ISCO INTERNATIONAL INC
Form 10-Q
May 13, 2005
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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2005.

¨ **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the transition period from ______ to ______

Commission file number: 000-22302

ISCO INTERNATIONAL, INC.

(Name of Registrant as Specified in Its Charter)

Delaware	**36-3688459**
(State or Other Jurisdiction of	**(I.R.S. Employer**

Incorporation or Organization)	**Identification No.)**
1001 Cambridge Drive, Elk Grove Village, Illinois **(Address of Principal Executive Offices)**	**60007** **(Zip Code)**

(847) 391-9400

(Registrant s Telephone Number, Including Area Code)

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 x No ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	Outstanding at April 30, 2005
Common Stock, par value $0.001 per share	162,918,703
Preferred Stock Purchase Rights	

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

ISCO INTERNATIONAL, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

	March 31, 2005	December 31, 2004
	(unaudited)	
Assets:		
Current Assets:		
Cash and cash equivalents	$ 839,153	$ 402,391
Inventories	1,319,958	969,048
Accounts receivable, net	829,272	122,460
Prepaid expenses and other	153,794	594,488
Total current assets	3,142,177	2,088,387
Property and equipment:		
Property and equipment	836,108	824,238
Less: accumulated depreciation	(664,846)	(638,968)
Net property and equipment	171,262	185,270
Restricted certificates of deposit	291,027	291,027
Goodwill	13,370,000	13,370,000
Intangible assets, net	1,057,264	1,051,320
Total assets	$ 18,031,730	$ 16,986,004
Liabilities and Stockholders Equity:		
Current liabilities:		
Accounts payable	$ 312,730	$ 202,613
Employee-related accrued liabilities	189,950	112,393
Accrued professional services	398,450	431,491
Other accrued liabilities	175,086	348,964
Total current liabilities	1,076,216	1,095,461
Notes and related accrued interest with related parties	9,935,994	8,642,908
Stockholders equity:		
Preferred stock; 300,000 shares authorized; No shares issued and outstanding at March 31, 2005 and December 31, 2004		
Common stock ($.001 par value); 250,000,000 shares authorized; 161,218,703 and 161,213,703 shares issued and outstanding at March 31, 2005 and December 31, 2004, respectively	161,219	161,214
Additional paid-in capital (net of unearned compensation)	164,403,260	164,149,827

Accumulated deficit	(157,544,959)	(157,063,406)
Total stockholders equity	7,019,520	7,247,635
Total liabilities and stockholders equity	$ 18,031,730	$ 16,986,004

NOTE: The condensed consolidated balance sheet as of December 31, 2004 has been derived from the audited financial statements for that date, but does not include all of the information and accompanying notes required by accounting principles generally accepted in the United States of America for complete financial statements.

See the accompanying Notes which are an integral part of the Condensed Consolidated Financial Statements.

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ISCO INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004
Net sales	$ 3,293,121	$ 421,950
Costs and expenses:		
Cost of sales	1,921,279	308,595
Research and development	346,511	233,989
Selling and marketing	366,391	223,539
General and administrative	851,401	1,233,550
Total costs and expenses	3,485,582	1,999,673
Operating loss	(192,461)	(1,577,723)
Other income (expense):		
Interest income	3,994	1,807
Non-cash interest expense		(250,297)
Interest expense	(293,086)	(131,445)
Other income (expense), net	(289,092)	(379,935)
Net loss	$ (481,553)	$ (1,957,658)
Basic and diluted loss per share	$ (0.00)	$ (0.01)
Weighted average number of common shares outstanding	161,217,259	154,233,040

See the accompanying Notes which are an integral part of the Condensed Consolidated Financial Statements.

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ISCO INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004
Operating Activities:		
Net loss	$ (481,553)	$ (1,957,658)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	38,615	209,373
Non-cash interest (warrant) expense		250,297
Non-cash compensation expense	252,739	48,705
Changes in operating assets and liabilities	(343,188)	273,706
Net cash used in operating activities	(533,387)	(1,175,577)
Investing Activities:		
Payment of patent costs	(18,681)	(13,231)
Acquisition of property and equipment	(11,870)	(16,111)
Net cash used in investing activities	(30,551)	(29,341)
Financing Activities:		
Exercise of warrants		2,000,000
Proceeds from loan	1,000,000	
Exercise of stock options	700	37,967
Net cash provided by financing activities	1,000,700	2,037,967
Increase in cash and cash equivalents	436,762	833,049
Cash and cash equivalents at beginning of period	402,391	346,409
Cash and cash equivalents at end of period	$ 839,153	$ 1,179,458

See the accompanying Notes which are an integral part of the Condensed Consolidated Financial Statements.

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ISCO INTERNATIONAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 1 - Basis of Presentation

The condensed consolidated financial statements include the accounts of ISCO International, Inc. and its wholly owned subsidiaries, Spectral Solutions, Inc. and Illinois Superconductor Canada Corporation (collectively referred to as the Company). All significant intercompany balances and transactions have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America (US GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by US GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of results for the interim periods have been included. These financial statements and notes included herein should be read in conjunction with the Company s audited financial statements and notes for the year ended December 31, 2004 included in the Company s Annual Report on Forms 10-K and 10-K/A filed with the Securities and Exchange Commission. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for any subsequent quarter of for the entire year ending December 31, 2005. For further information, refer to the financial statements, including the notes thereto, included in the Company s Annual Report on Form 10-K/A for the fiscal year ended December 31, 2004.

Recent Accounting Pronouncements

In November 2004, the FASB issued SFAS No. 151, Inventory Costs an amendment of ARB No. 43, Chapter 4. This statement amends the guidance in Accounting Research Bulletin (ARB) No. 43, Chapter 4, Inventory Pricing, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage) and requires that those items be recognized as current-period charges regardless of whether they meet the criterion of so abnormal. The statement also requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The provisions of this statement are effective for inventory costs incurred during fiscal years beginning after June 15, 2005 (as of January 1, 2006 for the Company) and are to be applied prospectively. The Company does not expect adoption of SFAS No. 151 to have a material effect on its results of operations or financial position.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment (SFAS No. 123R). This statement requires that the compensation cost relating to share-based payment transactions be recognized in the financial statements. Compensation cost is to be measured based on the estimated fair value of the equity-based compensation awards issued as of the grant date. The related compensation expense will be based on the estimated number of awards expected to vest and will be recognized over the requisite service period (often the vesting period) for each grant. The statement requires the use of assumptions and judgments about future events and some of the inputs to the valuation models will require considerable judgment by management.

SFAS No. 123(R) replaces FASB Statement No. 123 (SFAS No. 123), Accounting for Share-Based Compensation, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. The provisions of SFAS No. 123(R) are required to be applied by public companies that do not file as small business issuers, as of the first interim or annual reporting period that begins after June

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15, 2005, and all other public companies as of the first interim or annual reporting period that begins after December 15, 2005. On April 14, 2005, the Securities and Exchange Commission (SEC) adopted a new rule amending the effective date for Statement 123(R). The amended rule allows registrants to implement Statement 123(R) as of the first annual period beginning after June 15, 2005, which is January 1, 2006 for the Company.

The Company intends to continue applying APB Opinion No. 25 to equity-based compensation awards until the effective date of SFAS No. 123(R). At the effective date of SFAS No. 123(R), the Company expects to use the modified prospective application transition method without restatement of prior interim periods in the year of adoption. This will result in the Company recognizing compensation cost based on the requirements of SFAS No. 123(R) for all equity-based compensation awards issued after the effective date of this statement with respect to the Company. For all equity-based compensation awards that are unvested as of that date, compensation cost will be recognized for the unamortized portion of compensation cost not previously included in the SFAS No. 123 pro forma footnote disclosure. The Company is currently evaluating the impact that adoption of SFAS No. 123(R) may have on its results of operations or financial position and expects that the adoption may or may not have a material effect on the Company s results of operations depending on the level and form of future equity-based compensation awards issued.

The Company has a stock-based employee compensation plan, which is more fully described in Note 5. The Company accounts for its stock-based compensation plan under Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation,* as amended by SFAS No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure,* which allows companies to apply the provisions of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees,* and provide pro forma net income and net income per share disclosures for employee stock option grants as if the fair value method defined in SFAS No. 123 had been applied. The Company applies the intrinsic value method for accounting for stock-based compensation as outlined in APB Opinion No. 25.

Stock expense for the first quarters of 2005 and 2004, respectively, includes the result of options issued with an exercise price below the underlying stock s market price. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of FASB Statement 123, Accounting for Stock-Based Compensation as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure an amendment of FASB Statement No. 123, using the assumptions described in Note 5, to its stock-based employee plans:

	Quarter Ended 2005	March 31, 2004
Net loss, as reported	$ 482	$ 1,958
Add: Stock-based employee compensation expense included in reported net loss, net of related tax effects	252	49
Less: Total stock-based employee compensation determined under fair value based method for awards granted, modified, or settled, net of related tax effects	397	142
Pro forma net loss	$ 627	$ 2,051
Loss per share:		
Basic as reported	$ 0.00	$ 0.01
Basic pro forma	$ 0.00	$ 0.01
Diluted as reported	$ 0.00	$ 0.01
Diluted pro forma	$ 0.00	$ 0.01

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Note 2. Realization of Assets

The accompanying 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. However, the Company has sustained substantial losses from operations in recent years, and such losses have continued through the (unaudited) quarter ended March 31, 2005. In addition, the Company has used, rather than provided, cash in its operations.

In view of the matters described in the preceding paragraph, recoverability of a major portion of the recorded asset amounts shown in the accompanying balance sheet is dependent upon continued operations of the Company, which in turn is dependent upon the Company s ability to meet its operational and financing requirements on a continuing basis, to maintain present financing, and to succeed in its future operations. 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 has incurred, and continues to incur, losses from operations. For the years ended December 31, 2004, 2003, and 2002, the Company incurred net losses of $7 million, $7.2 million, and $13 million, respectively. Although financial performance has improved, the Company incurred an additional net loss of $482,000 during the first three months of 2005. During those years the Company implemented strategies to reduce its cash used in operating activities. The Company s strategy included the consolidation of its manufacturing and research and development facilities and a targeted reduction of the employee workforce, increasing the efficiency of the Company s processes, focusing development efforts on products with a greater probability of commercial sales, reducing professional fees and discretionary expenditures, and negotiating favorable payment arrangements with suppliers and service providers. More importantly, the Company configured itself along an outsourcing model, thus allowing for relatively large, efficient production without the associated overhead. The combination of these factors has been highly effective in bringing the Company closer to profitability (from a net loss as high as $28 million during 2001) while enabling it to deliver significant quantities of solutions.

To date, the Company has financed its operations primarily through public and private equity and debt financings. Subject to the uncommitted nature of the credit line, the Company believes that it has sufficient funds to operate its business as identified herein and to meet its obligations into the third quarter 2005, and quite possibly beyond, depending on working capital and other requirements. The Company intends to continue to review available alternatives in the marketplace as it seeks to augment and/or replace its existing capital position through other sources of capital, whether debt, equity, or hybrid.

Note 3 - Net Loss Per Share

Basic and diluted net loss per share is computed based on the weighted average number of common shares outstanding. Common shares issuable upon the exercise of options are not included in the per share calculations since the effect of their inclusion would be antidilutive.

Note 4 - Inventories

Inventories consisted of the following:

	March 31, 2005	December 31, 2004
Raw materials	$ 220,000	$ 268,000
Work in process	72,000	150,000
Finished product	1,028,000	551,000
	$ 1,320,000	$ 969,000

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Cost of product sales for the three months ending March 31, 2005, and the twelve months ending December 31, 2004 include approximately $0 and $57,000, respectively, of costs in excess of the net realizable value of inventory (including obsolete materials).

Note 5 - Stock Options and Warrants

On August 19, 1993, the Board of Directors adopted the 1993 Stock Option Plan for employees, consultants, and directors who are not also employees of the Company (outside directors). This plan reached its ten-year expiration during 2003. During the 2003 annual meeting of shareholders, the Company s shareholders approved a new 2003 Equity Incentive Plan to take the place of the expiring 1993 plan. Unissued options from the 1993 plan were used to fund the 2003 plan. The maximum number of shares issuable under these plans was 14,011,468. These Plans are collectively referred to as the Plan .

For employees and consultants, the Plan provides for granting of Incentive Stock Options (ISOs) and Nonstatutory Stock Options (NSOs). In the case of ISOs, the exercise price shall not be less than 100% (110% in certain cases) of the fair value of the Company s common stock, as determined by the Compensation Committee or full Board as appropriate (the Committee), on the date of grant. In the case of NSOs, the exercise price shall be determined by the Committee, on the date of grant. The term of options granted to employees and consultants will be for a period not to exceed 10 years (five years in certain cases). Options granted under the Plan default to vest over a four-year period (one-fourth of options granted vest after one year from the grant date and the remaining options vest ratably each month thereafter), but the vesting period is determined by the Committee and may differ from the default period. In addition, the Committee may authorize option grants with vesting provisions that are not based solely on employees rendering of additional service to the Company.

For outside directors, the Plan provides that each outside director will be automatically granted NSOs on the date of their initial election to the Board of Directors. On the date of the annual meeting of the stockholders of the Company, each outside director who is elected, reelected, or continues to serve as a director, shall be granted additional NSOs, except for those outside directors who are first elected to the Board of Directors at the meeting or three months prior. The options granted vest ratably over one or two years, based on the date of grant, and expire after ten years from the grant date.

On May 10, 1999, the Board of Directors granted to each employee of the Company (other than the executive officers of the Company) (collectively, the Non-Executive Employees) the option to (i) reduce the exercise prices of up to a maximum of 15,000 of the unexercised stock options previously granted to such Non-Executive Employee under the Plan to $.5625 per share (the closing price of the Company s Common Stock on May 10, 1999) and (ii) cause all of such stock options not otherwise scheduled to become fully vested on or before May 10, 2000 to become fully vested on such date. As a result thereof, an aggregate of 279,550 stock options previously granted under the Plan were amended as described in the preceding sentence. In addition, on May 10, 1999 the Board of Directors granted to the executive officers and certain Non-Executive Employees of the Company additional non-statutory stock options to purchase an aggregate of 343,575 shares of the Company s Common Stock under the Plan. Such stock options became fully vested on the first anniversary of the date of grant, with exercise prices of $.5625 per share and expire 10 years from the date of grant.

On July 1, 2000, Financial Accounting Standards Board Interpretation No. 44, Accounting for Certain Transactions involving Stock Compensation, an interpretation of APB Opinion No. 25 (FIN

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44) was adopted by the Company. FIN 44 requires that stock options that have been modified to reduce the exercise price be subject to variable accounting. The Company accounts for employee stock options under APB Opinion No. 25 and non-employee stock options under Statement of Financial Accounting Standards No. 123, Accounting for Stock Based Compensation (SFAS No. 123).

On May 10, 1999, as described above, the Company re-priced certain stock options granted to employees and in accordance with US GAAP, at that time, the Company accounted for the re-priced stock options as fixed . As a result of adopting FIN 44, the Company is required to apply variable accounting to these options. If the market price of the Company s common stock increases above the July 1, 2000 market price, the Company will have to recognize additional compensation expense equal to the increase in stock price multiplied by the number of re-priced options. No additional expense will be recognized if the stock does not exceed the July 1, 2000 value. However, the impact cannot be determined as it is dependent on the change in the market price of the common stock from July 1, 2000 until the stock options are exercised, forfeited, or expire unexercised. Because the stock price on March 1, 2005 was below that of July 1, 2000, no expense has been recognized during the period.

On February 5, 2001, the Company s Board of Directors authorized the re-pricing of certain out of the money stock options granted to employees during the calendar year of 2000 to the closing share price on such date, or $1.9375 per share. This re-pricing causes these options to be subject to variable accounting as described in FIN 44. Because the stock price on March 1, 2005, was lower than the re-priced strike price no gain or loss was recognized during the period.

On April 1, 2002, the Company s Board of Directors authorized the re-pricing of certain out of the money stock options granted to employees. A new strike price of $0.81 per share was established, provided the respective employees remain with the Company for at least six months following the re-pricing date. In addition, certain stock options granted to directors were repriced, with a new strike price of $1.00 per share. As the stock price on March 1, 2005, was lower than the re-priced strike price no gain or loss was recognized during the period.

On July 17, 2000, the Company granted an option to a non-Company advisor in connection with the establishment of a sales office in Japan to purchase 200,000 shares of common stock at $4.9375 per share, the price of the common stock on the date of the grant. According to the Black-Scholes valuation model, the value of the option was $4.53 per share. The option vested 25% immediately, with the balance vesting pro-rata over a three-year period. $906,000 of non-cash compensation expense was to be amortized during the life of the options. This arrangement was terminated during December 2001, as a result of a change in the structure of the Japanese sales office. The cumulative compensation expense charged for these services through termination was $545,000.

On February 15, 2000, the Company s Board of Directors granted to certain executive level employees an aggregate of 440,000 deferred stock units (DSUs) under the Plan. The DSU s represented the right to receive an equivalent number of restricted shares of the Company s common stock. On the date of the grant, the DSU s were set to vest at the rate of 10% on the first anniversary of the date of the grant, with the balance vesting at a rate of 20%, 30%, and 40% at the second, third, and fourth anniversary dates, respectively. The executive level employees had the right to elect to defer receipt of the common stock subject to the DSU s to a later date. In the third quarter of 2000, the Company began to recognize compensation expense for the DSU s over the vesting period (4 years) based on their intrinsic value of $1,925,000, which was the number of DSU s multiplied by the closing price of the Company s common stock on July 18, 2000, the measurement date ($4.38 per share). As of July 3, 2003, all DSU s granted under this plan had been either received or cancelled. As a result of these transactions, unamortized deferred charges of $308,448 were eliminated. No additional expense is expected for this purpose.

On February 15, 2002, the Company completed a Shareholder Rights Offering. Approximately $20 million was raised from existing shareholders as of the recording date in exchange for the issuance of approximately 40 million shares of the Company s common stock. A portion of the proceeds were then used to repay in full $9.8 million of debt and related accrued interest, as well as the payment of various other accrued expenses.

On October 31, 2003, the Company s Board of Directors authorized the re-pricing of certain out of the money stock options granted to directors. A new strike price of $0.24 per share was established. A non-cash charge reversal of ($21,000) was recognized during the first quarter 2005 to reflect the $0.31 closing price of the Company s common stock on March 31, 2005.

On January 2, 2003, the Company s Board of Directors granted 2,800,000 new stock options to six of the Company s employees, including officers. 950,000 of these options vested immediately, while the remaining 1,850,000 vested monthly in 12 installments. All of the options granted on January 2, 2003 were granted at a discount based on 25% of the average closing price of the Company s common stock as reported on the American Stock Exchange over ten trading days and ultimately valued at a $0.22 discount to the closing price of the Company s common stock as of the date of the grant. During July 2003, the Board of Directors cancelled approximately 2.8 million outstanding options held by certain Company employees, including officers. During January 2004 a total of 3.7 million options were granted to the employees of the Company, including officers, at a similar 25% discount. Such options vested for 1 or 2 years.

A charge of $289,000 was recognized during the first quarter 2005 to recognize the value of the discounts above. Additionally, certain of these 2003 options were deemed to be properly accounted for using variable accounting. Despite the period of time involved, the Company determined that the lesser of those options granted or cancelled should receive variable accounting treatment as if the former option terms were adjusted prospectively. As such, a charge reversal of ($16,000) was recognized during the first quarter 2005 to reflect the $0.31 closing price of the Company s common stock as of March 31, 2005.

During 2004, in addition to the disclosure above, the Company s Board of Directors granted 854,000 stock options to the Company s employees and non-employee Board members. These grants were issued at the closing market price on the date of grant.

During the first three months of 2005, the Company s Board of Directors granted 1,020,000 stock options to the Company s employees and non-employee Board members, and an additional 800,000 stock options that may vest as a result of certain performance objectives being met. All of these grants were issued at the closing market price on the date of grant.

Note 6 Debt

As of the reporting date, the Company has drawn $8.5 million of debt financing under a credit line, as described below. During October 2002, the Company entered into an Uncommitted Line of Credit with its two largest shareholders, an affiliate of Elliott Associates, L.P. (Manchester Securities Corporation) and Alexander Finance, L.P. This line provided up to $4 million to the Company. This line was uncommitted, such that each new borrowing under the facility would be subject to the approval of the lenders. Borrowings on this line bore an interest rate of 9.5% and collateralized by all the assets of the Company. Outstanding loans under this agreement would be required to be repaid on a priority basis should the Company receive new funding from other sources. Additionally, the lenders were entitled to receive warrants to the extent funds were drawn down on the line. The warrants bore a strike price of $0.20 per share of common stock and were to expire on April 15, 2004. The credit line was to mature and be due, including accrued interest thereon, on March 31, 2004. Due to an agreement between the parties no warrants were issued with subsequent borrowings. During February 2004, the warrant holders exercised all of their warrants, contributing $2 million to the Company in exchange for 10 million shares of common stock.

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According to existing accounting pronouncements and SEC guidelines, the Company allocated the proceeds of these borrowings between their debt and equity components. As a result of these borrowings during 2002, the Company recorded a non-cash charge of $1.2 million through the outstanding term of the warrants (April, 2004). $250,000 and $862,000 of that amount were recorded during 2004 and 2003, respectively. These warrants were valued at $1.2 million of the $2 million debt instrument based on a Black-Scholes valuation that included the difference between the value of the Company s common stock and the exercise price of the warrants on the date of each warrant issuance and a 30% discounted face value of the notes, leaving the remaining $0.8 million as the underlying value of the debt. This $1.2 million was amortized over the vesting period of the warrants (six quarters from the fourth quarter 2002 through the first quarter 2004).

During October 2003, the Company entered into an agreement with its lenders to supplement the credit line with an additional $2 million, $1 million of which was drawn immediately and $1 million subsequently drawn upon the Company s request and subject to the approval of the lenders. This supplemental facility bore a 14% rate of interest and was due October 31, 2004. The term of the previous credit line was not affected by this supplement, and as such the $4 million borrowed under that line, plus accrued interest, remained due March 31, 2004.

During February 2004, these credit lines were extended to a due date of April 2005, with interest after the initial periods to be charged at 14%. No warrants or other inducements were issued with respect to these extensions. Additionally, lenders exercised their 10 million warrants during February 2004, agreeing to let the Company use the funds for general purposes as opposed to repaying debt.

During July 2004, the Company and its lenders agreed to increase the aggregate loan commitments under the credit line from $6,000,000 to $6,500,000. Simultaneously, the Company drew the remaining $1,500,000 of the financing.

During November 2004, the Company and its lenders agreed to increase the line of credit to up to an additional $2 million to an aggregate loan commitment of $8,500,000, $1 million of which was drawn immediately by the Company with the remaining $1 million available to be drawn upon the Company s request and subject to the approval of the lenders, which occurred during January 2005.

During February 2005, the consolidated credit line was extended until April 1, 2006. Interest during the extension period is to be charged at 9%. No warrants or other inducements were issued with respect to this extension.

Item 2. Management s Discussion and Analysis of Financial Conditions and Results of Operations.

General

The following is a discussion and analysis of the historical results of operations and financial condition of the Company and factors affecting the Company s financial resources. This discussion should be read in conjunction with the financial statements, including the notes thereto, set forth herein under Part I. - Financial Information and Item 1. Financial Statements and in the Company s Annual Report on Form 10-K/A for the fiscal year ended December 31, 2004. This discussion contains forward-looking statements which involve certain risks, uncertainties and contingencies which could cause the Company s actual results, performance or achievements to differ materially from those expressed, or implied, by such forward-looking statements. Such factors include those described in Risk Factors

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included in the Company s Annual Report on Form 10-K/A. The forward-looking statements included in this report may prove to be inaccurate. In light of the significant uncertainties inherent in these forward-looking statements, you should not consider this information to be a guarantee by the Company or any other person that our objectives and plans will be achieved.

The Company develops and sells solutions designed to optimize the RF (Radio Frequency) link within wireless networks, particularly, but not exclusively, on the reverse link. RF link, or Radio link, is the signal between the mobile device (e.g., mobile phone) and the base station (Link). Reverse link is the signal from the mobile device to the base station. Forward link is the signal from the base station to the mobile device. The Company s array of solutions includes its ANF product line (adaptive notch filter, ANF). The RF^2 product family (radio link radio frequency fidelity, RF^2), services and other solutions, all focused on optimizing RF handling.

The continuing development and expansion in sales of the Company s RF product lines, as well as any required defense of its intellectual property or product line development or expansion, may require a commitment of funds. The actual amount of the Company s future funding requirements will depend on many factors, including: the amount and timing of future revenues, the level of product marketing and sales efforts to support the Company s commercialization plans, the magnitude of its research and product development programs, the ability of the Company to improve or maintain product margins, and the cost of protecting the Company s patents or other intellectual property.

The Company was founded in 1989 by ARCH Development Corporation, an affiliate of the University of Chicago, to commercialize superconductor technologies initially developed by Argonne National Laboratory. The Company was incorporated in Illinois on October 18, 1989 and reincorporated in Delaware on September 24, 1993. Its facilities and principal executive offices are located at 1001 Cambridge Drive, Elk Grove Village, IL 60007 and telephone number is (847) 391-9400.

Overview

The Company has shifted from manufacturing in-house to an outsourced manufacturing model wherein the Company supplies raw materials to external parties and products are then completed. This system allows for the Company to outsource procurement in the future if it chooses to do so. Manufacturing partners then produce to specification with Company personnel on hand to assist with quality control. The Company s products are designed for efficient production in this manner, emphasizing solid-state electronics over mechanical devices with moving parts. The decrease in cost associated with these developments, coupled with enhanced product functionality, has allowed the Company to realize improved margins and significantly reduced overhead costs. Extensions of developed technology, based on substantial input from customers, have allowed the Company to launch the RF^2 product family and consider additional solutions while controlling total R&D cost.

The first quarter 2005 has seen the conclusion of the patent litigation appeal process, the addition of John Thode as President and CEO of the Company, and an overall increase in business activity from prior years as seen in increased revenues, product shipments, and the expansion of the Company s portfolio of RF solutions. The wireless telecommunications industry continues to promote data services and consolidate with an increased requirement for disparate technologies to co-exist. These are trends that the Company looks to take advantage of with its RF products. Despite these improvements, the wireless telecommunications industry is subject to risks beyond the Company s control that can negatively impact customer capital spending budgets and/or spending patterns. For these and other reasons, the Company s financial statements have been prepared assuming the Company will continue as a going concern (see Note 2).

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Results of Operations

Three Months Ended March 31, 2005 and 2004

The Company s net sales increased $2,871,000, or 680%, to $3,293,000 for the three months ended March 31, 2005 from $422,000 for the same period in 2004. This increase was primarily due to the application of the RF^2 product family within wireless data networks. The Company anticipates its revenue during the second quarter 2005 to exceed revenue posted during the second quarter 2004 due to existing and/or anticipated future orders. The Company entered the second quarter 2005 with approximately $1.5 million in order backlog.

Cost of sales increased by $1,612,000, or 522%, to $1,921,000 for the three months ended March 31, 2005 from $309,000 for the same period in 2004. The increase in cost of sales was due to the increase in sales volume, less certain volume-related efficiencies.

The Company s research and development expenses increased by $113,000, or 48%, to $347,000 for the three months ended March 31, 2005, from $234,000 for the same period in 2004. This increase is due to the addition of personnel and prototype costs and is consistent with the continuing expansion of the Company s solution offerings within its RF product family, and more broadly to support new product and next generation products.

Selling and marketing expenses increased by $142,000, or 63%, to $366,000 for the three months ended March 31, 2005, from $224,000 for the same period in 2004. This increase is due to the addition of personnel and initiatives that helped drive the revenue increase, above.

General and administrative expenses decreased by $383,000, or 31%, to $851,000 for the three months ended March 31, 2005, from $1,234,000 for the same period in 2004. This decrease was primarily attributable to a decrease in legal expenses related to the recently concluded patent litigation appeal process.

Liquidity and Capital Resources

At March 31, 2005, the Company s cash and cash equivalents were $839,000, an increase of $437,000 from the balance at December 31, 2004 of $402,000.

During the first quarter 2005, the Company received the remaining $1 million from its equity line, using the funds to increase inventories. Those inventories were sold during the quarter, resulting in an increased accounts receivable balance of $800,000 and an increased inventory balance of $350,000. These numbers were consistent with the overall increase in business activity as reported herein.

The continuing development and expansion of sales of the Company s RF management solutions product lines will require a commitment of additional funds. The actual amount of the Company s future funding requirements will depend on many factors, including: the amount and timing of future revenues, the level of product marketing and sales efforts to support the Company s commercialization plans, the magnitude of the Company s research and product development programs, the ability of the Company to improve product margins, and the costs involved in protecting the Company s patents or other intellectual property.

As of the date of this filing, the Company believes that it has sufficient funds to operate its business as identified herein without the need for substantial future capital sources into the third quarter 2005, and very possibly longer, subject to working capital and other requirements (see Note 2). The Company intends to look into augmenting its existing capital position potentially through other sources of capital. For example, the Company regularly reviews the capital markets for appropriate debt, equity and hybrid instruments in search of both adequate operating capital and the best available capital structure.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk.

The Company does not have any material market risk sensitive instruments.

Item 4. Controls and Procedures.

(a) An evaluation was performed under the supervision and with the participation of the Company s management, including its Chief Executive Officer, or CEO, and Chief Financial Officer, or CFO, of the effectiveness of the Company s disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act) as of March 31, 2005. Based on that evaluation, the Company s management, including the CEO and CFO, concluded that the Company s disclosure controls and procedures are effective to ensure 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 as specified in Securities and Exchange Commission rules and forms.

(b) There were no significant changes in the Company s internal control over financial reporting identified in connection with the evaluation of such controls that occurred during the Company s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

Patent Litigation

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In July 2001, the Company filed suit in the United States District Court for the District of Delaware against Conductus, Inc. and Superconductor Technologies, Inc. alleging infringement of U.S. Patent No. 6,263,215, entitled Cryoelectronically Cooled Receiver Front End for Mobile Radio Systems (the 215 patent). This suit alleged that Conductus and Superconductor Technologies base station front-end systems containing cryogenically cooled superconducting filters infringe this patent. The Company sought a permanent injunction enjoining Conductus and Superconductor Technologies from marketing, selling or manufacturing these products, as well as triple damages and attorneys fees. Conductus and Superconductor Technologies denied these allegations and asked the court to enter a judgment that the patent is invalid and not infringed. Conductus and Superconductor Technologies also asserted the defense of inequitable conduct and a counterclaim for a declaration that the patent is unenforceable as well as federal and state law counterclaims, including claims of unfair competition. Conductus and Superconductor Technologies sought both compensatory and punitive damages as well as attorneys fees and costs.

On March 26, 2002, the Company replied to Conductus and Superconductor Technologies Second Amended Answer and Counterclaims and filed counterclaims alleging that Conductus and Superconductor Technologies also infringe U.S. Patent No. 6,104,934 entitled Cryoelectronic Receiver Front End and U.S. Patent No. 6,205,340 B1 entitled Cryoelectronic Receiver Front End For Mobile Radio Systems . On April 17, 2002, the court dismissed these (the Company s) counterclaims without prejudice to the Company s right to assert these counterclaims in a separate action.

On February 10, 2003, the court disposed of various motions for summary judgment filed by each party. The court denied Superconductor Technologies motion for summary judgment of invalidity of the 215 patent as well as Conductus motion for summary judgment limiting computation of damages to a reasonable royalty for sales to Dobson Communications, Inc. On Superconductor Technologies motion for summary judgment of non-infringement, the court granted the motion with respect to claim 13 of the 215 patent and otherwise denied the motion with respect to each of the other asserted claims. With regard to Conductus motion for summary judgment of non-infringement, the court granted the motion with respect to claim 13 of the 215 patent and otherwise denied the motion with respect to each of the other asserted claims. In addition, the court denied Conductus motion for summary judgment of invalidity of all asserted claims for causes of action existing prior to the date of issuance of the certificate of correction and of invalidity of claim 13. The court also denied the Company s motions for summary judgment that Superconductor Technologies internal projects are not prior art to the 215 patent and to dismiss the defendants counterclaims alleging unfair competition and interference with business relations.

On April 3, 2003, the jury returned with its verdict. The jury rejected the Company s positions and determined its patent to be invalid. Additionally, the jury determined that inequitable conduct had occurred and subsequently awarded defendants $3.87 million in damages from the Company. The Company was severely disappointed by this verdict and it engaged in the post-trial motion process to overturn it. On August 21, 2003, the court issued its ruling on the post-trial motions. The court overturned the jury s determination of unfair competition on the part of the Company and denied all requests for damages, including the $3.87 million jury award cited above. The court did not, however, overturn the jury determinations of patent invalidity and unenforceability based on inequitable conduct and denied the Company s motion for a new trial.

During September 2003, the Company filed an appeal of this verdict requesting the reinstatement of its patent and the rights inherent within that patent, and Superconductor Technologies, Inc. filed a cross-appeal requesting reinstatement of the jury award and attorney s fees.

On February 3, 2005, the Appellate Court issued its ruling. It did not find adequate grounds for reversal of the Trial Court decision, and thus maintained the verdict in favor of the defendant in allowing the patent to remain invalid and unenforceable and in favor of the Company in denying counterclaims for damages raised by the defendant. The Appellate Court s ruling concludes this matter.

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In November 2001, the Company filed suit against Dobson Communications, Inc. for allegedly infringing this patent. The action was stayed, per agreement between the parties, until resolution of the matter between the Company and Conductus and Superconductor Technologies. The parties agreed that Dobson Communications would be bound by any and all final, non-appealable determinations, holdings or findings with respect to all liability issues in the Company s case against Conductus. The Appellate Court s ruling concludes the Dobson matter as well.

Item 5. Other Information None.

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

Exhibits: A list of exhibits is set forth in the Exhibit Index found on page 17 of this report.

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Signatures

Pursuant to the requirements of Section 13 or 15(d) 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 on the 13th day of May 2005.

ISCO International, Inc.

By: /s/ John Thode

Mr. John Thode
President and Chief Executive
Officer (Principal Executive Officer)

By: /s/ Frank Cesario

Frank Cesario
Chief Financial Officer (Principal
Financial and Accounting Officer)

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EXHIBIT INDEX

Exhibit Number	Description of Exhibit
31.1	Certification by Chief Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by Chief Financial Officer pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.