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AMERICAN AMMUNITION INC /CA  
Form 10QSB  
October 21, 2002

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

Form 10-QSB

-----  
(Mark one)

Quarterly Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2002

Transition Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
-----

Commission File Number: 0-32379

American Ammunition, Inc.  
-----

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

California  
-----

91-2021594  
-----

(State of incorporation)

(IRS Employer ID Number)

3545 NW 71st Street, Miami, FL 33147  
-----

(Address of principal executive offices)

(305) 835-7400  
-----

(Issuer's telephone number)  
-----

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

State the number of shares outstanding of each of the issuer's classes of common equity as of the latest practicable date: October 14, 2002: 54,114,560

Transitional Small Business Disclosure Format (check one): YES NO X  
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American Ammunition, Inc.

Form 10-QSB for the Quarter ended September 30, 2002

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### Item 1 - Part 1 - Financial Statements

American Ammunition, Inc. and Subsidiaries  
(formerly FBI Fresh Burgers International)  
Consolidated Balance Sheets  
September 30, 2002 and 2001  
(Unaudited)

|                                     | September 30,<br>2002 | September 30,<br>2001 |
|-------------------------------------|-----------------------|-----------------------|
|                                     | -----                 | -----                 |
| ASSETS                              |                       |                       |
| Current Assets                      |                       |                       |
| Cash on hand and in bank            | \$ 238,695            | \$ 622,112            |
| Accounts receivable - trade, net of |                       |                       |

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|                                                                                                                               |                          |                          |
|-------------------------------------------------------------------------------------------------------------------------------|--------------------------|--------------------------|
| factored accounts of approximately<br>\$-0- and \$-0- and allowance for<br>doubtful accounts of \$-0- and \$-0-, respectively | 232,821                  | -                        |
| Inventory                                                                                                                     | 554,369                  | 116,128                  |
| Prepaid expenses                                                                                                              | 19,647                   | 7,323                    |
|                                                                                                                               | -----                    | -----                    |
| Total Current Assets                                                                                                          | 1,045,532                | 745,563                  |
|                                                                                                                               | -----                    | -----                    |
| Property and Equipment - at cost or contributed value                                                                         |                          |                          |
| Manufacturing equipment                                                                                                       | 6,683,688                | 6,468,864                |
| Office furniture and fixtures                                                                                                 | 50,907                   | 49,699                   |
| Leasehold improvements                                                                                                        | 193,606                  | 182,052                  |
|                                                                                                                               | -----                    | -----                    |
| Accumulated depreciation                                                                                                      | 6,928,201<br>(3,224,315) | 6,700,615<br>(2,005,907) |
|                                                                                                                               | -----                    | -----                    |
| Net Property and Equipment                                                                                                    | 3,703,886                | 4,694,708                |
|                                                                                                                               | -----                    | -----                    |
| Other Assets                                                                                                                  |                          |                          |
| Deposits and other                                                                                                            | 77,860                   | 59,712                   |
|                                                                                                                               | -----                    | -----                    |
| Total Other Assets                                                                                                            | 77,860                   | 59,712                   |
|                                                                                                                               | -----                    | -----                    |
| TOTAL ASSETS                                                                                                                  | \$ 4,827,278             | \$ 5,499,983             |
|                                                                                                                               | =====                    | =====                    |

- Continued -

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

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American Ammunition, Inc. and Subsidiaries  
(formerly FBI Fresh Burgers International)  
Consolidated Balance Sheets - Continued  
September 30, 2002 and 2001  
(Unaudited)

|                                      | September 30,<br>2002 | September 30,<br>2001 |
|--------------------------------------|-----------------------|-----------------------|
|                                      | -----                 | -----                 |
| LIABILITIES AND STOCKHOLDERS' EQUITY |                       |                       |
| Current Liabilities                  |                       |                       |
| Notes payable to a bank              | \$ -                  | \$ -                  |
| Current maturities of leases payable | 8,365                 | 31,260                |
| Accounts payable - trade             | 383,777               | 618,471               |

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|                                        |              |              |
|----------------------------------------|--------------|--------------|
| Customer deposits                      | 30,000       | -            |
| Note payable to stockholder            | -            | 200,000      |
|                                        | -----        | -----        |
| Total Current Liabilities              | 422,142      | 849,731      |
| Long-Term Liabilities                  |              |              |
| Note payable to a bank                 | 650,000      | 950,000      |
| Capital leases payable                 | 11,175       | 43,142       |
|                                        | -----        | -----        |
| Total Liabilities                      | 1,083,317    | 1,842,873    |
|                                        | -----        | -----        |
| Commitments and Contingencies          |              |              |
| Mandatory Convertible Preferred Stock  |              |              |
| 1,620,720 and 46,000 shares            |              |              |
| issued and outstanding, respectively   | 230,000      | 8,135,350    |
|                                        | -----        | -----        |
| Stockholders' Equity                   |              |              |
| Preferred stock - \$0.001 par value    |              |              |
| 20,000,000 shares authorized.          |              |              |
| 1,795,320 shares allocated to Series A | -            | -            |
| Common stock - \$0.001 par value.      |              |              |
| 300,000,000 shares authorized.         |              |              |
| 54,114,560 and 29,971,200 shares       |              |              |
| issued and outstanding, respectively   | 54,115       | 29,971       |
| Additional paid-in capital             | 16,052,506   | 4,971,029    |
| Accumulated deficit                    | (12,592,660) | (9,479,240)  |
|                                        | -----        | -----        |
| Total Stockholders' Equity             | 3,513,961    | (4,478,240)  |
|                                        | -----        | -----        |
| TOTAL LIABILITIES AND                  |              |              |
| STOCKHOLDERS' EQUITY                   | \$ 4,827,278 | \$ 5,499,983 |
|                                        | =====        | =====        |

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

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American Ammunition, Inc. and Subsidiaries  
(formerly FBI Fresh Burgers International)  
Consolidated Statements of Operations and Comprehensive Income (Loss)  
Nine and Three months ended September 30, 2002 and 2001  
(Unaudited)

|               |               |               |
|---------------|---------------|---------------|
| Nine months   | Nine months   | Three months  |
| ended         | ended         | ended         |
| September 30, | September 30, | September 30, |

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|                                                                                                                   | 2002           | 2001         | 2002         |
|-------------------------------------------------------------------------------------------------------------------|----------------|--------------|--------------|
| Revenues                                                                                                          | \$ 1,277,454   | \$ 350,969   | \$ 570,320   |
| Cost of Sales                                                                                                     |                |              |              |
| Materials, Direct Labor<br>and other direct costs                                                                 | 1,236,388      | 275,048      | 630,484      |
| Depreciation                                                                                                      | 483,537        | 454,906      | 163,238      |
| Total Cost of Sales                                                                                               | 1,719,925      | 729,954      | 793,722      |
| Gross Profit                                                                                                      | (442,471)      | (378,985)    | (223,402)    |
| Operating Expenses                                                                                                |                |              |              |
| Research and development expenses                                                                                 | 2,851          | 1,432        | 2,200        |
| Marketing and promotion expenses                                                                                  | 13,842         | 5,516        | 6,276        |
| Other operating expenses                                                                                          | 488,257        | 505,492      | 270,126      |
| Interest expense                                                                                                  | 76,060         | 277,685      | 14,941       |
| Depreciation expense                                                                                              | 3,061          | 8,022        | 248          |
| Compensation expense related to common<br>stock issuances at less than "fair value"                               | 11,346         | -            | 11,346       |
| Total Operating Expenses                                                                                          | 595,417        | 798,147      | 305,137      |
| Loss from Operations                                                                                              | (1,037,888)    | (1,177,132)  | (528,539)    |
| Other Income (Expense)                                                                                            |                |              |              |
| Settlement of litigation                                                                                          | -              | 754,830      | -            |
| Interest and other income                                                                                         | 11,048         | 3,777        | 515          |
| Income (Loss) before Income Taxes                                                                                 | (1,026,840)    | (418,525)    | (528,024)    |
| Provision for Income Taxes                                                                                        | -              | -            | -            |
| Net Income (Loss)                                                                                                 | (1,026,840)    | (418,525)    | (528,024)    |
| Other Comprehensive Income                                                                                        | -              | -            | -            |
| Comprehensive Income (Loss)                                                                                       | \$ (1,026,840) | \$ (418,525) | \$ (528,024) |
| Loss per weighted-average share of<br>common stock outstanding, computed<br>on net loss - basic and fully diluted | \$ (0.02)      | \$ (0.01)    | \$ (0.01)    |
| Weighted-average number of<br>common shares outstanding                                                           | 51,885,746     | 29,971,200   | 53,395,558   |

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

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American Ammunition, Inc. and Subsidiaries  
 (formerly FBI Fresh Burgers International)  
 Consolidated Statements of Cash Flows  
 Nine months ended September 30, 2002 and 2001  
 (Unaudited)

|                                                                                     | Nine months<br>ended<br>September 30,<br>2002 | Nine months<br>ended<br>September 30,<br>2001 |
|-------------------------------------------------------------------------------------|-----------------------------------------------|-----------------------------------------------|
|                                                                                     | -----                                         | -----                                         |
| Cash flows from operating activities                                                |                                               |                                               |
| Net loss for the period                                                             | \$ (1,026,840)                                | \$ (418,525)                                  |
| Adjustments to reconcile net loss to<br>net cash provided by operating activities   |                                               |                                               |
| Depreciation and amortization                                                       | 486,598                                       | 573,994                                       |
| Compensation expense related to common<br>stock issuances at less than "fair value" | 11,346                                        | -                                             |
| Gain on litigation settlement                                                       | -                                             | (754,830)                                     |
| Common stock issued for fees and services                                           | 50,520                                        | 127,458                                       |
| Accrued interest converted to common stock                                          |                                               | 240,440                                       |
| (Increase) Decrease in                                                              |                                               |                                               |
| Accounts receivable                                                                 | (232,821)                                     | 60,415                                        |
| Inventory                                                                           | (239,628)                                     | 217,282                                       |
| Prepaid expenses, deposits and other                                                | (13,739)                                      | (7,323)                                       |
| Increase (Decrease) in                                                              |                                               |                                               |
| Accounts payable - trade                                                            | 110,730                                       | (66,203)                                      |
| Interest payable                                                                    | -                                             | (2,000)                                       |
| Excise taxes payable                                                                | (8,641)                                       | (27,380)                                      |
| Customer deposits                                                                   | 30,000                                        | -                                             |
|                                                                                     | -----                                         | -----                                         |
| Net cash used in operating activities                                               | (832,475)                                     | (92,672)                                      |
|                                                                                     | -----                                         | -----                                         |
| Cash flows from investing activities                                                |                                               |                                               |
| Purchase of property and equipment                                                  | (225,229)                                     | (103,300)                                     |
|                                                                                     | -----                                         | -----                                         |
| Net cash used in investing activities                                               | (225,229)                                     | (103,300)                                     |
|                                                                                     | -----                                         | -----                                         |
| Cash flows from financing activities                                                |                                               |                                               |
| Decrease in cash overdraft                                                          | -                                             | 7,760                                         |
| Cash received (paid) on short term loans - net                                      | -                                             | (451,652)                                     |
| Cash received on long-term loans                                                    | -                                             | 950,000                                       |
| Cash paid on long-term loans                                                        | (300,000)                                     | -                                             |
| Principal paid on long-term capital leases                                          | (6,173)                                       | (33,882)                                      |
| Cash received on sale of Mandatory<br>Convertible Preferred Stock                   |                                               | 345,000                                       |
| Cash received on sale of common stock                                               | 1,006,153                                     | -                                             |
|                                                                                     | -----                                         | -----                                         |
| Net cash provided by financing activities                                           | 699,980                                       | 817,226                                       |
|                                                                                     | -----                                         | -----                                         |
| Increase (Decrease) in Cash                                                         | (357,724)                                     | 621,254                                       |
| Cash at beginning of year                                                           | 596,419                                       | 858                                           |

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|                     |            |            |
|---------------------|------------|------------|
|                     | -----      | -----      |
| Cash at end of year | \$ 238,695 | \$ 622,112 |
|                     | =====      | =====      |

- Continued -

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

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American Ammunition, Inc. and Subsidiaries  
(formerly FBI Fresh Burgers International)  
Consolidated Statements of Cash Flows  
Nine months ended September 30, 2002 and 2001

(Unaudited)

|                                                                                          | Nine months<br>ended<br>September 30,<br>2002 | Nine months<br>ended<br>September 30,<br>2001 |
|------------------------------------------------------------------------------------------|-----------------------------------------------|-----------------------------------------------|
|                                                                                          | -----                                         | -----                                         |
| Supplemental disclosure of interest<br>and income taxes paid                             |                                               |                                               |
| Interest paid for the period                                                             | \$ 52,060                                     | \$ 39,245                                     |
|                                                                                          | =====                                         | =====                                         |
| Income taxes paid for the period                                                         | \$ -                                          | \$ -                                          |
|                                                                                          | =====                                         | =====                                         |
| Supplemental disclosure of non-cash<br>investing and financing activities                |                                               |                                               |
| Conversion of debt and accrued interest<br>payable to a shareholder into preferred stock | \$ -                                          | \$ 7,553,600                                  |
|                                                                                          | =====                                         | =====                                         |
| Conversion of debt and accrued interest<br>payable to a shareholder into common stock    | \$ 125,000                                    | \$ -                                          |
|                                                                                          | =====                                         | =====                                         |
| Common stock issued in payment of trade accounts payable                                 | \$ 188,855                                    | \$ -                                          |
|                                                                                          | =====                                         | =====                                         |

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

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American Ammunition, Inc. and Subsidiaries  
(formerly FBI Fresh Burgers International)

Notes to Consolidated Financial Statements

### Note A - Organization and Description of Business

American Ammunition, Inc. (AAI or Company) was incorporated on February 1, 2000 in the State of California as FirstTelevision.com. AAI subsequently changed its corporate name to FBI Fresh Burgers International with a business plan of marketing the concept of a national "fast food" restaurant chain to children and young adults, with a menu of fresh burgers, fries and sandwiches. However, there was no assurance that this business concept would be successful.

On September 29, 2001, the Company, F&F Equipment, Inc. (F&F) and the individual shareholders of F&F entered into an "Agreement For The Exchange Of Common Stock" (Exchange Agreement) whereby the shareholders of F&F exchanged 100.0% of the issued and outstanding stock of F&F for 21,000,000 post-forward split shares of restricted, unregistered common stock of the Company. F&F Equipment, Inc. then became a wholly-owned subsidiary of the Company.

Concurrent with the September 29, 2001 reverse acquisition transaction, the Company amended its Articles of Incorporation to change the Company's name to American Ammunition, Inc. and modified the Company's capital structure to allow for the issuance of up to 320,000,000 total equity shares consisting of 20,000,000 shares of preferred stock and 300,000,000 shares of common stock. Both classes of stock have a par value of \$0.001 per share.

On October 9, 2001, the Company effected a three (3) for one (1) forward stock split. This action caused the then issued and outstanding shares to increase from 2,990,400 to 8,971,200 on the action date. The effect of this action is reflected in the accompanying financial statements as of the first day of the first period presented.

F&F Equipment, Inc. (Company) was incorporated on October 4, 1983 under the laws of the State of Florida. The Company was formed to engage principally in the "import, export, retail & wholesale of firearms equipment, ammunition & other devices and for the purpose of transacting any and/or all lawful business." The Company conducts its business operations under the assumed name of "American Ammunition".

In June 2002, American Ammunition, Inc. formed a wholly owned subsidiary, Industrial Plating Enterprise Co. (IPE), which started production on June 14, 2002. IPE is a fully licensed and approved state of the art electrochemical metallization facility with enormous capacity for processing the Company's line of projectiles as well as other products and services while employing environmentally sound water conservation and proven waste treatment techniques. The facility meets or exceeds all current environmental requirements and enjoys the "conditionally exempt small quantity generator" status for State and Federal regulations.

### Note B - Preparation of Financial Statements

The acquisition of F&F Equipment, Inc., on September 29, 2001, by the Company effected a change in control and was accounted for as a "reverse acquisition"



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whereby F&F Equipment, Inc. is the accounting acquiror for financial statement purposes. Accordingly, for all periods subsequent to the September 29, 2001 change in control transaction, the financial statements of the Company reflect the historical financial statements of F&F Equipment, Inc. from its inception on October 4, 1983 and the operations of the Company subsequent to September 29, 2001.

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### American Ammunition, Inc. and Subsidiaries (formerly FBI Fresh Burgers International)

#### Notes to Consolidated Financial Statements - Continued

##### Note B - Preparation of Financial Statements - Continued

The Company and its subsidiaries follow the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America and have adopted a year-end of December 31 for all entities.

During interim periods, the Company follows the accounting policies set forth in its annual audited financial statements filed with the U. S. Securities and Exchange Commission on its Annual Report on Form 10-KSB for the year ended December 31, 2001. The information presented within these interim financial statements may not include all disclosures required by accounting principles generally accepted in the United States of America and the users of financial information provided for interim periods should refer to the annual financial information and footnotes when reviewing the interim financial results presented herein.

In the opinion of management, the accompanying interim financial statements, prepared in accordance with the U. S. Securities and Exchange Commission's instructions for Form 10-QSB, are unaudited and contain all material adjustments, consisting only of normal recurring adjustments necessary to present fairly the financial condition, results of operations and cash flows of the Company for the respective interim periods presented. The current period results of operations are not necessarily indicative of results which ultimately will be reported for the full fiscal year ending December 31, 2002.

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 and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Management further acknowledges that it is solely responsible for adopting sound accounting practices, establishing and maintaining a system of internal accounting control and preventing and detecting fraud. The Company's system of internal accounting control is designed to assure, among other items, that 1) recorded transactions are valid; 2) valid transactions are recorded; and 3) transactions are recorded in the proper period in a timely manner to produce financial statements which present fairly the financial condition, results of operations and cash flows of the Company for the respective periods being presented

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For segment reporting purposes, the Company operated in only one industry segment during the periods represented in the accompanying financial statements and makes all operating decisions and allocates resources based on the best benefit to the Company as a whole.

The accompanying consolidated financial statements contain the accounts of American Ammunition, Inc. (formerly FBI Fresh Burgers International) and its wholly-owned subsidiaries, F&F Equipment, Inc. and Industrial Plating Enterprise Co. All significant intercompany transactions have been eliminated. The consolidated entities are collectively referred to as "Company".

(Remainder of this page left blank intentionally)

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### American Ammunition, Inc. and Subsidiaries (formerly FBI Fresh Burgers International)

#### Notes to Consolidated Financial Statements - Continued

##### Note C - Summary of Significant Accounting Policies

###### 1. Cash and cash equivalents

For Statement of Cash Flows purposes, the Company considers all cash on hand and in banks, including accounts in book overdraft positions, certificates of deposit and other highly-liquid investments with maturities of three months or less, when purchased, to be cash and cash equivalents.

Cash overdraft positions may occur from time to time due to the timing of making bank deposits and releasing checks, in accordance with the Company's cash management policies.

###### 2. Accounts receivable

In the normal course of business, the Company extends unsecured credit to virtually all of its customers which are located throughout the United States. Because of the credit risk involved, management has provided an allowance for doubtful accounts which reflects its opinion of amounts which will eventually become uncollectible. In the event of complete non-performance, the maximum exposure to the Company is the recorded amount of trade accounts receivable shown on the balance sheet at the date of non-performance.

###### 3. Inventory

Inventory consists of raw materials, work-in-process and finished goods related to the production and sale of small arms ammunition. Inventory is valued at the lower of cost or market using the first-in, first-out method.

###### 4. Property, plant and equipment

Property and equipment are recorded at historical cost. These costs are depreciated over the estimated useful lives of the individual assets using the straight-line method, generally three to ten years.

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Gains and losses from disposition of property and equipment are recognized as incurred and are included in operations.

### 5. Income Taxes

The Company uses the asset and liability method of accounting for income taxes. At September 30, 2002 and 2001, the deferred tax asset and deferred tax liability accounts, as recorded when material to the financial statements, are entirely the result of temporary differences. Temporary differences represent differences in the recognition of assets and liabilities for tax and financial reporting purposes, primarily accumulated depreciation and amortization, allowance for doubtful accounts and vacation accruals.

As of September 30, 2002 and 2001, the deferred tax asset related to the Company's net operating loss carryforward is fully reserved. If these carryforwards are not utilized, they will begin to expire in 2005.

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American Ammunition, Inc. and Subsidiaries  
(formerly FBI Fresh Burgers International)

### Notes to Consolidated Financial Statements - Continued

#### Note C - Summary of Significant Accounting Policies - Continued

### 6. Earnings (loss) per share

Basic earnings (loss) per share is computed by dividing the net income (loss) by the weighted-average number of shares of common stock and common stock equivalents (primarily outstanding options and warrants). Common stock equivalents represent the dilutive effect of the assumed exercise of the outstanding stock options and warrants, using the treasury stock method. The calculation of fully diluted earnings (loss) per share assumes the dilutive effect of the exercise of outstanding options and warrants at either the beginning of the respective period presented or the date of issuance, whichever is later. As of September 30, 2002 and 2001, and subsequent thereto, the Company had no warrants and/or options outstanding.

### 7. Advertising costs

The Company does not conduct any direct response advertising activities. For non-direct response advertising, the Company charges the costs of these efforts to operations at the first time the related advertising is published.

### 8. Reclassifications

Certain amounts in the accompanying financial statements for the quarter ended September 30, 2001 have been reclassified to conform to the Fiscal 2002 presentations.

#### Note D - Fair Value of Financial Instruments

The carrying amount of cash, accounts receivable, accounts payable and notes

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payable, as applicable, approximates fair value due to the short term nature of these items and/or the current interest rates payable in relation to current market conditions.

Interest rate risk is the risk that the Company's earnings are subject to fluctuations in interest rates on either investments or on debt and is fully dependent upon the volatility of these rates. The Company does not use derivative instruments to moderate its exposure to interest rate risk, if any.

Financial risk is the risk that the Company's earnings are subject to fluctuations in interest rates or foreign exchange rates and are fully dependent upon the volatility of these rates. The company does not use derivative instruments to moderate its exposure to financial risk, if any.

### Note E - Inventory

As of September 30, 2002, inventory consisted of the following components:

|                 | September 30, 2002 |
|-----------------|--------------------|
| Raw materials   | \$207,574          |
| Work in process | 264,048            |
| Finished goods  | 82,747             |
|                 | -----              |
| Totals          | \$554,369<br>===== |

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American Ammunition, Inc. and Subsidiaries  
(formerly FBI Fresh Burgers International)

Notes to Consolidated Financial Statements - Continued

### Note F - Property and Equipment

Property and equipment consist of the following components:

|                               | September 30,<br>2002 | September 30,<br>2001 | Estimated<br>useful life |
|-------------------------------|-----------------------|-----------------------|--------------------------|
|                               | -----                 |                       |                          |
| Manufacturing equipment       | \$6,683,688           | \$6,468,864           | 10 years                 |
| Office furniture and fixtures | 50,907                | 49,699                | 7 years                  |
| Leasehold improvements        | 193,606               | 182,052               | 20 years                 |
|                               | -----                 | -----                 |                          |
|                               | 6,928,201             | 6,700,615             |                          |
| Accumulated depreciation      | (3,224,315)           | (2,005,907)           |                          |
|                               | -----                 | -----                 |                          |
| Net property and equipment    | \$3,703,866<br>=====  | \$4,694,708<br>=====  |                          |

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Total depreciation expense charged to operations for the nine months ended September 30, 2002 and 2001, respectively, was approximately \$486,598 and \$462,928, respectively.

Included in the amounts reflected in the accompanying balance sheet are the following fixed assets on long-term capital leases:

|                                        | September 30,<br>2002 | September 30,<br>2001 |
|----------------------------------------|-----------------------|-----------------------|
|                                        | -----                 | -----                 |
| Manufacturing and processing equipment | \$153,400             | \$153,400             |
| Less accumulated depreciation          | (50,694)              | (35,344)              |
|                                        | -----                 | -----                 |
|                                        | \$106,551             | \$118,056             |
|                                        | =====                 | =====                 |

### Note G - Notes payable to a Bank

During 2001, the Company was operating under a bank approved moratorium on the payment of principal and interest on all notes payable and the Company and its President commenced litigation against the lending institution. On June 29, 2001, the Company and the Bank executed a Settlement and Compromise Agreement whereby all loans and debts of the Company to the Bank were settled and cancelled for a one-time cash payment of \$550,000. The source of funds for the \$550,000 settlement came from a new \$950,000 note payable to another financial institution.

As a result of the June 29, 2001 transaction, the Company recognized a one-time gain on the settlement of approximately \$754,830 on the settlement date.

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American Ammunition, Inc. and Subsidiaries  
(formerly FBI Fresh Burgers International)

Notes to Consolidated Financial Statements - Continued

### Note H - Capital Leases Payable

Capital leases payable consist of the following as of September 30, 2002 and 2001, respectively:

|                                                                                                                                                                                                                              | September 30,<br>2002 | September 30,<br>2001 |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------|-----------------------|
|                                                                                                                                                                                                                              | -----                 | -----                 |
| Three and six capital leases, respectively, payable to various equipment financing companies. Interest, at September 30, 2002, ranging between 11.37% and 14.05%. Payable in aggregate monthly installments of approximately |                       |                       |

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\$935, including accrued interest, as of September 30, 2002. Final maturities occur between September 2004 and December 2004. Collateralized the underlying leased manufacturing equipment.

|                         |           |           |
|-------------------------|-----------|-----------|
|                         | \$ 19,540 | \$ 74,402 |
| Less current maturities | (8,365)   | (31,260)  |
|                         | -----     | -----     |
| Long-term portion       | \$ 11,175 | \$ 43,142 |
|                         | =====     | =====     |

Future maturities of capital leases payable are as follows:

| Year ending<br>December 31 | Amount    |
|----------------------------|-----------|
| -----                      | -----     |
| 2002                       | \$ 8,365  |
| 2003                       | 9,507     |
| 2004                       | 1,668     |
|                            | -----     |
| Totals                     | \$ 19,540 |
|                            | =====     |

### Note I - Long-Term Debt Payable to a Bank

On June 28, 2001, in anticipation of the settlement of litigation with a financial institution, the Company executed a \$950,000 note payable to another financial institution. This note bears interest at the Wall Street Journal published prime rate plus 2.0%.

During July, August and September 30, 2002, the Company made three (3) lump-sum principal reductions of \$100,000 each (or an aggregate of \$300,000) to the outstanding balance on this note. As of September 30, 2002, the Company owes \$650,000 on this note. Upon each lump-sum payment, the Company executed a modification to the payment terms on the note.

At September 30, 2002, the note payment terms are as follows: payments of interest only beginning July 28, 2003 through January 28, 2004. Thereafter, starting on January 28, 2004, equal monthly payments of principal and interest shall be due until June 28, 2007 which payments shall represent the amount necessary to fully amortize the remaining principal balance of the note. The monthly payments shall be recalculated at the time of any change in the applicable interest rate. The note is secured by virtually all of the Company's real and personal property. A portion of the proceeds from the financing were used to pay the \$550,000 required in the Settlement and Compromise Agreement.

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### Notes to Consolidated Financial Statements - Continued

#### Note J - Preferred Stock Transactions

In September and October 2001, the Company issued 222,600 shares of \$5.00 Series A Convertible Preferred Stock (Series A Preferred Stock) for total proceeds of approximately \$1,113,000 through an ongoing private placement. The Series A Convertible Preferred Stock provides for cumulative dividends at a rate of 8.0% per year, payable quarterly, in cash or shares of the Company's common stock at the Company's election. Each share of Series A Preferred Stock is convertible into 11 shares of the Company's common stock at any time after 6 months of the date of issue and prior to the notice of redemption at the option of the holder, subject to adjustments for customary anti-dilution events.

In September 2001, the Company's principal shareholder converted approximately \$4,007,327 of unsecured debt and approximately \$3,546,273 of cumulative and unpaid accrued interest into 1,510,710 shares of Series A Preferred Stock.

In September 2001, a creditor of the Company agreed to convert approximately \$10,000 of trade accounts payable into 2,000 shares of Series A Preferred Stock.

In February 2002, certain holders of the Series A Preferred Stock notified the Company of their intent to exercise the conversion features on 1,749,320 issued and outstanding shares of Series A Preferred Stock into 19,242,520 shares of common stock. Due to the timing of the conversion in relation to the Company's year-end and the first available date for such conversion, the effect of the conversion exercise is reflected in the accompanying financial statements as if the conversion had occurred on December 31, 2001.

In conjunction with the issuance of certain shares of the Series A Preferred Stock, certain shares were issued with an equivalent per share value of common stock below the ending quoted market price of the Company's common stock on the issue date. This difference created a Beneficial Conversion Feature Discount of approximately \$1,207,993. This discount was then amortized over the unexpired time period between the date of issue of the eligible shares and the initial eligible conversion date. Approximately \$392,114 was amortized to operations and the unamortized balance was reclassified to additional paid-in capital on December 31, 2001 as a result of the February 2002 conversion exercise.

#### Note K - Common Stock Transactions

Concurrent with the September 29, 2001 reverse acquisition transaction, the Company amended its Articles of Incorporation to change the Company's name to American Ammunition, Inc. and modified the Company's capital structure to allow for the issuance of up to 320,000,000 total equity shares consisting of 20,000,000 shares of preferred stock and 300,000,000 shares of common stock. Both classes of stock have a par value of \$0.001 per share.

On October 9, 2001, the Company effected a three (3) for one (1) forward stock split. This action caused the then issued and outstanding shares to increase from 2,990,400 to 8,971,200 on the action date. The effect of this action is reflected in the accompanying financial statements as of the first day of the first period presented.

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American Ammunition, Inc. and Subsidiaries  
(formerly FBI Fresh Burgers International)

Notes to Consolidated Financial Statements - Continued

### Note K - Common Stock Transactions - Continued

In March and May 2001, the Company issued an aggregate 496,200 post-reverse split shares (165,400 pre-forward split shares) of common stock, pursuant to a Registration Statement on Form SB-2, to various individuals providing investment, financial and acquisition consulting services to the Company. These transactions were cumulatively valued at approximately \$165,400, which approximates the "fair value" of the services provided. These amounts are charged to operations in the accompanying pre-acquisition consolidated financial statements.

In September 2001, the Company issued 2,625,000 post-reverse split shares (875,000 pre-forward split shares) of common stock, pursuant to a Registration Statement on Form SB-2, to six individuals providing investment and financial consulting services to the Company. These transactions were cumulatively valued at approximately \$875,000, which approximates the "fair value" of the services provided. These amounts are charged to operations in the accompanying pre-acquisition consolidated financial statements.

In September 2001, the Company issued an aggregate 21,000,000 post-forward split shares of restricted, unregistered common stock to the shareholders of F&F Equipment, Inc. in exchange for 100.0% of the issued and outstanding stock of F&F Equipment, Inc. F&F Equipment, Inc. became a wholly-owned subsidiary of the Company as a result of this transaction.

In December 2001, the Company issued 222,222 shares of post-forward split shares of restricted, unregistered common stock to an unrelated entity in exchange for the cancellation of \$100,000 of short-term debt. On February 27, 2002, the Company issued an additional 277,777 shares of restricted, unregistered common stock in payment for \$100,000 in short-term debt payable and \$25,000 in agreed-upon interest payable to a shareholder, thereby satisfying all outstanding short-term debt in full.

In December 2001, the Company issued 535,272 shares of restricted, unregistered common stock to a creditor in settlement of approximately \$242,872 in open trade accounts payable.

In February 2002, the Company converted \$125,000 in short-term debt payable to an existing shareholder and accrued interest of approximately \$24,000 into 277,778 shares of restricted, unregistered common stock. This transaction was consummated at a price of \$0.45 per share, which approximates the discounted "fair value" of the Company's common stock based on the quoted closing price of the Company's common stock on the date of the respective transaction.

In March 2002, in two separate transactions, the Company sold an aggregate 1,388,890 shares of restricted, unregistered common stock to two separate investors for aggregate proceeds of approximately \$500,000. Each sale was made at a price of \$0.36 per share, which approximates the discounted "fair value" of the Company's common stock based on the quoted closing price of the Company's common stock on the date of each respective transaction.

In March 2002, the Company issued 32,000 shares of restricted, unregistered common stock to a member of the Company's Board of Directors for consulting services related to the Company's reverse merger transaction and for various marketing services. This transaction was valued at approximately \$11,520, or



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\$0.36 per share, which approximates the discounted "fair value" of the Company's common stock based on the quoted closing price of the Company's common stock on the date of the respective transaction.

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American Ammunition, Inc. and Subsidiaries  
(formerly FBI Fresh Burgers International)

### Notes to Consolidated Financial Statements - Continued

#### Note K - Common Stock Transactions - Continued

In March 2002, the Company issued 41,665 shares of restricted, unregistered common stock to an unrelated party for shareholder and other public relation services. This transaction was valued at approximately \$15,000, or \$0.36 per share, which approximates the discounted "fair value" of the Company's common stock based on the quoted closing price of the Company's common stock on the date of the respective transaction.

In April and May 2002, the Company issued an aggregate 432,721 shares of restricted, unregistered common stock to three creditors in settlement of approximately \$182,017 in open trade accounts payable. Each issuance was made at a price of either \$0.45 or \$0.36 per share, which approximates the discounted "fair value" of the Company's common stock based on the quoted closing price of the Company's common stock on the date of each respective transaction.

In June 2002, the Company issued 347,223 shares of restricted, unregistered common stock to an existing shareholder to reimburse said shareholder for the payment of legal fees associated with the bank related litigation concluded in June 2001 and related consulting services. This transaction was valued at approximately \$125,000, or \$0.36 per share, which approximates the discounted "fair value" of the Company's common stock based on the quoted closing price of the Company's common stock on the date of the respective transaction.

In June 2002, the Company sold 277,778 shares of restricted, unregistered common stock to an investor for aggregate proceeds of approximately \$100,000. This sale was made at a price of \$0.36 per share, which approximates the discounted "fair value" of the Company's common stock based on the quoted closing price of the Company's common stock on the date of the respective transaction.

In July 2002, the Company sold 384,615 shares of restricted, unregistered common stock to an existing shareholder for cash proceeds of approximately \$100,000. This sale was made at a price of \$0.26 per share, which approximates the discounted "fair value" of the Company's common stock based on the quoted closing price of the Company's common stock on the date of the respective transaction.

In August 2002, the Company sold 384,615 shares of restricted, unregistered common stock to an existing shareholder for cash proceeds of \$100,000. This sale was made at a price of \$0.26 per share, which was below the discounted "fair value" of the Company's common stock based on the quoted closing price of the Company's common stock on the date of the respective transaction. The differential between the discounted "fair value" (approximately \$0.29 per share) and the selling price resulted in a charge to operations of approximately

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\$11,346 for compensation expense related to common stock issuances at less than "fair value".

In August 2002, the Company sold 20,506 shares of restricted, unregistered common stock to an existing shareholder for cash proceeds of approximately \$6,152. This sale was made at a price of \$0.30 per share, which approximates the discounted "fair value" of the Company's common stock based on the quoted closing price of the Company's common stock on the date of the respective transaction.

In September 2002, the Company sold 277,778 shares of restricted, unregistered common stock to an existing shareholder for cash proceeds of approximately \$100,000. This sale was made at a price of \$0.36 per share, which approximates the discounted "fair value" of the Company's common stock based on the quoted closing price of the Company's common stock on the date of the respective transaction.

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American Ammunition, Inc. and Subsidiaries  
(formerly FBI Fresh Burgers International)

Notes to Consolidated Financial Statements - Continued

### Note K - Common Stock Transactions - Continued

In September 2002, the Company sold 277,778 shares of restricted, unregistered common stock to an existing shareholder for cash proceeds of approximately \$100,000. This sale was made at a price of \$0.26 per share, which approximates the discounted "fair value" of the Company's common stock based on the quoted closing price of the Company's common stock on the date of the respective transaction.

### Note L - Related Party Transactions

The Company leases its corporate office and manufacturing facility from its controlling stockholder under a long-term operating lease agreement. The lease requires a monthly payment of approximately \$5,410, inclusive of applicable sales taxes. Further, the Company is responsible for all utilities and maintenance expenses. The lease expires on October 31, 2003 and contains a clause that the lease may be renewed for an additional ten year period upon written notification to the lessor no later than 120 days prior to the scheduled expiration date at a rental rate based upon the fair value for similar space in a similar location.

### Note M - Income Taxes

The components of income tax (benefit) expense for the nine months ended September 30, 2002 and 2001, respectively, are as follows:

| Nine months<br>ended | Nine months<br>ended |
|----------------------|----------------------|
|----------------------|----------------------|

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|          | September 30,<br>2002 | September 30,<br>2001 |
|----------|-----------------------|-----------------------|
| -----    |                       |                       |
| Federal: |                       |                       |
| Current  | \$ -                  | \$ -                  |
| Deferred | -                     | -                     |
|          | -----                 | -----                 |
|          | -                     | -                     |
|          | -----                 | -----                 |
| State:   |                       |                       |
| Current  | -                     | -                     |
| Deferred | -                     | -                     |
|          | -----                 | -----                 |
|          | -                     | -                     |
|          | -----                 | -----                 |
| Total    | \$ -                  | \$ -                  |
|          | =====                 | =====                 |

As of September 30, 2002, the Company has a net operating loss carryforward of approximately \$3,500,000 to offset future taxable income. Subject to current regulations, components of this carryforward will begin to expire in 2003. The amount and availability of the net operating loss carryforwards may be subject to limitations set forth by the Internal Revenue Code. Factors such as the number of shares ultimately issued within a three year look-back period; whether there is a deemed more than 50 percent change in control; the applicable long-term tax exempt bond rate; continuity of historical business; and subsequent income of the Company all enter into the annual computation of allowable annual utilization of the carryforwards.

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American Ammunition, Inc. and Subsidiaries  
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Notes to Consolidated Financial Statements - Continued

Note M - Income Taxes - Continued

The Company's income tax expense (benefit) for the nine months ended September 30, 2002 and 2001, respectively, differed from the statutory federal rate of 34 percent as follows:

|                                                      | Nine months<br>ended<br>September 30,<br>2002 | Nine months<br>ended<br>September 30,<br>2001 |
|------------------------------------------------------|-----------------------------------------------|-----------------------------------------------|
| -----                                                |                                               |                                               |
| Statutory rate applied to income before income taxes | \$ (350,000)                                  | \$ (142,000)                                  |
| Increase (decrease) in income taxes resulting from:  |                                               |                                               |
| State income taxes                                   | -                                             | -                                             |

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|                                                 |                  |                  |
|-------------------------------------------------|------------------|------------------|
| Other, including reserve for deferred tax asset | 350,000<br>----- | 142,000<br>----- |
| Income tax expense                              | \$ -<br>=====    | \$ -<br>=====    |

Temporary differences, consisting primarily of statutory differences in the depreciable lives for property and equipment, between the financial statement carrying amounts and tax bases of assets and liabilities give rise to deferred tax assets and liabilities as of September 30, 2002 and 2001, respectively:

|                                      | September 30,<br>2002<br>----- | September 30,<br>2001<br>----- |
|--------------------------------------|--------------------------------|--------------------------------|
| Deferred tax assets - long-term      |                                |                                |
| Net operating loss carryforwards     | \$ 2,150,000                   | \$ 1,375,000                   |
| Deferred tax liabilities - long-term |                                |                                |
| Statutory depreciation differences   | (250,000)                      | (280,000)                      |
|                                      | -----                          | -----                          |
|                                      | 1,900,000                      | 1,095,000                      |
| Less valuation allowance             | (1,900,000)                    | (1,095,000)                    |
|                                      | -----                          | -----                          |
| Net Deferred Tax Asset               | \$ -<br>=====                  | \$ -<br>=====                  |

During the nine months ended September 30, 2002 and 2001, respectively, the valuation allowance increased (decreased) by approximately \$950,000 and \$145,000.

Note N - Significant Customers

During the years ended December 31, 2001 and 2000, respectively, the Company had a single customer responsible for approximately 51% and 32% of total sales. There were no other customers responsible for more than 10.0% of total net sales during 2001 and 2000, respectively. These trends were also in place at September 30, 2002 and 2001, respectively, and are anticipated to continue for the foreseeable future.

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### Note O - Subsequent Event

On October 4, 2002, the Company issued an 8.0% Convertible Debenture (Debenture) in the face amount of \$250,000 and a Warrant which requires the Holder to purchase shares of common stock equal to ten (10) times the number of shares of common stock issued to the Holder on conversion of the Debenture. In no event shall the number of shares issued under the Warrant exceed 30,000,000.

The Debenture bears interest at 8.0% and matures two years from the date of issuance. The Debenture is convertible into common stock, at the option of the Holder, at the lesser of \$1.00 per share or 80.0% of the average of the 5 lowest volume weighted average price days during the 20 trading days before, but not including the date of the Holder's election to convert. The Warrant is exercisable at the same price.

The full principal amount of the Debenture is due upon default, as defined in the Debenture agreement. The Debenture interest is payable monthly in arrears commencing on November 15, 2002.

The Company is obligated to file a Registration Statement under the Securities Act of 1933 to register the underlying conversion shares on either Form SB-2 or S-3 and have said Registration Statement effective no later than 120 days after October 4, 2002. Further, the Holder has agreed to convert not less than 5.0% and not more than 10.0% of the original face value of the Debenture monthly beginning the month after the effective date of the Registration Statement and the Holder is required to exercise warrants and purchase shares of common stock equal to ten (10) times the number of shares of common stock issued to the Holder on conversion of the Debenture.

The Holder has further contractually agreed to restrict its ability to convert the Debenture or exercise their warrants and receive shares of the Company's common stock such that the number of shares held by the Holder and its affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of common stock of the Company.

In the event an election to convert is made and the volume weighted average price of the Company's common stock is below \$0.30 per share, the Company shall have the right to prepay any portion of the outstanding Debenture that was elected to be converted, plus any accrued and unpaid interest, at 125.0%.

The Holder may demand repayment of the Debenture of 125.0% of the face amount outstanding, plus all accrued and unpaid interest, in cash at any time prior to the date that underlying Registration Statement under the Securities Act of 1933 has not been declared effective by the U. S. Securities and Exchange Commission within 3 business days of such demand. If the repayment is accelerated, the Company is also obligated to issue to the Holder 25,000 shares of common stock and \$10,000 cash for each 30 day period, or portion thereof, during which the face amount, including interest thereon, remains unpaid with the cash payment to increase to \$15,000 for each 30 day period the balance remains unpaid after the initial 90 day period.

If the Holder does not elect to accelerate the Debenture, the Company shall immediately issue and pay to the Holder 25,000 shares of common stock and \$10,000 cash for each 30 day period, or portion thereof, during which the face amount, including interest thereon, remains unpaid with the cash payment to increase to \$15,000 for each 30 day period the balance remains unpaid after the initial 90 day period.

Concurrent with the execution of the Debenture agreement, the Company executed an engagement letter with the Holder's counsel for legal representation with regard to the preparation of the aforementioned Registration Statement under the Securities Act of 1933.

## Part I - Item 2

## MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

## (1) Caution Regarding Forward-Looking Information

Certain statements contained in this quarterly filing, including, without limitation, statements containing the words "believes", "anticipates", "expects" and words of similar import, constitute forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements.

Such factors include, among others, the following: international, national and local general economic and market conditions; demographic changes; the ability of the Company to sustain, manage or forecast its growth; the ability of the Company to successfully make and integrate acquisitions; raw material costs and availability; new product development and introduction; existing government regulations and changes in, or the failure to comply with, government regulations; adverse publicity; competition; the loss of significant customers or suppliers; fluctuations and difficulty in forecasting operating results; changes in business strategy or development plans; business disruptions; the ability to attract and retain qualified personnel; the ability to protect technology; and other factors referenced in this and previous filings.

Given these uncertainties, readers of this Form 10-QSB and investors are cautioned not to place undue reliance on such forward-looking statements. The Company disclaims any obligation to update any such factors or to publicly announce the result of any revisions to any of the forward-looking statements contained herein to reflect future events or developments.

## (2) Summary

American Ammunition, Inc. (AAI or Company) was incorporated on February 1, 2000 in the State of California as FirstTelevision.com. AAI subsequently changed its corporate name to FBI Fresh Burgers International with a business plan of marketing the concept of a national "fast food" restaurant chain to children and young adults, with a menu of fresh burgers, fries and sandwiches. However, there was no assurance that this business concept would be successful.

On September 29, 2001, the Company, F&F Equipment, Inc. (F&F) and the individual shareholders of F&F entered into an "Agreement For The Exchange Of Common Stock" (Exchange Agreement) whereby the shareholders of F&F exchanged 100.0% of the issued and outstanding stock of F&F for 21,000,000 post-forward split shares of restricted, unregistered common stock of the Company. F&F Equipment, Inc. then became a wholly-owned subsidiary of the Company.

The acquisition of F&F Equipment, Inc., on September 29, 2001, by the Company effected a change in control and was accounted for as a "reverse acquisition" whereby F&F Equipment, Inc. is the accounting acquiror for financial statement purposes. Accordingly, for all periods subsequent to the September 29, 2001 change in control transaction, the financial statements of the Company reflect the historical financial statements of F&F Equipment, Inc. from its inception on

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October 4, 1983 and the operations of the Company subsequent to September 29, 2001.

Concurrent with the September 29, 2001 reverse acquisition transaction, the Company amended its Articles of Incorporation to change the Company's name to American Ammunition, Inc. and modified the Company's capital structure to allow for the issuance of up to 320,000,000 total equity shares consisting of 20,000,000 shares of preferred stock and 300,000,000 shares of common stock. Both classes of stock have a par value of \$0.001 per share.

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On October 9, 2001, the Company effected a three (3) for one (1) forward stock split. This action caused the then issued and outstanding shares to increase from 2,990,400 to 8,971,200 on the action date. The effect of this action is reflected in the accompanying financial statements as of the first day of the first period presented.

F&F Equipment, Inc.(Company) was incorporated on October 4, 1983 under the laws of the State of Florida. The Company was formed to engage principally in the "import, export, retail & wholesale of firearms equipment, ammunition & other devices and for the purpose of transacting any and/or all lawful business." The Company conducts its business operations under the assumed name of "American Ammunition".

In June 2002, American Ammunition, Inc. formed a wholly owned subsidiary, Industrial Plating Enterprise Co. (IPE), which has started production on June 14, 2002. IPE is a fully licensed and approved state of the art electrochemical metallization facility with enormous capacity for processing the Company's line of projectiles as well as other products and services while employing environmentally sound water conservation and proven waste treatment techniques. The facility meets or exceeds all current environmental requirements and enjoys the "conditionally exempt small quantity generator" status for State and Federal regulations.

The Company and its subsidiary have a year-end of December 31 and uses the accrual method of accounting.

### (3) Results of Operations

Nine months ended September 30, 2002 compared to Nine months ended September 30, 2001

During the first quarter of 2001, the Company filed a lawsuit against its financial institution extending the Company various working capital credit. As a result of this litigation, the Company became unable to access credit lines for working capital, offer selling terms comparable to its competitors and, accordingly, experienced a significant reduction in sales from prior years. This litigation was settled during June 2001 and the Company negotiated a new working capital note with a different financial institution which provided liquidity for the remainder of 2001.

During the nine months ended September 30, 2002, the Company experienced aggregate revenues of approximately \$1,277,000 as compared to approximately \$351,000 for the first nine months ended September 30, 2001. For the three month period ended September 30, 2002 and 2001, respectively, the Company realized revenues of approximately \$570,000 and \$14,000.

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The Company continues to experience positive demand for the Company's products.

During the quarter ended March 31, 2002, management elected to focus its efforts, capital resources and energies in streamlining production methods, securing key sources of raw material and exploring the addition of equipment to allow the Company to produce certain components of its manufacturing process which are currently being outsourced to unrelated third parties.

During June 2002, the Company initiated production of plating operations for projectiles utilized in the Company's small-arms ammunition manufacturing process through its newly formed wholly-owned subsidiary, Industrial Plating Enterprise Co. Further, during the three months ended June 30, 2002, management began to actively seek and process orders for products, resulting in an increase in sales of approximately \$374,000, or 112.3% over the same period of the preceding year.

During the quarter ended September 30, 2002, the Company expanded its production capability with the addition of a second production shift. Due to the necessary lead times for hiring and training qualified personnel, the Company experienced increases in direct labor of approximately \$43,000, plus related payroll burdens in the third quarter of 2002.

Management continues to anticipate events occurring in future quarters including increased levels of expenditures for marketing, increased product demand as a result of increased market exposure and the introduction of new products under development.

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The Company experienced costs of goods sold of approximately \$1,719,000 and \$730,000 for the nine months ended September 30, 2002 and 2001, respectively. The Company experiences variable costs in the area of material consumption and direct labor. The Company has recognized depreciation expense on production equipment of approximately \$484,000 and \$455,000, respectively, in the above cost of goods expense totals. These depreciation levels are anticipated to remain fairly constant for future periods as management anticipates that the acquisition of equipment for IPE will allow the Company to produce certain components which were previously outsourced to unrelated third parties.

For the nine months ended September 30, 2002 and 2001, respectively, has generated a negative gross profit of approximately \$(442,000), or (34.64%), and approximately \$(379,000), or (108.0%). For the comparable three month period ended September 30, 2002 and 2001, respectively, the Company's gross margin was approximately \$(223,000), or (39.2%), and \$(168,000), or (1,165.8%). The Company anticipates that with continued demand for its product, anticipated lower production costs from internally generated plating activities and adequate liquidity, it will be able to generate a positive gross profit by the end of Calendar 2002. Further, management has developed a new model for the pricing of its products to its customers. It is anticipated that this model will allow management to better manage expense levels, control labor costs and maximize revenue opportunities.

The Company experiences relatively consistent expenditure levels for executive and administrative compensation, interest expense and depreciation expense. The Company renegotiated its working capital note payable in June 2001. This note bears interest at the Wall Street Journal published prime rate plus 2.0%.



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In the months of July, August and September 2002, the Company reduced the outstanding principal and prepaid the interest on the debt through July 28, 2003. The note payment terms were also modified as follows: payments of interest only beginning July 28, 2003 through January 28, 2004. Thereafter, starting on January 28, 2004, equal monthly payments of principal and interest shall be due until June 28, 2007 which payments shall represent the amount necessary to fully amortize the remaining principal balance of the note. The monthly payments shall be recalculated at the time of any change in the applicable interest rate. As of September 30, 2002, the Company owes \$650,000 on this note.

The note is secured by virtually all of the Company's real and personal property. A portion of the proceeds from the financing were used to pay the \$550,000 required in the Settlement and Compromise Agreement. Accordingly, the Company anticipates relatively stable interest expense, or declining levels, in future periods depending on expansion and additional equipment financing requirements. The Company does not anticipate the addition of significant additions to office and administrative personnel.

The Company experienced nominal research and development expenses during the nine months ended September 30, 2002 and 2001 related to the development of a new patent-pending projectile for use in ammunition specifically for the public safety and security marketplace, especially in the rapidly expanding U. S. Air Marshall program and other product improvements.

Due to the lack of liquidity in 2001 and prior years, the Company has not developed an extensive marketing effort. Accordingly, expenditures in this area have been nominal. Due to improved liquidity during the last 1/2 of 2001 and for future periods, the Company anticipates, as internally generated funds are available, to increase its marketing efforts to boost sales.

Other general and administrative expenses decreased significantly from approximately \$505,000 for the first nine months of 2001 to approximately \$488,000 for the first nine months of 2002. The most significant reductions came in interest expense as a result of settling all litigation with the Company's former lending institution and lesser savings in the areas of legal and professional fees and other general and administrative fees.

The Company recognized a net loss of approximately \$(1,026,000) and \$(419,000) for the respective nine month periods ended September 30, 2002 and 2001, respectively, or \$(0.02) and \$(0.01) per share.

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#### (4) Liquidity and Capital Resources

As of September 30, 2002, December 31, 2001, and September 30, 2001, respectively, the Company had working capital of approximately \$623,000, \$341,000, and \$(104,000). The Company's working capital position improved significantly in Calendar 2001 with the settlement of litigation involving its outstanding debt to its-then financial institution and the concurrent restructuring of working capital debt into a long-term instrument.

The Company has generated (used) cash in operating activities of approximately \$(832,000), \$(1,100,000) and \$(93,000) during the nine months ended September 30, 2002, the year ended December 31, 2001 and the nine months ended September

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30, 2001. The most significant use of cash during the nine months ended September 30, 2002 was the buildup of inventory and the cost of sales related to the sale of merchandise on "industry standard" credit terms causing an increase in accounts receivable and an increase in inventory, particularly raw materials and work in process, to fulfill existing and anticipated product orders.

The Company anticipates that its improved liquidity position will continue to improve as management is of the opinion that the production capacity is in place to support all existing orders and accept existing inquiries which have previously been denied due to the lack of production capacity and liquidity.

During the nine months ended September 30, 2002, the Company added approximately \$225,000 in new equipment, principally in its new wholly-owned subsidiary, Industrial Plating Enterprise Co. This equipment allows the Company to replace previously outsourced portions of its manufacturing process with internally managed processes which is anticipated to result in additional cost savings to the Company and improved turnaround time on this process.

The Company continues to have plans to increase its production capability in the foreseeable future by 50% to 100%, as influenced by market conditions, availability of manufacturing equipment on the open market and product sales demand. Accordingly, this expansion will require additional capital which is anticipated to be raised in various combinations of capital leases, bank debt and/or equity offerings. At this time, the Company has no definitive budgets or timetables for such expansion and this expansion, if any, will be dependent upon market demand for the Company's products. Management is of the opinion that sufficient demand will be present, as supported by new product development and increased product marketing efforts, to justify this expansion. However, there can be no assurance that the Company will be able to obtain additional funding or, that such funding, if available, will be obtained on terms favorable to or affordable by the Company.

### (5) Product Research and Development

The Company believes that research and development activities will allow for the development and introduction of new products into the ammunition marketplace. Over the next 12 calendar months, the Company anticipates completing the design, development and introduction of its new patent-pending projectile for use in ammunition specifically for the public safety and security marketplace, especially in the rapidly expanding U. S. Air Marshall program. Management also believes that this projectile will have wide acceptance in the home security and sport hunting markets.

Further, additional ammunition calibers and/or projectiles may be developed by the Company depending upon market research, acceptance in the marketplace of existing products and production capabilities. At this time, there are no definitive plans for the further introduction of other new products into the marketplace.

## Part II - Other Information

### Item 1 - Legal Proceedings

None

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### Item 2 - Changes in Securities

On July 25, 2002, the Company sold 384,615 shares of restricted, unregistered common stock to Gala Enterprises, Ltd., an existing shareholder, for cash proceeds of approximately \$100,000. This sale was made at a price of \$0.26 per share, which approximates the discounted "fair value" of the Company's common stock based on the quoted closing price of the Company's common stock on the date of the respective transaction. The proceeds were used to reduce the Company's outstanding balance on a long-term note payable to a bank.

On August 14, 2002, the Company sold 384,615 shares of restricted, unregistered common stock to Gala Enterprises, Ltd., an existing shareholder, for cash proceeds of \$100,000. This sale was made at a price of \$0.26 per share, which was below the discounted "fair value" of the Company's common stock based on the quoted closing price of the Company's common stock on the date of the respective transaction. The differential between the discounted "fair value" (approximately \$0.29 per share) and the selling price resulted in a charge to operations of approximately \$11,346 for compensation expense related to common stock issuances at less than "fair value". The proceeds were used to reduce the Company's outstanding balance on a long-term note payable to a bank.

On August 21, 2002, the Company sold 20,506 shares of restricted, unregistered common stock to an existing shareholder for cash proceeds of approximately \$6,152. This sale was made at a price of \$0.30 per share, which approximates the discounted "fair value" of the Company's common stock based on the quoted closing price of the Company's common stock on the date of the respective transaction. The proceeds were used to retire trade accounts payable to a New Mexico law firm for legal services rendered to the Company.

On September 20, 2002, the Company sold 277,778 shares of restricted, unregistered common stock to Access Investments, Inc., an existing shareholder, for cash proceeds of approximately \$100,000. This sale was made at a price of \$0.36 per share, which approximates the discounted "fair value" of the Company's common stock based on the quoted closing price of the Company's common stock on the date of the respective transaction. The proceeds were used to reduce the Company's outstanding balance on a long-term note payable to a bank.

On September 26, 2002, the Company sold 277,778 shares of restricted, unregistered common stock to Access Investments, Inc., an existing shareholder, for cash proceeds of approximately \$100,000. This sale was made at a price of \$0.26 per share, which approximates the discounted "fair value" of the Company's common stock based on the quoted closing price of the Company's common stock on the date of the respective transaction. The proceeds were used to provide working capital liquidity for future periods.

### Item 3 - Defaults on Senior Securities

None

### Item 4 - Submission of Matters to a Vote of Security Holders

None

### Item 5 - Other Information

On October 4, 2002, the Company issued an 8.0% Convertible Debenture (Debenture) in the face amount of \$250,000 to La Jolla Cove Investors, Inc. (Holder) and a Warrant which allows the Holder to purchase shares of common stock equal to ten (10) times the number of shares of common stock issued to the Holder on conversion of the Debenture. In no event shall the number of shares issued under the Warrant exceed 30,000,000.

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The Debenture bears interest at 8.0% and matures two years from the date of issuance. The Debenture is convertible into common stock, at the option of the Holder, at the lesser of \$1.00 per share or 80.0% of the average of the 5 lowest volume weighted average price days during the 20 trading days before, but not including the date of the Holder's election to convert. The Warrant is exercisable at the same price.

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The full principal amount of the Debenture is due upon default, as defined in the Debenture agreement. The Debenture interest is payable monthly in arrears commencing on November 15, 2002.

The Company is obligated to file a Registration Statement under the Securities Act of 1933 to register the underlying conversion shares on either Form SB-2 or S-3 and have said Registration Statement effective no later than 120 days after October 4, 2002. Further, the Holder has agreed to convert not less than 5.0% and not more than 10.0% of the original face value of the Debenture monthly beginning the month after the effective date of the Registration Statement and the Holder is required to exercise warrants and purchase shares of common stock equal to ten (10) times the number of shares of common stock issued to the Holder on conversion of the Debenture.

The Holder has further contractually agreed to restrict its ability to convert the Debenture or exercise their warrants and receive shares of the Company's common stock such that the number of shares held by the Holder and its affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of common stock of the Company.

In the event an election to convert is made and the volume weighted average price of the Company's common stock is below \$0.30 per share, the Company shall have the right to prepay any portion of the outstanding Debenture that was elected to be converted, plus any accrued and unpaid interest, at 125.0%.

The Holder may demand repayment of the Debenture of 125.0% of the face amount outstanding, plus all accrued and unpaid interest, in cash at any time prior to the date that underlying Registration Statement under the Securities Act of 1933 has not been declared effective by the U. S. Securities and Exchange Commission within 3 business days of such demand. If the repayment is accelerated, the Company is also obligated to issue to the Holder 25,000 shares of common stock and \$10,000 cash for each 30 day period, or portion thereof, during which the face amount, including interest thereon, remains unpaid with the cash payment to increase to \$15,000 for each 30 day period the balance remains unpaid after the initial 90 day period.

If the Holder does not elect to accelerate the Debenture, the Company shall immediately issue and pay to the Holder 25,000 shares of common stock and \$10,000 cash for each 30 day period, or portion thereof, during which the face amount, including interest thereon, remains unpaid with the cash payment to increase to \$15,000 for each 30 day period the balance remains unpaid after the initial 90 day period.

Concurrent with the execution of the Debenture agreement, the Company executed an engagement letter with the Holder's counsel for legal representation with regard to the preparation of the aforementioned Registration Statement under the Securities Act of 1933.

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Item 6 - Exhibits and Reports on Form 8-K

Exhibits - None  
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.

American Ammunition, Inc.

Dated: October 18, 2002  
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/s/ Andres Fernandez  
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Andres Fernandez  
President and Director

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CERTIFICATIONS

I, Andres Fernandez, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of American Ammunition, Inc.

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report; and

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.

/s/ Andres Fernandez  
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Dated: October 18, 2002  
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Andres Fernandez  
Chief Executive Officer (or the equivalent thereof)

I, Andres Fernandez, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of American Ammunition, Inc.

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make

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the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report; and

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.

/s/ Andres Fernandez  
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Dated: October 18, 2002  
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Andres Fernandez  
Chief Financial Officer (or equivalent thereof)