

EARTHSHELL CORP  
Form 10-Q  
May 15, 2002

**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 March 31, 2002

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 May 14, 2002 is 131,031,891.

**EARTHSHELL CORPORATION  
FORM 10-Q  
For the Quarter Ended March 31, 2002  
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**EARTHSHELL CORPORATION**  
**(A Development Stage Enterprise)**  
**BALANCE SHEETS**

	<b>March 31,</b> <b><u>2002</u></b> (Unaudited)
<b>ASSETS</b>	
<b>CURRENT ASSETS:</b>	
Cash and cash equivalents.....	\$1,293,647
Prepaid expenses and other current assets.....	703,058
	-----
Total current assets.....	1,996,705
RESTRICTED CASH.....	3,500,000
PROPERTY AND EQUIPMENT, NET.....	13,972,489
INVESTMENT IN JOINT VENTURE.....	371,275
	-----
<b>TOTAL</b> .....	<b>\$19,840,469</b>
	=====
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>	
<b>CURRENT LIABILITIES:</b>	
Accounts payable and accrued expenses.....	\$8,196,450
	-----
Total current liabilities.....	8,196,450
	-----
<b>COMMITMENTS AND CONTINGENCIES</b>	

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**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 March 31, 2002 and December 31, 2001.....	-
Common stock, \$.01 par value, 200,000,000 shares authorized; 127,531,891 and 118,323,054 shares issued and outstanding as of March 31, 2002 and December 31, 2001.....	1,275,319
Additional paid-in common capital.....	276,824,034
Deficit accumulated during the development stage.....	(266,455,334)
	-----
Total stockholders' equity.....	11,644,019
	-----
<b>TOTAL</b> .....	<b>\$19,840,469</b>
	=====

See notes to financial statements.

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

	For the Three Ended March 31,		November 1992 (inception through March 31
	2002	2001	2002
	-----	-----	-----
Expenses:			
Related party research and development.....	\$300,000	\$326,307	\$68,697
Other research and development.....	6,667,159	4,420,431	115,547
Related party general and administrative expenses.....	-	-	2,247
Other general and administrative expenses...	2,471,363	2,184,906	55,257
Depreciation and amortization.....	795,353	1,285,183	20,157
Related party patent expenses.....	-	-	8,697
Total expenses.....	10,233,875	8,216,827	270,587
	-----	-----	-----
Interest income.....	(21,937)	(119,312)	(10,697)
Related party interest expense.....	-	-	4,777
Other interest expense.....	-	-	1,787
Loss Before Income Taxes.....	10,211,938	8,097,515	266,447
	-----	-----	-----

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Income Taxes.....	800	-	1
Net Loss.....	10,212,738	8,097,515	266,45
Preferred Dividends .....	-	-	9,92
Net Loss Available To Common Stockholders.....	\$10,212,738	\$8,097,515	\$276,38
Basic And Diluted Loss Per Common Share.....	\$0.08	\$0.08	
Weighted Average Number Of Common Shares.....	124,377,736	106,982,760	92,04

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	Common Stock	
	Shares	Amount	Capital	Shares	Amount
<b>ISSUANCE OF COMMON STOCK AT INCEPTION.....</b>	-	-	-	82,530,000	\$
Sale of preferred stock, net....	6,988,850	\$267	\$24,472,734	-	
Net loss.....	-	-	-	-	
<b>BALANCE, DECEMBER 31, 1993</b>	6,988,850	267	24,472,734	82,530,000	
Net loss.....	-	-	-	-	
<b>BALANCE, DECEMBER 31, 1994</b>	6,988,850	267	24,472,734	82,530,000	
Contribution to equity.....	-	-	-	-	
Net loss.....	-	-	-	-	
<b>BALANCE, DECEMBER 31, 1995</b>	6,988,850	267	24,472,734	82,530,000	
Contribution to equity.....	-	-	-	-	
Issuance of stock warrants.....	-	-	-	-	
Net loss.....	-	-	-	-	
<b>BALANCE, DECEMBER 31, 1996</b>	6,988,850	267	24,472,734	82,530,000	
Compensation related to stock options, warrants and stock grants.....	-	-	-	-	
Net loss.....	-	-	-	-	
<b>BALANCE, DECEMBER 31, 1997</b>	6,988,850	267	24,472,734	82,530,000	
262 to 1 stock split.....	-	69,621	(69,621)	-	82
Conversion of preferred stock to common stock.....	(6,988,850)	(69,888)	(24,403,113)	6,988,850	6
Issuance of common stock.....	-	-	-	10,526,316	10
Preferred stock dividends.....	-	-	-	-	
Net loss.....	-	-	-	-	

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<b>BALANCE, DECEMBER 31, 1998</b>	-	-	-	100,045,166	1,000,000
Net loss.....	-	-	-	-	-
<b>BALANCE, DECEMBER 31, 1999</b>	-	-	-	100,045,166	1,000,000
Net Loss.....	-	-	-	-	-
Issuance of common stock.....	-	-	-	4,457,169	4,457,169
<b>BALANCE, DECEMBER 31, 2000</b>	-	-	-	104,502,335	1,045,227,000
Net Loss.....	-	-	-	-	-
Compensation related to stock options, warrants and stock grants.....	-	-	-	300,000	300,000
Issuance of common stock.....	-	-	-	13,520,719	13,520,719
<b>BALANCE, DECEMBER 31, 2001</b>	-	-	-	118,323,054	1,183,247,719
Net Loss.....	-	-	-	-	-
Issuance of common stock.....	-	-	-	9,208,837	9,208,837
<b>BALANCE, MARCH 31, 2002</b>	-	-	-	127,531,891	\$1,275,456,556

See notes to financial statements

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

**For the**  
**Three Months Ended**  
**March 31,**

	2002	2001
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss.....	\$(10,212,738)	\$(8,097,515)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization.....	795,353	1,285,183
Issuance of stock options to director, consultant and officer	-	-
Amortization of debt issue costs.....	-	-
Loss on sale or disposal of property and equipment.....	25,623	-
Loss from investment in joint venture.....	15,000	22,500
Net Loss on Sale of Investments.....	-	-
Accretion of Discounts on Investments.....	-	-
Changes in operating assets and liabilities:		
Prepaid expense and other current assets.....	(122,586)	(83,476)
Accounts payable and accrued expenses.....	(153,358)	(1,593,814)
Trade payable to majority stockholder.....	-	(266,312)
Net cash used in operating activities.....	(9,652,706)	(8,733,434)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of short-term investments.....	-	-

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Purchase of restricted time deposit.....	-	-
Proceeds from sales and redemptions of investments.....	-	-
Proceeds from sale of property and equipment.....	-	-
Investment in joint venture.....	-	-
Purchase of property and equipment.....	(202,354)	(1,311,719)
	-----	-----
Net cash used in investing activities.....	(202,354)	(1,311,719)
	-----	-----
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from issuance of notes payable to stockholders.....	-	-
Proceeds from drawings on line of credit with bank.....	-	-
Proceeds from issuance of common stock.....	10,320,700	5,450,000
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.....	-	-
	-----	-----
Net cash provided by financing activities.....	10,320,700	5,450,000
	-----	-----
<b>(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS.....</b>	465,640	(4,595,153)
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD.....</b>	828,007	7,791,654
	-----	-----
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD.....</b>	\$1,293,647	\$3,196,501
	=====	=====

**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.....	-	-

See notes to financial statements.

**EARTHSHELL CORPORATION**

**NOTES TO FINANCIAL STATEMENTS (Unaudited)**  
**MARCH 31, 2002**

**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. Certain reclassifications have been made to prior year's financial statements to conform to the 2002 presentation.

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, 2001. The 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, 2001 included in the Company's Annual Report on Form 10-K.

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The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. During the period from November 1, 1992 (inception) to March 31, 2002, the Company has incurred a cumulative net loss of \$266,455,334 and has a working capital deficit of \$6,199,745 at March 31, 2002. These factors among others may indicate that the Company will be unable to continue as a going concern for a reasonable period of time.

The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern. The Company's continuation as a going concern is dependent upon its ability to generate sufficient cash flow to meet its obligations on a timely basis, to obtain additional financing or refinancing as may be required, and ultimately to attain successful operations. Management is continuing its efforts to obtain additional funds so that the Company can meet its obligations and sustain operations from sources that are described in the notes to the financial statements.

Basic and diluted loss per common share is calculated based on the weighted average shares outstanding of 124,377,736 and 106,982,760 for the three months ended March 31, 2002, and March 31, 2001, respectively. Basic and diluted are the same because common stock equivalents are considered anti-dilutive.

### Related Party Transactions

For the three months ended March 31, 2002 and 2001, the Company paid or accrued \$300,000 and \$326,307 respectively, for services performed by EKI under the Amended and Restated Technical Services Agreement. The Company reduced the use of EKI technical services and related expenses effective January 1, 2001.

### EARTHSHELL CORPORATION

#### NOTES TO FINANCIAL STATEMENTS

*Unaudited* - continued

MARCH 31, 2002

#### Property and Equipment:

At March 31, 2002 the property and equipment consisted of the following:

	2002
Commercial Manufacturing Equipment	
Owings Mills, Maryland.....	\$10,000,000
Goettingen, Germany.....	3,117,569
Other Construction in Progress.....	519,210
	13,636,779
Other Property and Equipment	
Product Development Center.....	3,793,737
Office Furniture and Equipment.....	774,146
Leasehold improvements.....	571,361
	5,139,244
Total cost.....	18,776,023
Less: accumulated depreciation and amortization.....	(4,803,534)
	\$13,972,489

## 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 contains 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 the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001.

### Overview of Operations

Organized in November 1992 as a Delaware corporation, EarthShell® Corporation (the Company), is engaged in the commercialization of composite material technology for the manufacture of foodservice disposable packaging designed with the environment in mind. EarthShell Packaging® is based on patented composite material technology (collectively, the EarthShell Technology), licensed on an exclusive, worldwide basis from E. Khashoggi Industries LLC and its wholly owned subsidiaries (EKI).

The EarthShell Technology has been developed over many years in consultation with leading material scientists and environmental experts to reduce the environmental burdens of foodservice disposable packaging through the careful selection of raw materials, processes, and suppliers. EarthShell Packaging, including hinged-lid sandwich containers, plates, bowls, and cups, is primarily made from commonly available natural raw materials such as natural ground limestone, and potato starch. The Company believes that EarthShell Packaging has comparable or superior performance characteristics, and can be commercially produced and sold at prices that are competitive with comparable paper and plastic foodservice disposable packaging.

Currently, the Company's strategic relationships include Sweetheart Cup Company Inc. (Sweetheart) in Maryland, Huhtamäki Oyj, (Huhtamäki) in Europe, Green Earth Packaging, Inc. (GEP) in the U.S., Green Packaging SDN BHD (Green Packaging) in Malaysia, and E.I. DuPont de Nemours and Company ("DuPont") in the U.S. Although the Company is manufacturing and selling initial quantities of commercial product in cooperation with its strategic partners, the Company has not recorded any revenues from operations since its inception, and proceeds from sales of hinged lid containers, plates, and bowls to date have been recorded as an offset to the cost of the manufacturing operations.

### Comparison of the Three Months Ended March 31, 2002, to the Three Months March 31, 2001.

**Total Research and Development Expenses** Total research and development expenditures for the development of EarthShell Packaging increased \$2.3 million to \$7.0 million from \$4.7 million for the three months ended March 31, 2002 compared with the three months ended March 31, 2001. The increase is attributable to the increased manufacturing expenditures to satisfy the demand for EarthShell Packaging products and for the development of EarthShell Packaging equipment in preparation for operational transfer to the Company's strategic partners.

**Total General and Administrative Expenses** Total general and administrative expenses increased \$0.3 million to \$2.5 million from \$2.2 million for the three months ended March 31, 2002 compared to the three months ended March 31, 2001. The increase is primarily a result of further development of EarthShell Packaging for the sandwich wrap.

**Depreciation and Amortization Expense** Depreciation and amortization expense decreased \$0.5 million to \$0.8 million from \$1.3 million for the three months ended March 31, 2002 compared with the three months ended March 31, 2001 resulting from the write down of assets to net realizable value at December 31, 2001.

**Interest Income** Interest Income decreased \$0.1 million for the three months ended March 31, 2002 compared to the three months ended March 31, 2001 due to reduced cash balances on hand.

**Net Loss** The Company's net loss increased \$2.1 million to \$10.2 million from \$8.1 million for the three months ended March 31, 2002 compared to the three months ended March 31, 2001. Removing the effects of the write down of \$19.4 million for quarter ended December 31, 2001 the Company's net loss decreased \$4.6 million to \$10.2 million from \$14.8 million for the three months ended March 31, 2002 compared to the three months ended December 31, 2001.



**Liquidity and Capital Resources at March 31, 2002**

*Cash Flow.* The Company's principal use of cash for the three months ended March 31, 2002 was to fund operations for EarthShell Packaging. Net cash used in operations was \$9.7 million for the three months ended March 31, 2002 and \$8.7 million for the three months ended March 31, 2001. Net cash used in investing activities was \$0.2 million and \$1.3 million for the three months ended March 31, 2002 and 2001, respectively. Net cash provided by financing activities was \$10.3 million and \$5.5 million for the three months ended March 31, 2002 and 2001, respectively. As of March 31, 2002 the Company had cash totaling \$1.3 million.

*Capital Requirements.* The Company expects to spend approximately \$3.0 million in 2002 for capital expenditures related to manufacturing equipment for EarthShell Packaging. The Company paid or accrued approximately \$3.6 million in capital expenditures for the year ended December 31, 2001.

*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. On April 18, 2000 and January 4, 2001, the Company filed shelf registrations statements for 5 million and 15 million shares, respectively, of the Company's common stock. During the year ended December 31, 2001 and December 31, 2000 the Company sold approximately 13.5 million and 4.5 million shares of common stock in negotiated transactions under such registration statements and received net proceeds from such sales of approximately \$30.5 million and \$10.5 million, respectively.

In December of 2001 the Company filed a shelf registration statement that provides for the sale of up to \$50 million of securities, including secured or unsecured debt securities, preferred stock, common stock, and warrants. These securities may be offered, separately or together, in distinct series, and in amounts, at prices and on terms to be set forth in the prospectus contained in the registration statement, and in subsequent supplements to the prospectus.

From January 1, 2002 through May 3, 2002 the Company sold approximately 12.7 million shares of common stock in negotiated transactions under such registration statements and received net proceeds from such sales of approximately \$14.6 million.

The Company's business plan calls for the transfer of operational and financial control of its manufacturing equipment to its operating partners. The sale of operating equipment and machinery and related manufacturing assets may be a key source of funding for the Company in 2002. However, until the transfer of such assets occurs, the Company cannot be certain of the timing or amount, if any, it will realize from these transfers.

With the transition of manufacturing to its partners the Company anticipates the beginning of royalty revenue in 2002. Meanwhile, the Company is restructuring its operations to reflect the transfer of manufacturing and demonstration activities. This will result in a significant reduction in operating costs which will begin to occur during the second quarter of 2002. The Company continues to sell equity in negotiated transactions using its shelf registration statements as it has in the past, and will continue to consider alternative financing opportunities to minimize the cost of capital to the Company. The Company believes that its existing cash, the financing provided through the sources of funding described, as well as new sources, will enable it to continue funding its operations over the remainder of the fiscal year. The Company cannot be certain, however, that funding 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**

Not Applicable

**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**

Not Applicable

**Item 5. Other Information**

Not Applicable

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

Not Applicable

*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: May 15, 2002

By: /s/ D. SCOTT HOUSTON

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

*(Principal Financial and Accounting Officer  
and Duly Authorized Officer)*