PROTON LABORATORIES INC
Form 10KSB/A
August 05, 2005

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

FORM 10-KSB AMENDMENT NUMBER 1

|X| Annual Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Fiscal Year Ended December 31, 2004.

| | Transition Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from --- to ---

Commission file number: 000-31883

PROTON LABORATORIES, INC.
(Name of small business issuer in its charter)

Washington	91-2022700
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1135 Atlantic Avenue, Suite 101 Alameda, CA	94501
(Address of principal executive offices)	(Zip Code)

(510) 865-6412
Issuer's telephone number

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

Title of Each Class:	Name of exchange on which registered:
None.	None.

Securities registered under Section 12(g) of the Act:
Common Stock, $0.0001 par value
(Title of class)

Check whether the Issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities 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

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B is contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. |X|

Registrant's revenues for its most recent fiscal year: $379,989

The aggregate market value of the common stock held by non-affiliates of the registrant on March 30, 2005, based on the last price which was $0.40 per share on March 30, 2005, was $1,900,400. On March 30, 2005, the closing bid price on our common stock on the OTCBB was $0.38.

On March 30, 2005, the registrant had outstanding 12,975,000 shares of Common Stock, $0.0001 par value per share. However, 376,500 of those shares have not been certificated as of April 12, 2005.

Transitional Small Business Disclosure Format: Yes | | No |X|

Explanatory Paragraph:

This FORM 10-KSB AMENDMENT NUMBER 1 is being filed to reflect our responses to the SEC Staff's comment letter dated July 26, 2005. Only those portions of our Form 10-KSB being amended pursuant to the SEC Staff's comment letter are contained in this FORM 10-KSB AMENDMENT NUMBER 1. This FORM 10-KSB AMENDMENT NUMBER 1 does not contain all of the information related to Form 10-KSB, but, rather, only the information that has been amended. This FORM 10-KSB AMENDMENT NUMBER 1 should be read in conjunction with our original submission of FORM 10-KSB.

PART I

ITEM 1. DESCRIPTION OF BUSINESS.

SUBSEQUENT EVENTS

In February 2005, MIZ Company, a Japanese company that owns four U.S. patents whose subject matter is the electrolysis of water, assigned a 50% ownership interest in those four patents to Mr. Alexander in consideration of consulting services provided to MIZ Company by Mr. Alexander. Mr. Alexander has agreed to allow us to exploit the four patents on a royalty-free basis. Since MIZ Company and Mr. Alexander each has an ownership interest in the four patents, either Mr. Alexander or the Japanese company could grant licenses to others to use the four patents, and the Japanese company could exploit the four patents by itself.

In March 2005, we proposed to engaged the services of J. P. Turner & Company, L.L.C. for its best efforts to raise funds for us. We proposed to issue 550,000 shares of our restricted common stock to J. P. Turner & Company, L.L.C. as a non-refundable fee and we proposed to pay J. P. Turner & Company, L.L.C. a sales commission of 10% on any funds raised and grant a warrant to J. P. Turner & Company, L.L.C. to acquire our common stock in the amount of 10% of the equivalent of the funds that are raised. Upon a successful money raise, we proposed that J. P. Turner & Company, L.L.C. would act as our investment banker for a fee of 4.5% of our restricted common stock as calculated immediately after the funds are raised. These share have not been issued and this agreement has since been abandoned.

In March 2005, we issued a note payable in the amount of $164,000 for the purchase of inventory. The inventory will be held by the lender as collateral until the note is repaid in May 2005. We also agreed to pay $28,500, or approximately 17%, in interest. In addition, we will issue to the lender 47,500 shares of common stock, which will be recorded as a $27,075 discount valued on the date of issuance and amortized over the term of the note. These shares are to be issued prior to the note's due date.

In January 2005, a shareholder advanced $40,000 to us. This advance bears interest at 7% with principal and accrued interest due January 2007.

ITEM 6. MANAGEMENT'S DISCUSSION & ANALYSIS.

FORWARD-LOOKING STATEMENT

Certain statements contained in this report, including, without limitation, statements containing the words, "believes," "anticipates," "expects," and other words of similar meaning, constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements, of to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements. Given these uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements. We disclaim any obligation to update any such factors or to announce publicly the results of any revision of the forward-looking statements contained or incorporated by reference herein to reflect future events or developments. In addition to the forward-looking statements contained in this Form 10-KSB, the following forward-looking factors could cause our future results to differ materially our forward-looking statements: competition, funding, government compliance and market acceptance of our products.

INTRODUCTION

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the audited financial statements and accompanying notes and the other financial information appearing elsewhere in this Form 10-KSB. The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the U.S.A., which contemplate our continuation as a going concern.

Our independent auditors made a going concern qualification in their report dated March 7, 2005, which raises substantial doubt about our ability to

continue as a going concern. Our 2004 revenue increased by 59% compared to our 2003 revenue. Capital contributions were required from our President to fund operations. These conditions raise a substantial doubt about our ability to continue as a going concern. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts and classification of liabilities that might be necessary should we be unable to continue in existence. Our ability to continue as a going concern is dependent upon our ability to generate sufficient cash flows to meet our obligations on a timely basis, to obtain additional financing as may be required, and ultimately to attain profitable operations. However, there is no assurance that profitable operations or sufficient cash flows will occur in the future.

We have incurred net losses of $965,840 in 2004 and $217,333 in 2003. We had a working capital deficit of $273,400 at December 31, 2004 and $156,505 at December 31, 2003.

Our operations are located in Alameda, California. Our business consists of the sales and marketing of the industrial, environmental and residential systems throughout the U.S.A. which alter the properties of water to produce functional water. We act as an exclusive importer and master distributor of these products to various companies in which uses for the product range from food processing to retail water sales. We: formulate intellectual properties under licensing agreements; supply consumer products; consult on projects utilizing functional water; facilitate usage, uses and users of functional water between manufacturer and industry; and act as educators on the benefits of functional water.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. These estimates and assumptions provide a basis for us to make judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Our actual results may differ from these estimates under different assumptions or conditions, and these differences may be material.

We recognize revenue when all four of the following criteria are met: (i) persuasive evidence that an arrangement exists; (ii) delivery of the products and/or services has occurred; (iii) the selling price is both fixed and determinable and; (iv) collectibility is reasonably probable. Our revenues are derived from sales of our industrial, environmental and residential systems which alter the properties of water to produce functional water. We believe that this critical accounting policy affects our more significant judgments and estimates used in the preparation of our consolidated financial statements.

During the period from March 14, 2000 through November 15, 2002, prior to our acquisition of Proton Laboratories, LLC in November 2002, we did not engage in significant operations. No revenues were received by us during that period.

In November 2002, we acquired Proton Laboratories, LLC, which is active in the functional water business. This acquisition was reported in detail on our Form 8-K for the event dated November 15, 2002 as filed with the Commission on November 25, 2002. Proton Laboratories, LLC is now our wholly-owned subsidiary and in April 2004 was renamed Water Science Corporation. Since our acquisition of Proton Laboratories, LLC in November 2002, our business has been focused on marketing functional water equipment and systems. Alkaline-concentrated functional water may have health-beneficial properties and may be used for drinking and cooking purposes. Acidic-concentrated functional water may be used as a topical, astringent medium

Our fiscal year end is December 31.

RESULTS OF OPERATIONS-YEARS ENDED DECEMBER 31, 2004 AND 2003.

We had revenue of $379,989 for the year ended December 31, 2004 compared to revenue of $238,805 for the year ended December 31, 2003. This increase is a 59% increase in revenue. This increase in revenue was due primarily to our hiring a sales manager in 2004.

We had a net loss $965,840 for the year ended December 31, 2004 compared to a net loss of $217,333 for the year ended December 31, 2003. This increase in net loss was due primarily to our increase in equity-based compensation for sales, general and administrative expenses.

Cash used by operating activities was $323,722 for the year ended December 31, 2004 compared to cash used by operating activities of $80,587 for the year ended December 31, 2003. This increase in cash used by operating activities was due primarily to the issuance of common stock used as in-kind compensation to pay for legal services and consulting services.

LIQUIDITY

As of December 31, 2004, we had cash on hand of $14,412. Our growth is dependent on attaining profit from our operations, or our raising additional capital either through the sale of stock or borrowing. There is no assurance that we will be able to raise any equity financing or sell any our products at a profit.

During the year ended December 31, 2004, our President, Edward Alexander, advanced to us the amount of $178,000 in cash. This advance accrues interest at the rate of 7% per annum and is due on dates ranging from March through September 2006. At December 31, 2004, the aggregate balance we owe on loans from shareholders is $262,000 which includes $84,000 in loans from prior periods. All of these loans accrues interest at the rate of 7% per annum and are due on dates ranging from November 2005 through September 2006. At December 31, 2004, the aggregate accrued interest on these loans was $16,681.

During the year ended December 31, 2004, we accrued $60,000 as salary payable to Mr. Alexander resulting in an aggregate of $105,000 of salary payable to Mr. Alexander at December 31, 2004.

During 2004, we raised $276,000 in cash through the sale of our securities.

FUTURE CAPITAL REQUIREMENTS

Our growth is dependent on attaining profit from our operations, or our raising additional capital either through the sale of stock or borrowing. There is no assurance that we will be able to raise any equity financing or sell any of our products at a profit.

Our future capital requirements will depend upon many factors, including:

- The cost to acquire equipment to resell.
- The cost of sales and marketing our products.
- The rate at which we expand our operations.
- The results of our consulting business.
- The response of competitors.

ITEM 7. FINANCIAL STATEMENTS.

The financial statements required by this item are set forth beginning on page F-1.

ITEM 13. EXHIBITS.

Exhibit Number	Exhibit Description
31.1	Certification pursuant to Section 13a-14 of CEO
31.2	Certification pursuant to Section 13a-14 of CFO
32.1	Certification pursuant to Section 1350 of CEO

32.2 Certification pursuant to Section 1350 of CFO

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this FORM 10-KSB AMENDMENT NUMBER 1 to be signed on its behalf by the undersigned, thereunto duly authorized in Alameda, California.

PROTON LABORATORIES, INC.

August 4, 2005 By: /s/ Edward Alexander
Edward Alexander
Director, Chief Executive Officer, President and
Chief Financial Officer

In accordance with the Exchange Act, this FORM 10-KSB AMENDMENT NUMBER 1 has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

August 4, 2005 By: /s/ Edward Alexander
Edward Alexander
Director, Chief Executive Officer and
Chief Financial Officer

August 4, 2005 By: /s/ Michael Fintan Ledwith
Michael Fintan Ledwith
Director

August 4, 2005 By: /s/ Gary Taylor
Gary Taylor
Director and President

PROTON LABORATORIES, INC.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS
AND
CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2004 AND 2003

HANSEN, BARNETT & MAXWELL
A Professional Corporation
CERTIFIED PUBLIC ACCOUNTANTS

PROTON LABORATORIES, INC.
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Fax: (801) 532-7944
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REGISTERED WITH THE PUBLIC COMPANY
ACCOUNTING OVERSIGHT BOARD

[GRAPHIC OMITTED]
in independent member of
BAKER TILLY
INTERNATIONAL

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and the Stockholders
Proton Laboratories, Inc. and subsidiaries

We have audited the consolidated balance sheets of Proton Laboratories, Inc. as of December 31, 2004 and 2003, and the related consolidated statements of operations, stockholders' deficit and cash flows for the years ended December 31, 2004 and 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Proton Laboratories as of December 31, 2004 and 2003, and the results of their consolidated operations and their cash flows for the years ended December 31, 2004 and 2003, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company has an accumulated deficit, has suffered reoccurring losses from operations, has negative working capital, and has required loans from the Company's majority shareholder to fund operations. These factors raise substantial doubt about its ability to continue as a going concern. Management's plans in regards to these matters are also described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

HANSEN, BARNETT & MAXWELL

Salt Lake City, Utah
March 7, 2005

PROTON LABORATORIES, INC
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2004 AND 2003

	2004	2003
ASSETS		
CURRENT ASSETS		
Cash	$ 14,412	$ 4,423
Accounts receivable, less allowance for doubtful accounts of $16,522 and $10,092, respectively	10,633	24,583
Inventory	34,097	27,800
TOTAL CURRENT ASSETS	59,142	56,806
PROPERTY AND EQUIPMENT		
Furniture and fixtures	18,438	4,670
Equipment and machinery	95,039	43,724
Leasehold improvements	10,995	1,886
Deposit on equipment	69,500	-
Less: accumulated depreciation	(19,160)	(11,672)
NET PROPERTY AND EQUIPMENT	174,812	38,608
TOTAL ASSETS	$ 233,954	$ 95,414

LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES		
Accounts payable	$ 134,780	$ 197,576
Accrued expenses	110,562	15,735
Preferred dividends payable	3,200	-
Stockholder loan, current portion	84,000	-
TOTAL CURRENT LIABILITIES	332,542	213,311
STOCKHOLDER LOAN, NET OF CURRENT PORTION	178,000	84,000
STOCKHOLDERS' DEFICIT		
Series A convertible preferred stock, 400,000 shares authorized with a par value of $0.0001; 8,000 and no shares issued and outstanding, respectively; liquidation preference of $80,000 and $0, respectively	80,000	-
Undesignated preferred stock, 19,600,000 shares authorized with a par value of $0.0001; no shares issued or outstanding	-	-
Common stock, 100,000,000 common shares authorized with a par value of $0.0001; 12,975,000 and 11,250,000 shares issued and outstanding, respectively	1,299	1,126
Additional paid in capital	1,350,616	536,440
Accumulated deficit	(1,708,503)	(739,463)
TOTAL STOCKHOLDERS' DEFICIT	(276,588)	(201,897)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	$ 233,954	$ 95,414

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

PROTON LABORATORIES, INC
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR YEARS ENDED DECEMBER 31, 2004 AND 2003

	2004	2003
SALES	$ 379,989	$ 238,805
COST OF GOODS SOLD	263,395	175,505
GROSS PROFIT	116,594	63,300
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES (including		

equity-based expenses of $663,349 and $45,000, respectively)	1,065,595	270,420
LOSS FROM OPERATIONS	(949,001)	(207,120)
OTHER INCOME AND (EXPENSE)		
Loss on disposal of property and equipment	(1,648)	(9,483)
Interest income	20	5
Interest expense	(15,211)	(735)
NET OTHER EXPENSE	(16,839)	(10,213)
NET LOSS	(965,840)	(217,333)
PREFERRED STOCK DIVIDEND	(3,200)	-
LOSS APPLICABLE TO COMMON SHAREHOLDERS	$ (969,040)	$ (217,333)
BASIC AND DILUTED LOSS PER COMMON SHARE	$ (0.08)	$ (0.02)
BASIC AND DILUTED WEIGHTED AVERAGE SHARES OUTSTANDING	11,525,510	11,250,000

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

PROTON LABORATORIES, INC
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT
FOR THE YEARS ENDED DECEMBER 31, 2003 AND 2004

	PREFERRED STOCK		COMMON STOCK		ADDITI PAID
	SHARES	AMOUNT	SHARES	AMOUNT	CAPIT
BALANCE - DECEMBER 31, 2002	-	$ -	11,250,000	1,126	491
Fair value of officer services, no additional shares issued	-	-	-	-	45
Net loss for the period	-	-	-	-	
BALANCE - DECEMBER 31, 2003	-	-	11,250,000	1,126	536
Sale of preferred stock	8,000	80,000	-	-	
Issuance of shares for legal services	-	-	100,000	10	39

Issuance of shares for consulting services	-	-	1,345,000	135	578
Issuance of common stock for cash	-	-	280,000	28	195
Dividends accrued	-	-	-	-	
Net loss for the period	-	-	-	-	
BALANCE - DECEMBER 31, 2004	8,000	$ 80,000	12,975,000	$ 1,299	$1,350

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

PROTON LABORATORIES, INC
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003

	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$(965,840)	$(217,333)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation	9,814	7,480
Bad debt expense	6,430	-
Loss on disposal of property and equipment	1,648	9,483
Fair value of officer services	-	45,000
Common stock issued for legal services and consulting services	618,349	-
Changes in operating assets and liabilities		
Accounts receivable	7,520	8,172
Inventory	(33,674)	(18,879)
Accounts payable	(62,796)	69,938
Accrued expenses	94,827	15,552
NET CASH FROM OPERATING ACTIVITIES	(323,722)	(80,587)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(120,289)	(375)
NET CASH FROM INVESTING ACTIVITIES	(120,289)	(375)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from stockholder loans	178,000	84,000
Proceeds from sale of preferred stock	80,000	-
Proceeds from sale of common stock	196,000	-

NET CASH FROM FINANCING ACTIVITIES	454,000	84,000
NET INCREASE IN CASH	9,989	3,038
CASH AT BEGINNING OF PERIOD	4,423	1,385
CASH AT END OF PERIOD	$ 14,412	$ 4,423
NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Transfer of inventory to equipment	$ 27,377	$ 11,740

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

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PROTON LABORATORIES, INC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - ORGANIZATION AND BASIS OF PRESENTATIONS

ORGANIZATION- Proton Laboratories, LLC. (Proton) was incorporated on February 16, 2000 in the State of California. Proton did not begin its operations until January 1, 2001. On January 1, 2001, Proton's sole owner contributed inventory and property and equipment to the Company.

BentleyCapitalCorp.com Inc. (Bentley) was incorporated in the State of Washington, U.S.A. on March 14, 2000. On November 15, 2002, Proton entered into an Agreement and Plan of Reorganization with Bentley whereby the Company merged with and into VWO I Inc. (VWO), a wholly owned subsidiary of Bentley (the "Merger"). In April 2004 the subsidiary changed its name to Water Science, Inc.

For financial statement purposes Proton is considered the parent corporation and originally elected to maintain BentleyCapitalCorp.com, Inc as its business name. In December 2003 the Company's board elected to change its name to Proton Laboratories, Inc., and hereafter collectively referred to as the "Company".

CONSOLIDATION POLICY - The accompanying consolidated financial statements reflect the financial position of and operations for Proton as of and for the years ended December 31, 2004 and 2003. All significant intercompany transactions have been eliminated in consolidation.

NATURE OF OPERATIONS - The Company's operations are located in Alameda, California. The core business of the Company consists of the sales and marketing of the Company's industrial, environmental and residential systems throughout the United States of America which alter the properties of water to produce functional water. The Company acts as an exclusive importer and master distributor of these products to various companies in which uses for the product range from food processing to retail water sales. Additionally, the Company formulates intellectual properties under licensing agreements, supplies consumer products, consults on projects utilizing functional water, facilitates between manufacturer and industry and acts as educators on the benefits of functional water.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

FINANCIAL INSTRUMENTS -The Company is subject to concentration of credit risk with respect to sales primarily in the functional water industry and sales to a significant customer and purchases from a significant vendor. Accounts receivable are generally unsecured. The Company normally obtains payments from customers prior to delivery of the related products. Otherwise, the Company does not require collateral for accounts receivable.

The carrying value of the note payable approximates fair value based on it bearing interest at a rate which approximates market rates. The amount reported as inventory is considered to be a reasonable

approximation of its fair value. The fair value estimates presented herein were based on market information available to management at the time of the preparation of the financial statements.

BUSINESS CONDITION - The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern. The Company has incurred net losses of $965,840 and $217,333 for the years ended December 31, 2004 and 2003, respectively. The Company had a working capital deficit of $273,400 and $156,505 at December 31, 2004 and 2003, respectively. Loans from the Company's president were required to fund operations. These conditions raise a substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence.

The Company is working towards raising public funds to expand its marketing and revenues. The Company has spent considerable time in contracting with several major overseas corporations for the co-development of enhanced antioxidant beverages for distribution into the overseas markets. In addition, the Company is working with its Canadian business associates to identify institutional businesses to market various disinfection applications based upon functional water, pending government approval.

The Company's ability to continue as a going concern is dependent upon its ability to generate sufficient cash flows to meet its obligations on a timely basis, to obtain additional financing as may be required, and ultimately to attain profitable operations. However, there is no assurance that profitable operations or sufficient cash flows will occur in the future.

CASH AND CASH EQUIVALENTS - The Company considers all highly liquid instruments purchased with a maturity of less than three months to be cash equivalents.

ACCOUNTS RECEIVABLE - Accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company determines the allowance based on historical write-off experience. Past due balances over 90 days and a specified amount are reviewed individually for collectibility. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The Company does not have any off-balance sheet credit exposure related to its customers.

INVENTORY - Inventory consists of purchased finished goods and is stated at the lower of cost (using the first-in, first-out method) or market value.

PROPERTY AND EQUIPMENT - Equipment, and furniture and fixtures are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Estimated useful lives range from 3 to 7 years. Depreciation expense for the years ended December 31, 2004 and 2003, was $9,814 and $7,480, respectively. Expenditures for maintenance, repairs, and renewals are charged to expense as incurred. Expenditures for major renewals and betterments that extend the useful lives of existing equipment are capitalized and depreciated. On retirement or disposition of property and equipment, the cost and accumulated depreciation are removed and any resulting gain or loss is recognized in the statement of operations.

Long-lived assets are reviewed for impairment yearly. Recoverability of assets to be held and used is measured by comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount that the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. Based on the evaluation, no impairment was considered necessary during the years ended December 31, 2004 or 2003.

INCOME TAXES - The Company recognizes an asset or liability for the deferred tax consequences of all temporary differences between the tax bases of assets or liabilities and their reported amounts in the financial statements. That will result in taxable or deductible amounts in future years when the reported amounts of the assets or liabilities are recovered. These deferred tax assets and or liabilities are measured using the enacted tax rates that will be in effect when the differences are expected to reverse. Deferred tax assets are reviewed periodically for recoverability and valuation allowances and adjustments are provided as necessary.

ADVERTISING - The Company follows the policy of charging the cost of advertising to expense as incurred. Advertising expense for the year ended December 31, 2004 and 2003 was $10,776 and $3,952, respectively.

CONCENTRATIONS OF RISK - Sales to major customers are defined as sales to any one customer which exceeded 10% of total sales. The risk of loss of a major customer subjects the Company to the possibility of decreased sales. Purchases from major vendors are defined as inventory purchases from any one vendor which exceeded 10% of total inventory purchases. The risk of loss of a major vendor subjects the Company to the possibility of increased costs and not being able to fulfill customer orders. See Note 7.

REVENUE RECOGNITION - The Company recognizes revenue when all four of the following criteria are met: (i) persuasive evidence that arrangement exists; (ii) delivery of the products and/or services has occurred; (iii) the selling price is both fixed and determinable and; (iv) collectibility is reasonably probable. The Company's revenues are derived from sales of their industrial, environmental and residential systems which alter the properties of water to produce functional water.

BASIC AND DILUTED LOSS PER COMMON SHARE - Basic loss per common share is calculated by dividing net loss by the weighted-average number of common shares outstanding. Diluted loss per common share is calculated by dividing net loss by the weighted-average number of Series A convertible preferred shares and common shares outstanding to give effect to potentially issuable common shares except during loss periods when those potentially issuable shares are anti-dilutive. Potential common shares from convertible preferred stock have not been included as they are anti-dilutive.

NEW ACCOUNTING STANDARDS - In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment," which is an amendment to SFAS No. 123, "Accounting for Stock-Based Compensation." This new standard eliminates the ability to account for share-based compensation transactions using Accounting Principles Board (APB) No. 25, "Accounting for Stock Issued to Employees" (APB 25) and requires such transactions to be accounted for using a fair-value-based method and the resulting cost recognized in the Company's financial statements. This new standard is effective for interim and annual periods beginning after June 15, 2005. The Company is currently evaluating SFAS No. 123 as revised and intends to implement it in the third quarter of 2005 and will not presently have an effect on the Company's financial statements.

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PROTON LABORATORIES, INC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In December 2004, the FASB issued SFAS Statement No. 153, "Exchanges of Non-monetary Assets-an amendment of APB Opinion No. 29." This Statement amends APB Opinion 29 to eliminate the exception for non-monetary exchanges of similar productive assets and replaces it with a general exception for exchanges of non-monetary assets that do not have commercial substance. A non-monetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The Statement will be effective in January 2006. The Company does not expect that the adoption of SFAS No. 153 will have a material impact on its Consolidated Financial Statements.

NOTE 3 - RELATED PARTY TRANSACTIONS

During the years ended December 31, 2004 and 2003, the Company's president and majority shareholder advanced the Company $178,000 and $84,000, respectively. These advances bear interest at 7% with principal and accrued interest due between November 2005 and September 2006. At December 31, 2004 and 2003, the accrued interest was $15,946 and $735, respectively.

NOTE 4 - INCOME TAXES

There was no provision for or benefit from income tax for any period. The components of the net deferred tax asset at December 31, 2004 and 2003 are as follows:

	2004	2003
Net operating loss carryforward	$ 416,124	$ 71,395
Bad debt reserve	6,381	3,898
Accrued salaries	29,000	5,793
Less: valuation allowance	(451,505)	(81,086)
NET DEFERRED TAX ASSET	$ -	$ -

For tax reporting purposes, the Company has net operating loss carry forwards in the amount of $1,077,482 which will begin expiring in 2023.

The following is a reconciliation of the amount of tax benefit that would result from applying the federal statutory rate to pretax loss with the benefit from income taxes for the years ended December 31, 2004 and 2003:

	2004	2003
Benefit as statutory rate (34%)	$(328,386)	$(73,893)
Non-deductible expenses	2,589	17,567
Change in valuation allowance	370,419	66,367
State tax benefit, net of federal tax effect	(44,622)	(10,041)
NET BENEFIT FROM INCOME TAXES	$ -	$ -

NOTE 5 - PREFERRED STOCK

During May 2004, the Company designated 400,000 shares of the preferred stock as Series A convertible preferred stock.

The holders of Series A convertible preferred stock are entitled to a cumulative dividend of 8% per year in cash payable in arrears.

The holders of Series A convertible preferred stock may convert any or all of their shares plus all accrued dividends on the preferred stock into common stock at any time. Each share of preferred stock may be

converted into 5 shares of common stock. The holder will receive one share of common stock for $2 of accrued dividends.

Upon the liquidation, dissolution or winding up of the Company, holders of Series A convertible preferred stock, are entitled to receive, out of legally available assets, a liquidation preference of $10 per share, plus an amount equal to any unpaid dividends through the payment date, before any payment or distribution was made to holders of common stock. The holders of Series A convertible preferred stock are not entitled to vote.

During the July 2004, the Company issued 8,000 shares of preferred stock for $80,000. At December 31, 2004, dividends payable was $3,200, or 40 cents per share.

NOTE 6 - COMMON STOCK

During September 2004, the Company issued 100,000 shares of common stock for $40,000 of legal services. These shares were valued using the per share fair value of the Company's common stock on the date of issuance.

In December 2003, the Company's shareholders approved the 2004 Stock and Stock Option Plan effective January 1, 2004 whereby up to 500,000 shares may be granted, optioned or sold. The plan is for its key employees and directors who contribute materially to the success and profitability of the Company as well as attracting other key employees and directors. In November 2004, 400,000 common shares were issued pursuant to this plan, resulting in $172,000 in consulting expense. These shares were valued using the per share fair value of the Company's common stock on the date of issuance.

In November 2004, the Company's board of directors approved the 2004 Marketing Consultant Stock Plan whereby up to 945,000 common shares may be granted, optioned or sold. The plan is for its consultants, key employees, and directors who contribute materially to the success and profitability of the Company as well as attracting other key employees and directors. In November 2004, 945,000 shares were issued under this plan resulting in $406,349 of consulting and employee expense valued using the per share fair value of the Company's common stock on the date of issuance.

NOTE 7 - COMMITMENTS AND CONTINGENCIES

OPERATING LEASES - The Company currently leases office and storage space from a third party. On August 1, 2004, the Company entered into a lease agreement to pay a monthly lease payment of $3,066 until June 2005.

Future minimum lease payments under operating lease obligations as of December 31, 2004, were as follows:

Year Ending December 31,	
2005	$21,462

Rent expense for the years ended December 31, 2004 and 2003 was $33,678 and $27,097, respectively.

MAJOR CUSTOMER - During the year ended December 31, 2004, sales to three customers accounted for 37% of total sales. As of December 31, 2004, there were no amounts due from these customers. During the year ended December 31, 2003, sales to one customer accounted for 11% of total sales. As of December 31, 2003, there were no amounts due from this customer.

MAJOR VENDOR - During the year ended December 31, 2004, purchases from three vendors accounted for 96% of total inventory purchases. As of December 31, 2004, amounts due to these vendors accounted for 54% of accounts payable. During the year ended December 31, 2003, purchases from two vendors accounted for 87% of total inventory purchases. As of December 31, 2003, amounts due to these vendors accounted for 65% of accounts payable.

NOTE 8 - SUBSEQUENT EVENTS (Unaudited)

COMMON STOCK - During March 2005, the Company entered into a tentative agreement with a consultant related to promoting the Company and the possibility of a future offering of the Company's common stock. Under this agreement, the Company agreed to immediately issue the consultant 550,000 shares of the Company's common stock. In addition, the Company agreed to pay a cash fee equal to 10% of the gross proceeds of any future common stock offering. The Company also agreed to issue the investment bank company a warrant to purchase a number of the Company's common shares equal to 10% of the gross proceeds of the offering. As part of the agreement, the consultant is to provide advisory services for 12 months from the close of the offering. In consideration for these services, the Company will issue the consultant common shares equal to 4.5% of the total number of common shares outstanding following the close of the offering. This agreement was abandoned with no shares or funds being delivered.

NOTES PAYABLE - In March 2005 the Company also issued a note payable in the amount of $164,000 for the purchase of inventory. The inventory will be held by the lender as collateral until the note is repaid in May 2005. The Company has also agreed to pay $28,500, or approximately 17%, in interest. In addition, the Company is to issue the lender 47,500 shares of common stock, which will be recorded as a $27,075 discount valued on the date of issuance and amortized over the term of the note. These shares are to be issued prior to the note's due date.

During January 2005, a shareholder advanced the Company $40,000. This advance bears interest at 7% with principal and accrued interest due January 2007.

EXHIBIT INDEX

Exhibit Number	Exhibit Description
31.1	Certification pursuant to Section 13a-14 of CEO
31.2	Certification pursuant to Section 13a-14 of CFO
32.1	Certification pursuant to Section 1350 of CEO
32.2	Certification pursuant to Section 1350 of CFO