PROTON LABORATORIES INC
Form 10QSB
May 18, 2007

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

FORM 10-QSB

[X] Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended Marcy 31, 2007

[ ] 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)

(510) 865-6412
Issuer's telephone number

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

Indicate by check whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] [X] No

On May 16, the registrant had outstanding 26,470,523 Common Stock, $0.0001 par value per share.

Transitional Small Business Disclosure Format: Yes [ ] No [X]

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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PROTON LABORATORIES, INC
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	MARCH 31, 2007	DECEMBER 31, 2006
ASSETS		
CURRENT ASSETS		
Cash	$ 7,469	$ 9,768

Accounts receivable, less allowance for doubtful accounts of $24,586 and $30,419, respectively	2,119	794
Inventory	115,938	143,865
TOTAL CURRENT ASSETS	125,526	154,427
PROPERTY AND EQUIPMENT		
Furniture and fixtures	23,316	23,316
Equipment and machinery	242,330	238,776
Leasehold improvements	11,323	11,323
Accumulated depreciation	(80,184)	(69,550)
NET PROPERTY AND EQUIPMENT	196,785	203,865
DEPOSITS	6,131	6,131
TOTAL ASSETS	$ 328,442	$ 364,423
LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES		
Accounts payable	$ 48,169	$ 71,314
Accrued expenses	287,171	266,079
Deferred revenue	52,506	52,506
Preferred dividends payable	17,600	16,000
TOTAL CURRENT LIABILITIES	405,446	405,899
STOCKHOLDER LOANS, NET OF CURRENT PORTION	307,642	270,642
TOTAL LIABILITIES	$ 713,088	$ 676,541
STOCKHOLDERS' DEFICIT		
Series A convertible preferred stock, 400,000 shares authorized with a par value of $0.0001; 8,000 shares issued and outstanding; liquidation preference of $80,000 and $0, respectively	80,000	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; 26,470,523 and 21,658,223 shares issued and outstanding, respectively	2,649	2,168
Additional paid in capital	5,515,441	4,045,371
Stock subscription receivable	(20,000)	(20,000)
Accumulated deficit	(5,962,736)	(4,419,657)
TOTAL STOCKHOLDERS' DEFICIT	(384,646)	(312,118)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	$ 328,442	$ 364,423

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

PROTON LABORATORIES, INC
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

FOR THE THREE MONTHS ENDED MARCH 31, 2007	2007	2006
SALES	$ 51,741	$ 50,922
COST OF GOODS SOLD	29,800	44,292
GROSS PROFIT	21,941	6,630
OPERATING EXPENSES		
Selling, general and administrative expenses (including equity-based expenses of $0 and $40,526, respectively)	87,538	128,030
Product development costs (including equity-based expenses of $1,470,551 and $0, respectively)	1,470,551	-
LOSS FROM OPERATIONS	(1,536,148)	(121,400)
OTHER INCOME AND (EXPENSE)		
Interest income	53	25
Interest expense	(5,384)	(17,737)
NET OTHER EXPENSE	(5,331)	(17,712)
NET LOSS	(1,541,479)	(139,112)
PREFERRED STOCK DIVIDEND	(1,600)	(1,600)
LOSS APPLICABLE TO COMMON SHAREHOLDERS	$(1,543,079)	$ (140,712)
BASIC AND DILUTED LOSS PER COMMON SHARE	$ (0.07)	$ (0.01)
BASIC AND DILUTED WEIGHTED AVERAGE SHARES OUTSTANDING	22,721,415	14,337,412

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

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PROTON LABORATORIES, INC
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

FOR THE THREE MONTHS ENDED MARCH 31,	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$(1,541,479)	$(139,112)

Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation	10,634	7,649
Common stock issued for services	1,470,551	40,526
Changes in operating assets and liabilities		
Accounts receivable	(1,325)	8,319
Inventory	27,927	4,139
Accounts payable	(23,145)	(28,644)
Accrued expenses	21,092	33,286
NET CASH FROM OPERATING ACTIVITIES	(35,745)	(73,837)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(3,554)	-
NET CASH FROM INVESTING ACTIVITIES	(3,554)	-
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from stockholder loans	37,000	73,852
NET CASH FROM FINANCING ACTIVITIES	37,000	73,852
NET INCREASE (DECREASE) IN CASH	(2,299)	15
CASH AT BEGINNING OF PERIOD	9,768	1,384
CASH AT END OF PERIOD	$ 7,469	$ 1,399
NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Stock issued for accrued legal services	$ -	$ 40,526
Accrual of preferred stock dividends	$ 1,600	$ 1,600

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

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PROTON LABORATORIES, INC
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1 - BASIS OF PRESENTATION AND NATURE OF OPERATIONS

BASIS OF PRESENTATION - The condensed consolidated financial statements include the accounts of Proton Laboratories, Inc., and its wholly owned subsidiary ("Proton" or the "Company"). All significant intercompany transactions and balances have been eliminated in consolidation.

In April 2004, the Company changed its name from BentleyCapitalCorp.com, Inc. to Proton Laboratories, Inc. The Company's subsidiary also changed its name from Proton Laboratories, Inc. to Water Science, Inc.

CONDENSED FINANCIAL STATEMENTS - The accompanying unaudited condensed consolidated financial statements are condensed and, therefore, do not include all disclosures normally required by accounting principles generally accepted in the United States of America. These statements should be read in conjunction with the Company's annual financial statements included in the Company's December 31, 2006 Annual Report on Form 10-KSB. In particular, the Company's significant accounting principles were presented as Note 1 to the consolidated financial statements in that report. In the opinion of management, all adjustments necessary for a fair presentation have been included in the accompanying condensed consolidated financial statements and consist of only normal recurring adjustments. The results of operations presented in the accompanying condensed consolidated financial statements for the three months ended March 31, 2007 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2007.

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. 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.

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.

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.

NOTE 2 - 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 losses applicable to common shareholders of $1,543,079 for the three months ended March 31, 2007. For March 31, 2007 and December 31, 2006 the Company had working capital deficits of $279,920 and $251,472, respectively. Loans and equity funding were required to fund operations.

The Company is working towards raising additional 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.

On February 20, 2007, the Board of Directors of Proton Laboratories, Inc. (the "Company") ratified an exclusive Marketing, Distribution and Sales Agreement ("Marketing Agreement") and a Manufacturing and Packaging Agreement ("Manufacturing Agreement"), each made with Aqua Thirst, Inc. Through the enactment of these agreements, the Company has been able to acquire what is views as key components necessary to strengthen its infrastructure for the manufacturing, marketing and sales of its products and applications.

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.

NOTE 3 - RELATED PARTY TRANSACTIONS

Stockholder loans as of March 31, 2007 and December 31, 2006 consist of the following:

	2007	2006
Note payable to CEO and majority shareholder; principal and interest due December 2009; interest is accrued at 7% per annum; unsecured.	$287,642	$270,642
Note payable to shareholder; principal and interest due December 2009; interest is accrued at 7% per annum; unsecured.	20,000	-
TOTAL STOCKHOLDER LOANS	307,642	270,642
Less: Current Portion	-	-
TOTAL STOCKHOLDER LOANS - LONG TERM	$307,642	$270,642

During the three months ended March 31, 2007, two shareholders advanced the Company $37,000. The Company did not make any payments on notes during the three months ended March 31, 2007.

At March 31, 2007, the Company had accrued interest relating to shareholder loans of $56,938.

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During the three months ended March 31, 2007, the Company accrued $15,000 as salaries payable to the company's CEO, resulting in $210,091 of salaries payable at March 31, 2007.

NOTE 4 - COMMON STOCK

During January through March 31, 2007 the Company issued 4,812,300 shares of common stock for various services and agreements. The value of the shares was $1,470,551 based on market prices ranging from $0.30 to $0.37 per share which was the market price of the Company's common stock on the dates of issuances.

NOTE 5 - COMMITMENTS

PRODUCTION AGREEMENT - In June 2005, the Company entered into an agreement with Mitachi, a Japanese electronics component manufacturer, to aid in the production of enhanced drinking water generators. Pursuant to this agreement, Mitachi agreed to pay the Company 25,000,000 Yen for engineering design, molding, tooling and preparation costs, and the exclusive product distribution rights for China, Taiwan, and Japan. As of March 31, 2007, Mitachi had paid 6,000,000 Yen, or $52,506, for the above mentioned distribution rights. Since the project is not yet completed and no units have been sold, this amount is classified as deferred revenue.

EQUITY LINE - In March 2007, the Company entered into an equity line agreement with EFUND SMALL CAP FUND II, LP, a Nevada Limited Partnership, (the "Equity Line Investor"). Under the equity line, the Company has the right to draw up to $10,000,000 from the Equity Line Investor. The Company is entitled to draw funds and to "put" to the Equity Line Investor shares of the Company's common stock in lieu of repayment of the draw. The Equity Line Investor has registration rights related to any common stock purchased under the equity line agreement.

NOTE 6 - SUBSEQUENT EVENTS

During April 2007, the Company issued 200,000 shares of common stock for services rendered.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

FORWARD-LOOKING STATEMENT

Certain statements contained herein, 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, 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. In addition to the forward-looking statements contained herein, 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 our audited financial statements and the accompanying notes thereto for the year ended December 31, 2006 which appear in our Form 10-KSB for the year then ended, and our unaudited financial statements for the quarter ended March 31, 2007 and the accompanying notes thereto and the other financial information appearing elsewhere herein. The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the USA, which contemplates our continuation as a going concern. We have incurred losses applicable to common shareholders of $1,543,079 for the three months ended March

31, 2007. We had working capital deficit of $279,920 at March 31, 2007. Loans and equity funding were required to fund operations.

We had a stockholder deficit of $384,646 at March 31,2007 and a stockholders deficit of $312,118 at December 31, 2006.

Our independent auditors made a going concern qualification in their report dated April 13, 2007, which raises 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 the Company 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 our primary office located in Alameda, California. During 2006 we created a presence in Quincy, Washington and Portland, Oregon by aligning ourselves with office spaces that were made available to us. These offices are used primarily for marketing and sales generation.

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Our business consists of the development, marketing and sales of the industrial, environmental, and residential systems through the United States which alter the properties of water to produce functional water. During 2006, we continued to import and resell systems manufactured by various Japanese companies; however, during the same time period the company started design, engineering, parts sourcing and assembly identification for developing its own brand labeled products. In Management's view, the company has successfully designed, engineered and developed five commercial systems and one residential unit. If the company can raise sufficient capital, of which there is no assurance, management believes these units will be ready for market introduction during the second quarter of 2007.

We continue to raise funds to bring inventory to market. The company in late 2006 started a dialogue with a funding sourcing entity to raise $10,000,000 to advance its market-ready products to production and revenue. These negotiations have been finalized in the first quarter of 2007.

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. 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.

In February, 2007, the Company entered into an exclusive Marketing, Distribution and Sales Agreement and a Manufacturing and Packaging Agreement with Aqua Thirst, Inc. These agreements effectively provide that the Company will have access to Aquathirst's product distribution channels in domestic and international markets. These distribution channels will cover residential, cosmetic, medical, agricultural, food processing and consumer product areas.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our financial condition and results of operations is 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.

Our fiscal year end is December 31.

At March 31, 2007, we had accrued interest relating to shareholder loans of $56,938 and outstanding principal due to shareholder loans of $307,642.

During the three months ended March 31, 2007 we accrued $15,000 as salaries payable to our CEO, resulting in $210,091 of salaries payable at March 31, 2007.

RESULTS OF OPERATIONS-Three Months ended March 31, 2007 and 2006.

We had revenue of $51,741 for the three months ended March 31, 2007 compared to revenue of $50,922 for the three months ended March 31, 2006. During the period that the company is developing its new line of products, the revenue base will remain fairly consistent.

We incurred a net loss of $1,541,479 for the three months ended March 31, 2007 and a net loss of $139,112 for the three months ended March 31, 2006. This was an increase in net loss attributable to in-kind consultant compensation expenses incurred in the sourcing of manufacturing, marketing and sales infrastructure necessary for the company.

Cash used by operating activities was $35,745 for the for the three months ended March 31, 2007 compared to cash used by operating activities of $73,837 for the three months ended March 31, 2006.

We had total assets at March 31, 2007 of $328,442, compared to $364,423 at December 31, 2006. During the period that the company is developing its new line of products, the total asset base will remain fairly consistent.

LIQUIDITY

At March 31, 2007, we had cash on hand of $7,469. Our growth is dependent on our attaining profit from our operations and our raising of additional capital either through the sale of stock or borrowing funds. There is no assurance that we will be able to raise any equity financing or sell any of our products to generate a profit.

At March 31, 2007, we owed stockholder loans of $307,642.

In 2007, we entered into an equity line of credit with a private investor by which we have the right to draw an aggregate of up to $10,000,000 from time to time. As of March 31, 2007 we had not drawn funds under the equity line.

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 that we then would resell.

- The cost of sales and marketing.

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- The rate at which we expand our operations.

- The results of our consulting business.

- The response of competitors.

Item 3T. Controls and Procedures

(a) Evaluation of disclosure controls and procedures.

As of the end of the period covered by this report, the Company conducted an evaluation, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the 1934 Act. The evaluation was prompted by the following communication from the Company's registered public accounting firm.

In connection with its review of the Company's consolidated financial statements for the quarter ended March 31, 2007, Hansen, Barnett & Maxwell ("HB&M"), the Company's registered public accounting firm, advised the Audit Committee and management of internal control matters with respect to certain financial reporting controls that they considered being a material weakness, which is described below. A material weakness is a control deficiency, or a combination of control deficiencies, that results in there being more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The material weakness identified at March 31, 2007 was as follows:

A material weakness existed in our control environment relating to inadequate staffing of our technical accounting function, including a lack of sufficient personnel with skills, training and familiarity with certain complex technical accounting pronouncements that have or may affect our financial statements and disclosures.

We considered these matters in connection with the condensed closing process and the preparation of the March 31, 2007 consolidated financial statements included in this Form 10-QSB and determined that no prior period financial statements were materially affected by such matters. In response to the observations made by HB&M, we are in the process of implementing enhancements to our internal controls, accounting staff and procedures, which we believe address the matters raised by HB&M, including the retaining of additional outside consultants and employees who will have the skills, training and familiarity with certain complex technical accounting pronouncements appropriate to preparing our financial statements and disclosures.

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PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 2. CHANGES IN SECURITIES.

During January through March 31, 2007 the Company issued 4,812,300 shares of restricted common stock for various services and agreements. The value of the shares was $1,470,551 based on market prices ranging from $0.30 to $0.37 per share which was the market price of the Company's common stock on the dates of issuances. These securities were issued in private transactions, with respect to Canadian residents, in reliance on the exemption from registration with the SEC provided by Regulation S, and with respect to U.S. citizens, in reliance on the exemption available under Section 4(2) of the 1933 Act.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

NONE.

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

None.

ITEM 5. OTHER INFORMATION

N/A

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

NONE

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SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PROTON LABORATORIES, INC.
(REGISTRANT)

Date: May 18, 2007

By: /s/ Ed Alexander

ED ALEXANDER,
Chief Executive Officer and President