stock issued for services | | | |
| (\$0.05 Per share) | -- | -- | 92,850 |
| (\$0.15 Per share) | -- | -- | 53,650 |
| Preferred stock dividend | (75,493) | | |
| Common stock issued for satisfaction of liabilities | | | |
| (\$0.165 Per share) | -- | -- | 5,673,720 |
| Preferred stock converted to common stock | -- | -- | -- |
| Net loss | -- | (3,302,675) | (3,302,675) |
| Balance - September 30, 2004 | \$ (14,531,596) | \$ (8,427,900) | \$ (2,831,350) |

See notes to condensed financial statements.

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WATERCHEF, INC.
(A Development-Stage Company Commencing January 1, 2002)

CONDENSED STATEMENTS OF CASH FLOWS
(UNAUDITED)

For the Nine Months Ended

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| | September 30, | | For the Period January 1, 2002 to September 30, |
|--|------------------|------------------|---|
| | 2004 | 2003 | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net loss | \$ (3,302,675) | \$ (2,241,504) | \$ (8,427,900) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | | |
| Depreciation and amortization | 1,391 | 1,390 | 5,090 |
| Non-cash compensation | 311,037 | 148,283 | 560,720 |
| Non-dilution agreement termination cost | (223,860) | 1,432,699 | 2,462,450 |
| Loss on settlement of debt | 2,407,867 | -- | 2,614,010 |
| Inventory reserve | -- | -- | 159,250 |
| Write-off of stock subscription receivable | -- | -- | 21,800 |
| Changes in assets and liabilities: | | | |
| Inventory | 26,500 | -- | -- |
| Prepaid expenses and other current assets | (10,025) | (6,000) | 35,250 |
| Accounts payable, accrued expenses and interest | 125,523 | 315,199 | 909,310 |
| NET CASH USED IN OPERATING ACTIVITIES | (664,242) | (349,933) | (1,659,990) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Stock subscription receivable | -- | 15,500 | 45,700 |
| Proceeds from sale of preferred stock | 412,756 | 341,010 | 1,130,120 |
| Proceeds from sale of common stock | 207,600 | -- | 307,600 |
| Proceeds from sale of common stock to be issued | -- | -- | 200,000 |
| NET CASH PROVIDED BY FINANCING ACTIVITIES | 620,356 | 356,510 | 1,683,420 |
| NET CHANGE IN CASH | (43,886) | 6,577 | 23,430 |
| CASH - BEGINNING OF PERIOD | 102,831 | 22,758 | 35,510 |
| CASH - END OF PERIOD | \$ 58,945 | \$ 29,335 | \$ 58,945 |

See notes to condensed financial statements.

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WATERCHEF, INC.

(A Development Stage Company Commencing January 1, 2002)

NOTES TO CONDENSED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 - DESCRIPTION OF BUSINESS

WaterChef, Inc. (the "Company"), is a Delaware Corporation currently engaged in the design and marketing of water purification equipment both inside and outside the United States.

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NOTE 2 - BASIS OF PRESENTATION AND ACCOUNTING POLICES

The accompanying unaudited condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. Accordingly these financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary to make the financial statements not misleading have been included. Operating results for the three and nine-month period ended September 30, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004. These financial statements should be read in conjunction with the financial statements and footnotes thereto included in the Company's Annual Report on Form 10-KSB, filed on March 12, 2004, for the year ended December 31, 2003.

Stock-Based Compensation - In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FASB Statement No.123." SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The disclosure requirements apply to all companies for fiscal years ending after December 15, 2002. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. The Company will continue to account for stock-based compensation according to APB Opinion No. 25.

The following table summarizes relevant information as to reported results under the Company's intrinsic value method of accounting for stock awards, with supplemental information as if the fair value recognition provisions of FAS 123 had been applied for the following periods ended September 30, 2004 and 2003 as follows:

| | Three Months Ended September 30, 2004 | | Nine Months Ended September 30, 2004 | |
|--|---|----------------|--|----------------|
| | 2004 | 2003 | 2004 | 2003 |
| Net loss applicable to common stock | \$ (537,312) | \$ (1,364,490) | \$ (5,468,541) | \$ (2,347,000) |
| Stock-based employee compensation cost, net of tax effect, under fair value accounting | 44,656 | -- | 125,213 | |
| Pro-forma net loss under fair value method | \$ (581,968) | \$ (1,364,490) | \$ (5,593,754) | \$ (2,347,000) |
| Loss per share - basic and diluted | \$ (0.00) | \$ (0.02) | \$ (0.05) | \$ (0.02) |
| Per share stock-based employee compensation cost, net of tax effect, under fair value accounting | 0.00 | 0.00 | 0.00 | 0.00 |
| Pro-forma loss per share - basic and diluted | \$ (0.00) | \$ (0.02) | \$ (0.05) | \$ (0.02) |

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During 2004, the Company has issued 6,000,000 stock options to purchase common stock of the Company to the president and a director. The total stock options granted may be converted to common stock at an exercise price of \$0.25 and expire in five years.

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WATERCHEF, INC.

(A Development Stage Company Commencing January 1, 2002)

NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 3 - GOING CONCERN

The accompanying condensed financial statements have been prepared assuming that the Company will continue as a going concern. The Company has suffered recurring losses and has a working capital deficiency at September 30, 2004. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management's plans with respect to these matters include restructuring its existing debt, settling its existing debt by issuing shares of its common stock and raising additional capital through future issuance of stock and or debentures. The accompanying financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern.

NOTE 4 - RECENT ACCOUNTING STANDARDS

In January 2003, the FASB issued Interpretation Number 46, "Consolidation of Variable Interest Entities" ("FIN No. 46"). This interpretation of Accounting Research Bulletin ("ARB") No. 51, "Consolidated Financial Statements," provides guidance for identifying a controlling interest in a variable interest entity ("VIE") established by means other than voting interests. FIN No. 46 also requires consolidation of a VIE by an enterprise that holds such a controlling interest. In December 2003, the FASB completed its deliberations regarding the proposed modification to FIN No. 46 and issued Interpretation Number 46(R), "Consolidation of Variable Interest Entities - an Interpretation of ARB No. 51" ("FIN No. 46(R)"). The decisions reached included a deferral of the effective date and provisions for additional scope exceptions for certain types of variable interests. Application of FIN No. 46(R) is required in financial statements of public entities that have interests in VIEs or potential VIEs commonly referred to as special-purpose entities for periods ending after December 15, 2003. Application by public small business issuers' entities is required in all interim and annual financial statements for periods ending after December 15, 2004.

The adoption of this pronouncement is not expected to have a material effect on the Company's financial statements.

NOTE 5 - COMMON STOCK ISSUED

On June 4, 2004, the Company convened a special meeting of its common, Series A Preferred, Series C Preferred, Series D Preferred, Series F Preferred stockholders (together the "Stockholders"). The Stockholders, voting as a single class, voted and approved a proposal to amend the Certificate of Incorporation to increase the Company's authorized capital stock from 100,000,000 shares to 200,000,000 shares, consisting of 190,000,000 shares of common stock and

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10,000,000 shares of preferred stock.

During the nine months ended September 30, 2004, the Company recorded the following transactions:

a. Cash

During 2002, the Company received \$200,000 for 4,000,000 shares of its common stock. These shares were issued during the June 2004 quarter upon the approval by the stockholders of the increase in the number of authorized common shares of the Company.

During the September 2004 quarter, the Company received \$207,600 for 2,541,595 shares of its common stock.

b. Non-Dilution Agreement Termination Cost

In 2002, the Company agreed to issue to the Company's President and Chief Executive Officer, and to related parties of such, an aggregate of 14,923,958 shares of its common stock in connection with the voluntary surrender of a non-dilution agreement that the President had entered into with the Company in June 1997.

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WATERCHEF, INC.

(A Development Stage Company Commencing January 1, 2002)

NOTES TO CONDENSED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 5 - COMMON STOCK ISSUED(Continued)

Since the issuance of these shares was subject to stockholder approval, the measurement date for purposes of valuation was established when such stockholder approval was obtained. Accordingly, the Company was utilizing variable accounting to determine the value of these shares. These shares were issued during the June 2004 quarter upon the approval by the stockholders of the increase in the number of authorized common shares of the Company. The value of these shares was \$2,462,451.

c. Services

During 2002, the Company agreed to issue to various parties an aggregate of 1,075,000 shares of its common stock for value of \$84,000 in connection with professional services. These shares were issued during the June 2004 quarter upon the approval by the stockholders of the increase in the number of authorized common shares of the Company.

During the September 2004 quarter, the Company issue to various parties an aggregate of 2,214,933 shares of its common stock for value of \$146,507 in connection with professional services. These shares were issued during the current quarter.

d. Debenture Liabilities

The Company was a defendant in an action brought by certain debenture holders (The "Bridge Loans") in New Hampshire Superior Court seeking

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repayment of \$300,000 of debenture principal together with interest from 1997, and the issuance of penalty shares for non payment of principal and interest. In addition, the plaintiffs claim that they had suffered by the Company's failure to register the shares issued under the warrant agreement.

The Company had interposed defenses and counterclaims. In June 1997, in connection with the debentures, the Company had issued 6,667 shares of common stock for every \$1,000 of debt at a price of \$0.15 per share. The Company claimed that it was owed the \$300,000 consideration for such shares. In addition, the Company had issued warrants for the purchase of 2,500,000 shares of common stock at an exercise price of \$0.15 per share originally exercisable until March 2002.

Furthermore, the Company had issued another 100,000 shares of common stock to each debenture holder, or 1,300,000 shares, at a price of \$0.15 per share.

In 2002, the Company and the Bridge Lenders participating in the legal action, settled this dispute requiring the Company to: (i) Issue a minimum of 3,000,000 shares of common stock valued at \$497,500 in lieu of the principal and interest owed to the debenture holders who participated ("participants") in this legal action. The Company recorded the debentures at \$300,000, plus accrued interest of \$39,400, for a total of \$339,400. The difference between the \$497,500 settlement and the \$339,400, or \$158,100, was recorded as a loss on settlement of debt; (ii) Extend the warrants attached to the participants' debentures for another two years until March 2004, for which the Company has recorded a non cash charge of \$111,000; (iii) In 2004, in connection with the issuance of the Bridge Lender shares, the Company further extended the term of the warrants for twelve months until March 2005 and recorded \$94,151 as a loss on settlement of debt in connection with such warrant extension; and (iv) Issued additional shares since the product of the \$497,500, as valued for the 3,000,000 shares above, divided by the average daily trading price for the 30 days subsequent to the settlement, was greater than the original 3,000,000 shares. Due to these requirements, the Company was obligated to issue an additional 14,037,671 shares. As of June 30, 2004, the Company has issued the 3,000,000 shares and the additional 14,037,671 shares originally valued at \$497,500. The Company recorded a loss on settlement of debt of \$2,313,716 since the total value of the shares on the date of issuance was \$2,811,216.

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WATERCHEF, INC.

(A Development Stage Company Commencing January 1, 2002)

NOTES TO CONDENSED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 5 - COMMON STOCK ISSUED(Continued)

The debenture holders that did not participate ("non-participating debentures") in the above legal action had total debentures of \$75,000, plus accrued interest of \$9,850 as of the settlement date, totaling \$84,850. In conjunction with the above settlement, the Company settled these outstanding non-participating debentures, plus accrued interest, with the issuance of 750,000 shares of common

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stock valued at \$0.0292 per share, or \$21,900. During the June 2004 quarter, the 750,000 shares were issued.

e. Conversion of preferred stock into common stock

During the June 30, 2004 quarter, the Company agreed to issue to various parties an aggregate of 5,228,333 shares of its common stock in connection with the conversion of preferred stock.

During the September 30, 2004 quarter, the Company agreed to issue to various parties an aggregate of 12,103,854 shares of its common stock in connection with the conversion of preferred stock.

The total shares issued upon stockholder approval of the increase in the authorized stock of the Company as a result of the transactions described above aggregate 59,875,344.

NOTE 6 - NET LOSS PER SHARE OF COMMON STOCK

Basic net loss per share of common stock is computed based on the weighted average number of common shares outstanding during the periods presented.

Diluted net income per share of common stock is computed based on the weighted average number of common shares outstanding during the periods presented, plus any dilutive common stock equivalents. Common stock equivalents consisting of warrants and options were not included in the calculation of loss per share for the three and nine months ended September 30, 2004 and 2003 because their inclusion would have been antidilutive. Total potential shares issuable upon the exercise of options, warrants, the conversion of preferred stock, and payment of accrued dividends for the nine months ended September 30, 2004 and 2003 were 37,555,044 and 24,982,154, respectively.

NOTE 7 - COMMITMENTS AND CONTINGENCIES

The Company's lease for its administrative facilities located in Glen Head, New York expired in September 2001. The Company has been leasing such facilities since the expiration on a month-to-month basis.

In May 2001, the Company entered into a distribution agreement with a company (the "Sub distributor") based in the State of Jordan. The Sub distributor has agreed to purchase no fewer than 100 units of the Company's "Pure Safe Water Station", in the calendar year commencing January 1, 2001. A minimum purchase of 50 units are required to be purchased in each of the subsequent years commencing January 1, 2002 and 2003, respectively. During the year ended December 31, 2001, 18 units had been shipped under this agreement. The sale will be recognized when the Company receives payments. The Company recorded the cost of the inventory shipped as a loss contingency of \$242,035 during the year ended December 31, 2001, since return of the items is uncertain.

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NOTE 7 - COMMITMENTS AND CONTINGENCIES (Continued)

On November 17, 2000, the Company entered into a three-year master distribution agreement for their "Pure Safe Water Station" with a distributor based out of Hong Kong ("the distributor"). Under this agreement, upon meeting minimum quantities of sales in each of the years of agreement, the distributor will receive a rebate of 20% of the total price for all products, parts and supplies purchased from the Company. Furthermore, the distributor, upon meeting these minimum sales quantities will have the right to purchase up to 30,000,000 shares of the Company's common stock at \$0.05 per share. The sales targets were never met and the agreement was cancelled on June 17, 2002.

NOTE 8 - PREFERRED STOCK-SERIES F & SERIES C

During 2003, management authorized the Company to raise up to \$550,000 through a private placement by issuing 10% two-year convertible preferred instruments. The preferred, designated as Series F, and providing for one million shares in total, will be convertible into shares of Water Chef's common stock at such time as the stockholders of the corporation approve an increase in the authorized capital stock of the corporation, which occurred on June 4, 2004. All dividends are cumulative and are payable in cash or in shares of the Company's common stock valued at the then current market price per share, at the time of maturity, or upon conversion, whichever is earlier. The conversion rate for shares is 40 shares of common for each share of preferred stock. The Series F convertible preferred stockholders have voting rights equal to the common stockholders. The Series F convertible preferred stock has no stated rights in the assets of the Company upon liquidation.

Although there was a discount upon the issuance of all of the preferred stock in accordance with Emerging Issue Task Force ("EITF") 98-5, a security is not yet convertible if certain contingencies exist which are dependent upon the occurrence of a future event outside the control of the security holder. In this case, the shares could only be converted into common stock after the stockholders of the Company approve an increase in the authorized capital stock of the corporation. In accordance with EITF 98-5, any beneficial conversion (discount) feature is measured at the commitment date, but will not be recognized as an adjustment to earnings until the contingency is resolved, (the date the increase in shares are approved). On June 4, 2004, the Company voted and approved a proposal to amend the Certificate of Incorporation to increase the Company's authorized capital stock from 100,000,000 to 200,000,000 shares, consisting of 190,000,000 shares of common stock and 10,000,000 shares of preferred stock. During the June 2004 quarter, the Company recorded the deferred contingent beneficial conversion adjustment of \$2,072,697 as a deemed dividend since the contingency was resolved.

In connection with Series F conversions and the maturity of Series C preferred stock, the Company recorded accrued dividends of \$75,493 as of September 30, 2004 in the condensed balance sheet.

Cash

During the nine months ended September 30, 2004, the Company issued 145,702 shares and raised \$412,756 through the sale of Series F convertible preferred stock.

Services

During the nine months ended September 30, 2004, the Company issued an aggregate of 52,433 shares of its Series F convertible preferred stock for professional

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services totaling \$164,530.

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ITEM 2 - MANagements Discussion and Analysis or Plan of Operation

The following discussion and analysis of financial condition and results of operations of the Company should be read in conjunction with the Company's Financial Statements and related Footnotes.

Forward-Looking Statements

Management's discussion and analysis of financial condition and results of operations and other sections of this Report contain "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. We intend for the forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in these sections. All statements regarding the Company's expected financial position, business and financing plans are forward-looking statements. Such forward-looking statements are identified by use of forward-looking words such as "anticipates," "believes," "plans," "estimates," "expects," and "intends" or words or phrases of similar expression. These forward-looking statements are subject to various assumptions, risks and uncertainties, including but not limited to, changes in political and economic conditions, demand for the Company's products, acceptance of new products, technology developments affecting the Company's products and to those discussed in the Company's filings with the Securities and Exchange Commission. Accordingly, actual results could differ materially from those contemplated by the forward-looking statements.

Introduction

Until the fourth quarter of 2001 Water Chef was engaged in the manufacture and marketing of water coolers and water purification and filtration products. In the fourth quarter of 2001, the Company negotiated the sale of this business in order to focus its activities on its PureSafe line of business. The PureSafe Water Station has been designed by the Company to meet the needs of communities who either do not have access to municipal water treatment systems, or for those whose systems have been compromised, either by environmental factors or by faulty design or maintenance.

Results of Operations

There were no sales recognized for the three months ended September 30, 2004 and September 30, 2003. Revenue for the nine months ended September 30, 2004 and September 30, 2003 were \$56,290 and \$0 respectively.

Cost of sales for the three month periods ended September 30, 2004 and 2003 were \$24,000 (rent and overhead payments to manufacturers). Cost of sales for the nine month periods ended September 30, 2004 and September 30, 2003 were \$77,250 and \$72,000 respectively. An analyses of the components of cost of sales in the 2004 and 2003 periods follows:

| Cost of Sales Period | Actual CGS | Rent and Overhead Payments to Manufacturer | Total |
|-------------------------|---------------|---|-----------|
| 09/30/04 | \$ 13,250 | \$ 64,000 | \$ 77,250 |

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09/30/03

-

72,000

72,000

Selling, general and administrative expenses for the three months ended September 30, 2004 were \$428,357, compared to \$216,094 for the year earlier period, an increase of 98%. Selling, general and administrative expenses for the nine months ended September 30, 2004 were \$985,037, compared to \$621,884 for the year earlier period, an increase of 58%, primarily due to higher marketing costs and sales commissions. In the quarter ended September 30, 2004, expenses included \$75,000 paid to IMSCO (International Multiracial Shared Cultural Organization) upon approval of the Company's application for certification and consultant status with IMSCO, an NGO in Specialized status with the Economic and Social Council of the United Nations. The Company believes that the United Nations certification of its humanitarian water projects will enhance its ability to secure the funding needed for the successful completion of its projects.

In the quarter ended June 30, 2004, The Company recognized a loss on settlement of debt of \$2,407,867.

The net loss for the three and nine month periods ended September 30, 2004 was \$489,914 and \$3,302,675, respectively, and \$1,324,578 and \$2,241,504 for the three and nine month periods ended September 30, 2003, respectively.

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Liquidity and Capital Resources

At September 30, 2004 the Company had a working capital deficiency. In addition the Company continues to suffer recurring losses. These conditions raise substantial doubt about the Company's ability to continue as a going concern. The accompanying financial statements have been prepared assuming that that the Company will continue as a going concern. Management's plans with respect to these matters include restructuring its existing debt, raising additional capital through future issuances of stock and/or equity, and finding sufficient profitable markets for its products to generate sufficient cash to meet its business obligations. The accompanying financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern.

During the nine months ended September 30, 2004 the Company raised \$412,756 from the sale of preferred stock and \$207,600 from the sale of common stock.

Common Stock Issued

On June 4, 2004, the Company convened a special meeting of its common, Series A Preferred, Series C Preferred, Series D Preferred, Series F Preferred stockholders (together the "Stockholders"). The Stockholders, voting as a single class, voted and approved a proposal to amend the Certificate of Incorporation to increase the Company's authorized capital stock from 100,000,000 shares to 200,000,000 shares, consisting of 190,000,000 shares of common stock and 10,000,000 shares of preferred stock.

During the nine months ended September 30, 2004, the Company recorded the following transactions:

a. Cash

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During 2002, the Company received \$200,000 for 4,000,000 shares of its common stock. These shares were issued during the June 2004 quarter upon the approval by the stockholders of the increase in the number of authorized common shares of the Company.

During the September 2004 quarter, the Company received \$207,600 for 2,541,595 shares of its common stock.

b. Non-Dilution Agreement Termination Cost

In 2002, the Company agreed to issue to the Company's President and Chief Executive Officer, and to related parties of such, an aggregate of 14,923,958 shares of its common stock in connection with the voluntary surrender of a non-dilution agreement that the President had entered into with the Company in June 1997.

Since the issuance of these shares was subject to stockholder approval, the measurement date for purposes of valuation was established when such stockholder approval was obtained. Accordingly, the Company was utilizing variable accounting to determine the value of these shares. These shares were issued during the June 2004 quarter upon the approval by the stockholders of the increase in the number of authorized common shares of the Company. The value of these shares was \$2,462,451.

c. Services

During 2002, the Company agreed to issue to various parties an aggregate of 1,075,000 shares of its common stock for value of \$84,000 in connection with professional services. These shares were issued during the June 2004 quarter upon the approval by the stockholders of the increase in the number of authorized common shares of the Company.

During the September 2004 quarter, the Company issue to various parties an aggregate of 2,214,933 shares of its common stock for value of \$146,507 in connection with professional services. These shares were issued during the current quarter.

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d. Debenture Liabilities

The Company was a defendant in an action brought by certain debenture holders (The "Bridge Loans") in New Hampshire Superior Court seeking repayment of \$300,000 of debenture principal together with interest from 1997, and the issuance of penalty shares for non payment of principal and interest. In addition, the plaintiffs claim that they had suffered by the Company's failure to register the shares issued under the warrant agreement.

The Company had interposed defenses and counterclaims. In June 1997, in connection with the debentures, the Company had issued 6,667 shares of common stock for every \$1,000 of debt at a price of \$0.15 per share. The Company claimed that it was owed the \$300,000 consideration for such shares. In addition, the Company had issued warrants for the purchase of 2,500,000 shares of common stock at an exercise price of \$0.15 per share originally exercisable until March 2002.

Furthermore, the Company had issued another 100,000 shares of common stock to each debenture holder, or 1,300,000 shares, at a price of \$0.15 per

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share.

In 2002, the Company and the Bridge Lenders participating in the legal action, settled this dispute requiring the Company to: (i) Issue a minimum of 3,000,000 shares of common stock valued at \$497,500 in lieu of the principal and interest owed to the debenture holders who participated ("participants") in this legal action. The Company recorded the debentures at \$300,000, plus accrued interest of \$39,400, for a total of \$339,400. The difference between the \$497,500 settlement and the \$339,400, or \$158,100, was recorded as a loss on settlement of debt; (ii) Extend the warrants attached to the participants' debentures for another two years until March 2004, for which the Company has recorded a non cash charge of \$111,000; (iii) In 2004, in connection with the issuance of the Bridge Lender shares, the Company further extended the term of the warrants for twelve months until March 2005 and recorded \$94,151 as a loss on settlement of debt in connection with such warrant extension; and (iv) Issued additional shares since the product of the \$497,500, as valued for the 3,000,000 shares above, divided by the average daily trading price for the 30 days subsequent to the settlement, was greater than the original 3,000,000 shares. Due to these requirements, the Company was obligated to issue an additional 14,037,671 shares. As of June 30, 2004, the Company has issued the 3,000,000 shares and the additional 14,037,671 shares originally valued at \$497,500. The Company recorded a loss on settlement of debt of \$2,313,716 since the total value of the shares on the date of issuance was \$2,811,216.

The debenture holders that did not participate ("non-participating debentures") in the above legal action had total debentures of \$75,000, plus accrued interest of \$9,850 as of the settlement date, totaling \$84,850. In conjunction with the above settlement, the Company settled these outstanding non-participating debentures, plus accrued interest, with the issuance of 750,000 shares of common stock valued at \$0.0292 per share, or \$21,900. During the June 2004 quarter, the 750,000 shares were issued.

e. Conversion of preferred stock into common stock

During the June 30, 2004 quarter, the Company agreed to issue to various parties an aggregate of 5,228,333 shares of its common stock in connection with the conversion of preferred stock.

During the September 30, 2004 quarter, the Company agreed to issue to various parties an aggregate of 12,103,854 shares of its common stock in connection with the conversion of preferred stock.

The total shares issued upon stockholder approval of the increase in the authorized stock of the Company as a result of the transactions described above aggregate 59,875,344.

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Recent Accounting Standards

The following pronouncements have been issued by the Financial Accounting Standards Board ("FASB").

In January 2003, the FASB issued Interpretation Number 46, "Consolidation of Variable Interest Entities" ("FIN No. 46"). This interpretation of Accounting Research Bulletin ("ARB") No. 51, "Consolidated Financial Statements," provides

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guidance for identifying a controlling interest in a variable interest entity ("VIE") established by means other than voting interests. FIN No. 46 also requires consolidation of a VIE by an enterprise that holds such a controlling interest. In December 2003, the FASB completed its deliberations regarding the proposed modification to FIN No. 46 and issued Interpretation Number 46(R), "Consolidation of Variable Interest Entities - an Interpretation of ARB No. 51" ("FIN No. 46(R)"). The decisions reached included a deferral of the effective date and provisions for additional scope exceptions for certain types of variable interests. Application of FIN No. 46(R) is required in financial statements of public entities that have interests in VIEs or potential VIEs commonly referred to as special-purpose entities for periods ending after December 15, 2003. Application by public small business issuers' entities is required in all interim and annual financial statements for periods ending after December 15, 2004.

The adoption of this pronouncement is not expected to have a material effect on the Company's financial statements.

ITEM 3 - CONTROLS AND PROCEDURES

Evaluation and Disclosure Controls and Procedures

The Company, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's "disclosure controls and procedures," as such term is defined in Rules 13a-15e and 15d-15e promulgated under the Exchange Act as of this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer has concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report to provide reasonable assurance that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

Changes in Internal Controls

There have been no changes in internal controls or in other factors that could significantly affect those controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Limitations on the Effectiveness of Controls

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a Company have been detected.

PART II - OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS

None.

ITEM 2 - UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

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During the three months ended September 30, 2004, the Company issued 2,541,595 shares and raised \$207,600 through the sale of common stock to two domestic and one foreign trust and six individual accredited investors. The sale proceeds were used to pay proxy preparation and mailing expenses, and annual meeting, legal and accounting expenses, and general operating expenses.

During the three months ended September 30, 2004, the Company issued to various parties an aggregate of 1,857,800 shares of its common stock for value of \$128,650 in connection with United Nations membership fees, tax return preparation expense, marketing and professional services.

The Company issued these shares in reliance on the exemption from registration afforded by Section 4(2) of the Securities Act of 1933 and Regulation D promulgated there under. These shares were offered to less than 35 "non-accredited" investors and were purchased for investment purposes with no view to resale.

ITEM 3 - DEFAULT UPON SENIOR SECURITIES

None.

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

None.

ITEM 5 - OTHER INFORMATION

None.

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ITEM 6 - EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

| Exhibit No. | Description |
|-------------|---|
| ----- | ----- |
| *10.1 | Preliminary Agreement, dated September 8, 2004 by, and among, WaterChef, Inc., Samaritan Group International, and International Multiracial Shared Cultural Organization (IMSCO). |
| *31 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act. |
| *32 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 8 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| *99.1 | United Nations certification letter-Bangladesh |
| *99.2 | United Nations certification letter-Honduras |

* filed herewith

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(b) Reports on Form 8-K

None.

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SIGNATURE

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

WaterChef, Inc.

11/17/2004
Date

/s/ David A. Conway

David A. Conway
President, Chief Executive
Officer, and Chief Financial
Officer
(Principal Operating Officer)

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Index of Exhibits

| Exhibit No. | Description |
|-------------|---|
| ----- | ----- |
| 10.1 | Preliminary Agreement, dated September 8, 2004 by, and among, WaterChef, Inc., Samaritan Group International, and International Multiracial Shared Cultural Organization (IMSCO). |
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| 99.1 | United Nations certification letter-Bangladesh |
| 99.2 | United Nations certification letter-Honduras |

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