ILLINOIS SUPERCONDUCTOR CORPORATION
Form 10-Q
November 14, 2002

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**SECURITIES AND EXCHANGE COMMISSION**
**WASHINGTON, D.C. 20549**

**Form 10-Q**

(Mark One)

QUARTERLY REPORT PURSUANT TO 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 000-22302**

**ISCO INTERNATIONAL, INC.**
(Name of Registrant as Specified in Its Charter)

| | |
|---|---|
| **Delaware** | **36-3688459** |
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification No.) |
| **451 Kingston Court Mt. Prospect, Illinois** | **60056** |
| (Address of Principal Executive Offices) | (Zip Code) |

Registrant s Telephone Number, Including Area Code **(847) 391-9400**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

| Class | Outstanding at October 1, 2002 |
|---|---|
| Common Stock, par value $0.001 per share<br>Preferred Stock Purchase Rights | 147,944,927 |

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## PART I. FINANCIAL INFORMATION

**Item 1. Financial Statements.**

### ISCO INTERNATIONAL, INC.
### CONDENSED CONSOLIDATED BALANCE SHEETS

| | September 30, 2002 | December 31, 2001 |
|---|---|---|
| | (unaudited) | |
| **Assets:** | | |
| Current Assets: | | |
| Cash and cash equivalents | $ 787,995 | $ 1,720,697 |
| Inventories | 1,149,424 | 1,682,669 |
| Accounts receivable, net | 370,431 | 234,850 |
| Prepaid expenses, settlement receivable, and other | 27,413 | 456,818 |
| Total current assets | 2,335,263 | 4,095,034 |
| Property and equipment: | | |
| Property and equipment | 8,964,483 | 9,286,725 |
| Less: accumulated depreciation | (7,345,776) | (6,991,050) |
| Net property and equipment | 1,618,707 | 2,295,675 |
| Restricted certificates of deposit | 272,844 | 263,094 |
| Intangible assets, net | 14,381,446 | 14,273,292 |
| Other assets, net | | |
| Total assets | $ 18,608,260 | $ 20,927,095 |
| **Liabilities and Stockholders Equity:** | | |
| Current liabilities: | | |
| Accounts payable | $ 134,397 | $ 537,636 |
| Accrued liabilities | 1,215,867 | 2,781,146 |
| Current debt | | 208,094 |
| Total current liabilities | 1,350,264 | 3,526,876 |
| Other long-term debt, less current portion | | 9,425,000 |
| Stockholders equity: | | |
| Preferred stock; 300,000 shares authorized; No shares issued and outstanding at September 30, 2002 and December 31, 2001, respectively | | |
| Common stock ($.001 par value); 250,000,000 shares authorized; 147,944,927 and 107,905,231 shares issued and outstanding at September 30, 2002 and December 31, 2001, respectively | 147,945 | 107,905 |
| Additional paid-in capital (net of unearned compensation) | 157,761,668 | 137,729,512 |
| Accumulated deficit | (140,651,617) | (129,862,198) |

| | | |
|---|---|---|
| Total stockholders equity | 17,257,996 | 7,975,219 |
| Total liabilities and stockholders equity | $ 18,608,260 | $ 20,927,095 |

NOTE: The condensed consolidated balance sheet as of December 31, 2001 has been derived from the audited financial statements for that date, but does not include all of the information and accompanying notes required by accounting principles generally accepted in the United States of America for complete financial statements.

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

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**ISCO INTERNATIONAL, INC.**
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**(UNAUDITED)**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2002** | **2001** | **2002** | **2001** |
| Net sales | $ 429,645 | $ 90,304 | $ 2,127,005 | $ 1,976,427 |
| Costs and expenses: | | | | |
| Cost of sales | 541,304 | 484,735 | 2,668,189 | 2,926,465 |
| Research and development | 659,287 | 1,938,585 | 2,357,633 | 5,624,482 |
| Selling and marketing | 387,522 | 887,388 | 1,723,013 | 2,680,652 |
| General and administrative | 1,653,416 | 2,060,414 | 6,058,902 | 5,369,630 |
| Goodwill amortization | | 509,499 | | 1,528,497 |
| Total costs and expenses | 3,241,529 | 5,880,621 | 12,807,737 | 18,129,726 |
| Operating loss | (2,811,884) | (5,790,317) | (10,680,732) | (16,153,299) |
| Other income (expense): | | | | |
| Interest income | 6,241 | 31,958 | 59,915 | 129,158 |
| Other interest expense | | | (168,602) | (29,682) |
| Other income (expense), net | | (4,931,083) | | (4,911,602) |
| | 6,241 | (4,899,125) | (108,687) | (4,812,126) |
| Net loss | $ (2,805,643) | $ (10,689,442) | $ (10,789,419) | $ (20,965,425) |
| Basic and diluted loss per share | $ (0.02) | $ (0.10) | $ (0.08) | $ (0.19) |
| Weighted average number of common shares outstanding | 147,944,927 | 107,879,175 | 141,764,798 | 107,803,169 |

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

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**ISCO INTERNATIONAL, INC.**
**CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY**
**Nine Months ended September 30, 2002**

**(UNAUDITED)**

| | Common Stock | | | | | |
|---|---|---|---|---|---|---|
| | Number of Shares | Amount | Additional Paid-In Capital | Accumulated Deficit | Unearned Compen-sation | Total |
| Balance at December 31, 2001 | 107,905,231 | $ 107,905 | $ 138,612,160 | $ (129,862,198) | $ (882,648) | $ 7,975,219 |
| Exercise of stock options/DSU s; $0-0.18 per share | 109,725 | 110 | 201 | | | 311 |
| Shareholder Rights Offering, net | 39,929,971 | 39,930 | 19,725,055 | | | 19,764,985 |
| Compensation Expense for non-employee stock options/other stock compensation | | | 19,800 | | 287,100 | 306,900 |
| Net Loss | | | | (10,789,419) | | (10,789,419) |
| Balance at September 30, 2002 | 147,944,927 | $ 147,945 | $ 158,357,216 | $ (140,651,617) | $ (595,548) | $ 17,257,996 |

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

**ISCO INTERNATIONAL, INC.**
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(UNAUDITED)**

| | Nine Months Ended September 30, | |
|---|---|---|
| | **2002** | **2001** |
| **Operating Activities:** | | |
| Net loss | $ (10,789,419) | $ (20,965,425) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization, excluding goodwill | 698,582 | 743,562 |
| Goodwill amortization | | 1,528,497 |
| Non-cash compensation expense | 306,900 | 570,771 |
| Changes in operating assets and liabilities | (1,177,543) | 4,697,463 |
| Net cash used in operating activities | (10,961,480) | (13,425,132) |
| **Investing Activities:** | | |
| (Increase) in restricted certificates of deposit | (9,750) | (68,666) |
| Payment of patent costs | (177,061) | (285,040) |
| Acquisition of property and equipment | (124,707) | (465,032) |
| Net cash (used in) investing activities | (311,518) | (818,738) |
| **Financing Activities:** | | |
| Proceeds from Shareholder Rights Offering | 19,764,985 | |
| Proceeds from settlement, net | | 13,750,000 |
| Exercise of stock options | 311 | 80,853 |
| Payments on other long-term debt | (9,425,000) | (5,827) |
| Net cash provided by financing activities | 10,340,296 | 13,825,026 |
| Decrease in cash and cash equivalents | 932,702 | 418,844 |
| Cash and cash equivalents at beginning of period | 1,720,697 | 2,453,845 |
| Cash and cash equivalents at end of period | $ 787,995 | $ 2,035,001 |

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

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**ISCO INTERNATIONAL, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Note 1 Basis of Presentation**

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

The accompanying interim unaudited condensed consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America ( US GAAP ) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by US GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of results for the interim periods have been included. These interim financial statements and notes included herein should be read in conjunction with the Company s audited financial statements and notes therein for the year ended December 31, 2001 included in the Company s Annual Report on Form 10-K filed with the Securities and Exchange Commission (the SEC ). The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for any subsequent quarter or for the entire year ending December 31, 2002.

**Recent Accounting Pronouncements**

On July 20, 2001, The FASB issued Statement of Financial Accounting Standards No. 141 ( SFAS No. 141 ), Business Combinations , and Statement of Financial Accounting Standards No. 142 ( SFAS No. 142 ), Goodwill and Intangible Assets. SFAS No. 141 is effective for all business combinations completed after June 30, 2001. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001; however , certain provisions of such Statement apply to goodwill and other intangible assets acquired between July 1, 2001, and the effective date of SFAS No. 142. Major provisions of these Statements and their effective dates for the Company are as follow:

1) All business combinations initiated after June 30, 2001 must use the purchase method of accounting. The pooling of interest method of accounting is prohibited except for transactions initiated before July 1, 2001.

2) Intangible assets acquired in a business combination must be recorded separately from goodwill if they arise from contractual or other legal rights or are separable from the acquired entity and can be sold, transferred, licensed, rented, or exchanged, either individually or as a part of a related contract, assets, or liability.

3) Goodwill, as well as intangible assets with indefinite lives, acquired after June 30, 2001, will not be amortized. Effective January 1, 2002, all previously recognized goodwill and intangible assets with indefinite lives will no longer be subject to amortization.

4) Effective January 1, 2002, goodwill and intangible assets with indefinite lives will be tested for impairment annually and whenever there is an impairment indicator.

5) All acquired goodwill must be assigned to reporting units for purposes of impairment testing and segment reporting.

As of the reporting date, the Company had recorded unamortized goodwill assets resulting from the acquisitions of Spectral Solutions, Inc. and the Adaptive Notch Filter division of Lockheed Martin Canada, Inc.

during 2000. The Company has concluded that no impairment exists as of the reporting date. As mentioned elsewhere in this document, litigation is ongoing with respect to intellectual property rights between the Company and two primary competitors. These intellectual property rights were acquired as part of the Spectral Solutions, Inc. acquisition. While the Company believes its position in the matter to be both correct and strong, an adverse ruling in this litigation may cause the Company to reassess the carrying value of a material portion of the Company s recorded goodwill asset.

During 2001, the FASB issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, to address significant implementation issues related to SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of, and to develop a single accounting model to account for long-lived assets to be disposed of. SFAS No. 144 carries over the recognition and measurement provisions of SFAS No. 121. Accordingly, an entity should recognize an impairment loss if the carrying amount of a long-lived asset or asset group (a) is not recoverable, and (b) exceeds its fair value. Similar to SFAS No. 121, SFAS No. 144 requires an entity to test an asset or asset group for impairment whenever events or circumstances indicate that its carrying amount may not be recoverable. SFAS No. 144 provides guidance on estimating future cash flows to test recoverability. SFAS No. 144 includes criteria that have to be met for an entity to classify a long-lived asset or asset group as held for sale. However, if the criteria to classify an asset as held for sale are met after the balance sheet date but before the issuance of the financial statements, the asset group would continue to be classified as held and used in those financial statements when issued, which is a change from current practice. The measurement of a long-lived asset or asset group classified as held for sale is at the lower of its carrying amount of fair value less cost to sell. Expected future losses associated the operations of a long-lived asset or asset group classified as held for sale are excluded from that measurement.

SFAS No. 144 is effective for financial statements issued for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years. However, the provisions of SFAS No. 144 related to assets to be disposed of are effective for disposal activities initiated by an entity s commitment to a plan after the effective date or after the Statement is initially applied.

**Note 2 Net Loss Per Share**

The Company follows SFAS No. 128, Earnings Per Share, which requires a dual presentation of basic and diluted earnings per share on the face of the statements of operations. Basic and diluted net loss per share is computed based on the weighted average number of common shares outstanding. Common shares issuable upon the exercise of options and warrants are not included in the per share calculations since the effect of their inclusion would be antidilutive. Excluded from this calculation, as indicated, were approximately 6.7 million outstanding options (both vested and unvested).

**Note 3 Inventories**

Inventories consisted of the following:

| | September 30, 2002 | December 31, 2001 |
|---|---|---|
| Raw Materials | $ 680,000 | $ 768,000 |
| Work in process | 335,000 | 659,000 |
| Finished product | 134,000 | 256,000 |
| | $ 1,149,000 | $ 1,683,000 |

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**Note 4 Stock Options and Equity Transactions**

On July 1, 2000, Financial Accounting Standards Board Interpretation No. 44, Accounting for Certain Transactions involving Stock Compensation, an interpretation of APB Opinion No. 25 ( FIN 44 ) was adopted by the Company. FIN 44 requires that stock options that have been modified to reduce the exercise price be subject to variable accounting. The Company accounts for employee stock options under APB Opinion No. 25 and non-employee stock options under Statement of Financial Accounting Standards No. 123, Accounting for Stock Based Compensation ( SFAS No. 123 ).

On May 10, 1999, the Company re-priced certain stock options granted to employees and in accordance with US GAAP, at that time, the Company accounted for the re-priced stock options as fixed . As a result of adopting FIN 44, the Company is required to apply variable accounting to these options. If the market price of the Company s common stock increases above the July 1, 2000 market price, the Company will have to recognize additional compensation expense equal to the increase in stock price multiplied by the number of re-priced options. No additional expense will be recognized if the stock does not exceed the July 1, 2000 value. However, the impact cannot be determined as it is dependent on the change in the market price of the common stock from July 1, 2000 until the stock options are exercised, forfeited, or expire unexercised. Because the stock price on September 30, 2002 was below that of July 1, 2000, no expense has been recognized during the period.

On February 5, 2001, the Company s board of directors authorized the re-pricing of certain out of the money stock options granted to employees during the calendar year of 2000 to the closing share price on such date, or $1.9375 per share. Options for a total of 2,676,000 shares of common stock were affected. This re-pricing causes these options to be subject to variable accounting as described in FIN 44. Because the stock price on September 30, 2002, was lower than the re-priced strike price no gain or loss was recognized during the period.

On April 1, 2002, the Company s board of directors authorized the re-pricing of certain out of the money stock options granted to employees. A new strike price of $0.81 per share was established, provided the respective employees remain with the Company for at least six months following the re-pricing date. In addition, certain stock options granted to directors were repriced, with a new strike price of $1.00 per share. As the stock price on September 30, 2002, was lower than the re-priced strike price no gain or loss was recognized during the period.

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

On February 15, 2000, the Company s board of directors granted to certain executive level employees an aggregate of 440,000 deferred stock units ( DSUs ) under the Company s 1993 Amended and Restated Stock Option Plan (the Plan ). The DSU s represent the right to receive an equivalent number of restricted shares of the Company s common stock. On the date of the grant, the DSU s were set to vest at the rate of 10% on the first anniversary of the date of the grant, with the balance vesting at a rate of 20%, 30%, and 40% at the second, third, and fourth anniversary dates, respectively. The executive level employees had the right to elect to defer receipt of the common stock subject to the DSU s to a later date. In the third quarter of 2000, the Company began to recognize compensation expense for the DSU s over the vesting period (4 years) based on their intrinsic value of $1,925,000, which was the number of

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DSU s multiplied by the closing price of the Company s common stock on July 18, 2000, the measurement date ($4.38 per share).

During the first nine months of 2002, the Company s Board of Directors granted 785,000 new stock options to the Company s employees, including officers (option prices are generally set at the closing price of the Company s common stock as of the date of each respective grant).

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

**Note 5 Debt and Financial Position**

As of the reporting date, the Company had no outstanding long-term debt or short-term debt. As noted in the management discussion, the Company previously announced its intention to try to augment its capital position through existing funding mechanisms identified and through other sources of capital to support its operations and expected increases in levels of inventory and receivables. During October 2002, the Company entered into an Uncommitted Line of Credit with its two largest shareholders, an affiliate of Elliott Associates, L.P. (Manchester Securities, L.P.) and Alexander Finance, L.P. This line is intended to provide up to $4 million to the Company, with $1 million of the total borrowed during October, 2002, upon completion of the transaction. This line is uncommitted, such that each new borrowing under the facility would be subject to the approval of the lenders. Borrowings on this line bear an interest rate of 9.5% and are secured by all the assets of the Company. Additionally, warrants are issued to the lenders to the extent funds are drawn down on the line. The warrants bear a strike price of $0.20 per share of common stock and expire on April 15, 2004. A maximum of 20 million warrants may be issued as a result of this transaction, presuming certain antidilutive features are not triggered. A copy of that note is attached as an exhibit to this document.

Subject to the uncommitted nature of this credit line, the Company believes it has sufficient capital resources available to meet its obligations and support its operations forecast into the second quarter of 2003. There can be no assurance that other funding mechanisms, whether identified or not, will allow the Company to access additional funds beyond that date.

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**Note 6 Subsequent or Other Events**

During September 2002, the Company announced that Mr. Roger Boivin, President and Chief Operating Officer of the Company since October 2001, was no longer with the Company. The Company announced that Mr. Boivin would not be replaced. The Company also announced that Mr. Stuart Chase Van Wagenen, a Board member since August 2001 and who currently serves on the Audit Committee, has been elected Chairman of the Board. Mr. Van Wagenen replaced Dr. George Calhoun as Chairman. Dr. Calhoun continues to serve on the Board of Directors.

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

**General**

The following is a discussion and analysis of the historical results of operations and financial condition of the Company and factors affecting the Company s financial resources. This discussion should be read in conjunction with the financial statements, including the notes thereto, set forth herein under Part I. Financial Information and Item 1. Financial Statements and in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2001. This discussion contains forward-looking statements which involve certain risks, uncertainties and contingencies which could cause the Company s actual results, performance or achievements to differ materially from those expressed, or implied, by such forward-looking statements. Such factors include those described in Risk Factors included in the Company s Annual Report on Form 10-K and other filings with the SEC. The forward-looking statements included in this report may prove to be inaccurate. In light of the significant uncertainties inherent in these forward-looking statements, you should not consider this information to be a guarantee by the Company or any other person that our objectives and plans will be achieved.

The Company provides a broad range of interference-control solutions for the wireless telecommunications industry. The Company develops, manufactures and markets radio frequency front-end systems for wireless networks using patented and proprietary high-temperature superconductor ( HTS ) filters, cryogenic low-noise amplifiers and adaptive notch filter ( ANF ) technologies to monitor, suppress and eliminate out-of-band and in-band interference in wireless base stations.

The Company was founded in 1989 by ARCH Development Corporation, an affiliate of the University of Chicago, to commercialize superconductor technologies initially developed by Argonne National Laboratory. The Company was incorporated in Illinois on October 18, 1989 and reincorporated in Delaware on September 23, 1993. On June 25, 2001, the Company changed its name from Illinois Superconductor Corporation to ISCO International, Inc. The Company s principal offices are located at 451 Kingston Court, Mount Prospect, IL 60056 and telephone number is (847) 391-9400.

**Results of Operations**

*Three Months Ended September 30, 2002 and 2001*

The Company s net sales increased $339,000, or 373%, to $430,000 for the three months ended September 30, 2002 from $91,000 for the same period in 2001. This increase was primarily due to the shipment of ANF products during the third quarter of 2002. The Company anticipates its unit volume and related revenue to increase during the fourth quarter of 2002 as compared to both the fourth quarter of 2001 and third quarter of 2002, due to existing customer orders. During October 2002, the Company

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announced the receipt of a $1.2 million order for ANF product that it expects to ship during the fourth quarter of 2002.

Cost of sales increased by $57,000, or 12%, to $541,000 for the three months ended September 30, 2002 from $484,000 for the same period in 2001. The increase in cost of sales was due to the increase in sales volume, net of certain cost control measures adopted during the previous year.

The Company s research and development expenses decreased by $1,279,000, or 66%, to $659,000 for the three months ended September 30, 2002, from $1,938,000 for the same period in 2001. The consolidation of the Colorado and Canadian facilities into the Mount Prospect facility including related headcount reduction, as well as other cost control measures, were the primary reasons for this reduction.

Selling and marketing expenses decreased by $500,000, or 56%, to $388,000 for the three months ended September 30, 2002, from $888,000 for the same period in 2001. This decrease was due to cost reductions implemented during the previous year.

General and administrative expenses decreased by $407,000, or 20%, to $1,653,000 for the three months ended September 30, 2002, from $2,060,000 for the same period in 2001. This decrease was attributable to cost reduction programs that were offset in part by increased legal expenses incurred in the ongoing patent litigation. If not for this litigation, which increased by a net cost of approximately $300,000 during these respective periods, general and administrative expenses would have decreased by approximately $707,000, or 34%, from the third quarter of 2001 to the third quarter of 2002.

Goodwill amortization, resulting from acquisitions by the Company in 2000, was $509,000 for the three months ended September 30, 2001. No such charge was recognized during 2002 due to the change in accounting pronouncements further detailed in Note 1.

*Nine Months Ended September 30, 2002 and 2001*

The Company s net sales increased $151,000, or 8%, to $2,127,000 for the nine months ended September 30, 2002 from $1,976,000 for the same period in 2001. This increase was due to the increase in ANF revenue during the first nine months of 2002, as compared to the comparable period of 2001. The Company anticipates its unit volume and related revenue during the full year 2002 to exceed related figures during 2001 due to existing customer orders. During October 2002, the Company announced the receipt of a $1.2 million order for ANF product that it expects to ship during the fourth quarter of 2002.

Cost of sales decreased by $258,000, or 9%, to $2,668,000 for the nine months ended September 30, 2002 from $2,926,000 for the same period in 2001. The decrease in cost of sales, despite the increase in net sales revenue, was due to cost control measures adopted during the previous year.

The Company s research and development expenses decreased by $3,267,000, or 58%, to $2,358,000 for the nine months ended September 30, 2002, from $5,625,000 for the same period in 2001. The consolidation of the Colorado and Canadian facilities into the Mount Prospect facility including related headcount reduction, as well as other cost control measures, were the primary reasons for this reduction.

Selling and marketing expenses decreased by $958,000, or 36%, to $1,723,000 for the nine months ended September 30, 2002, from $2,681,000 for the same period in 2001. This decrease was due to cost reductions implemented during the previous year.

General and administrative expenses increased by $689,000, or 13%, to $6,059,000 for the nine months ended September 30, 2002, from $5,370,000 for the same period in 2001. This increase was attributable to legal expenses incurred in the ongoing patent litigation. If not for this litigation, which increased by a net cost of approximately $1,700,000 during these respective periods, general and administrative expenses would have decreased by approximately $1,011,000, or 19%, during the first nine months of 2002 compared to the same period of 2001.

Goodwill amortization, resulting from acquisitions by the Company in 2000, was $1,528,000 for the nine months ended September 30, 2001. No such charge was recognized during 2002 due to the change in accounting pronouncements further detailed in Note 1.

**Liquidity and Capital Resources**

At September 30, 2002, the Company s cash and cash equivalents were $788,000, a decrease of $933,000 from the balance at December 31, 2001 of $1,721,000. The Company completed a Shareholder Rights Offering which raised approximately $20 million during February, 2002. A portion of the proceeds were then used to repay in full $9.8 million of debt and related accrued interest, as well as the payment of various other accrued expenses.

The continuing development of, and expansion in, sales of the Company s interference-control solutions product lines, as well as the continued defense of its intellectual property in the ongoing patent litigation which has been rescheduled for trial in March 2003, will require a commitment of substantial additional funds. The actual amount of the Company s future funding requirements will depend on many factors, including, but not limited to: the amount and timing of future revenues, the level of product marketing and sales efforts to support the Company s commercialization plans, the magnitude of the Company s research and product development programs, the ability of the Company to improve product margins, the cost of additional plant and equipment for manufacturing and the costs involved in protecting the Company s patents or other intellectual property, including the ongoing patent litigation.

As part of its overall financing strategy, the Company filed a $50 million universal shelf offering registration statement in the first quarter of 2001, and then entered into an agreement with Paul Revere Capital Partners, Ltd., whereby Paul Revere Capital Partners committed to acquire up to $20 million of the Company s common stock over a 24-month period, upon demand by the Company, subject to the conditions contained in the purchase agreement. Pursuant to this facility, the Company may, at its discretion, sell shares of its common stock to Paul Revere Capital Partners at a purchase price per share which is equal to 94% of the average weighted volume price over a 22 day period. Each draw down is limited to the lesser of $4 million or 20% of the trading volume over a specified period of time. The Company would also issue a warrant to Paul Revere Capital Partners to purchase a number of shares of common stock equal to 0.5% of the shares issued in each draw down. The Company also agreed to pay its placement agent a fee equal to 4% of each draw down and issue a warrant to the placement agent to purchase a number of shares of common stock equal to 0.5% of the shares issued in each draw down. Subsequent to entering into this agreement, the SEC issued an interpretive release that requires the Company to amend the registration statement to include the purchase agreement prior to drawing down on this facility. As of September 30, 2002, the Company had not amended the registration statement nor had it drawn down on this facility. The facility expires during March 2003. Due to the depressed stock price and reduced trading volume, the Company does not consider this facility to be an effective source of capital.

The Company s common stock is listed on the American Stock Exchange ( AMEX ) under the symbol ISO . Prior to June 7, 2002, the first trading date on AMEX, the Company s common stock was traded in the over-the-counter market and quoted on the National Association of Securities Dealers, Inc. electronic bulletin board under the symbol ISCO .

As of the reporting date, the Company had no outstanding long-term debt or short-term debt. The Company previously announced its intention to try to augment its capital position through existing

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funding mechanisms identified and through other sources of capital to support its operations and expected increases in levels of inventory and receivables. During October 2002, the Company entered into an Uncommitted Line of Credit with its two largest shareholders, an affiliate of Elliott Associates, L.P. (Manchester Securities, L.P.) and Alexander Finance, L.P. This line is intended to provide up to $4 million to the Company, with $1 million of the total borrowed during October, 2002, upon completion of the transaction. This line is uncommitted, such that each new borrowing under the facility would be subject to the approval of the lenders. Borrowings on this line bear an interest rate of 9.5% and are secured by all the assets of the Company. Additionally, warrants are issued to the lenders to the extent funds are drawn down on the line. The warrants bear a strike price of $0.20 per share of common stock and expire on April 15, 2004. A maximum of 20 million warrants may be issued as a result of this transaction, presuming certain antidilutive features are not triggered. A copy of that note is attached as Exhibit 10 to this document.

Subject to the uncommitted nature of this credit line, the Company believes it has sufficient capital resources available to meet its obligations and support its operations forecast into the second quarter of 2003. There can be no assurance that other funding mechanisms, whether identified or not, will allow the Company to access additional funds beyond that date.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

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

**Item 4. Controls and Procedures.**

(a) Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-14(c) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act ), within 90 days of the filing date of this report. Based on their evaluation, our principal executive officer and principal accounting officer concluded that ISCO s disclosure controls and procedures are effective.

(b) There have been no significant changes (including corrected actions with regard to significant deficiencies or material weaknesses) in our internal controls or in other factors that could significantly affect these controls subsequent to the date of the evaluation referenced in paragraph (a) above.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings.**

*Laves Litigation*

On July 17, 2000 Edward W. Laves (the Plaintiff ) filed an action (the Complaint ) in the Law Division of the Circuit Court of Cook County, Illinois, against the Company and three of its directors, (George Calhoun, Samuel Perlman, and Mark Brodsky) charging the Company with constructive

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termination under and in breach of the Plaintiff s employment agreement, and with violation of the Illinois Wage Payment and Collection Act. The Plaintiff seeks damages estimated to exceed $12 million . The Company filed an appearance on behalf of all of the Defendants on October 3, 2000. On October 6, 2000, the Company filed on Defendants behalf a motion to dismiss the Complaint. On January 22, 2001, the court issued an order granting our motion to dismiss the claims against the individual Defendants, but denied the motion to dismiss with respect to claims against the Company. On February 21, 2001, the Plaintiff filed a motion to reconsider the court s dismissal of claims against the individual Defendants. On March 13, 2001, the Defendants filed an answer to the Complaint and a memorandum in opposition to the motion to reconsider. By order dated March 15, 2001, the court allowed the Plaintiff leave to file an amended motion to reconsider, which the Plaintiff filed on April 5, 2001, along with a motion to dismiss one of the Company s affirmative defenses. Following a substitution of judges and a hearing on August 9, 2001, the court granted Plaintiff s motion to dismiss one of the Company s affirmative defenses and ordered the case transferred back to the judge originally assigned to the case for the limited purposes of ruling on Plaintiff s amended motion to reconsider the dismissal of claims against the Defendants. On September 7, 2001, following a hearing, the Judge denied Plaintiff s amended motion to reconsider and entered an order retaining jurisdiction of the matter for 30 days. On November 9, 2001 the Judge granted Plaintiff leave to file his First Amended Count II. On November 11, 2001, Plaintiff filed his amended pleading. On January 31, 2002, Plaintiff filed a corrected Unified Complaint . On February 15, 2002, all Defendants filed their Answers to the Unified Complaint. On March 5, 2002, the individual defendants served their answers to Plaintiff s interrogatories and responses to Plaintiff s discovery requests. On April 8, 2002, Laves was given leave to amend his Complaint and add Count III against the individual defendants for tortuous interference with contractual obligations. Laves seeks damages against these individuals for: (1) an amount to be provided at trial estimated to exceed $12 million; (2) $500,000 for Laves anxiety, mental suffering, and humiliation; (3) $500,000 for punitive damages; and (4) pre- and post- judgment interest and costs. Non-expert discovery was to conclude by November 7, 2002; non-expert oral discovery is to conclude by November 15, 2002 (but this will likely be extended); no date is set for the close of expert discovery. A status hearing was set for November 8, 2002. No trial date is set.

The Company believes these claims to be without merit and intends to defend against them vigorously.

*Patent Litigation*

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

On March 26, 2002, the Company replied to Conductus and Superconductor Technologies Second Amended Answer and Counterclaims and filed counterclaims alleging that Conductus and Superconductor Technologies also infringe U.S. Patent No. 6,104,934 entitled Cryoelectronic Receiver Front End and U.S. Patent No. 6,205,340 B1 entitled Cryoelectronic Receiver Front End For Mobile

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Radio Systems . On April 17, 2002, the court dismissed these counterclaims without prejudice to the Company s right to assert these counterclaims in a separate action.

On October 30, 2002, the U.S. District Court in Delaware issued its ruling concerning patent claim construction following the Markman Hearing, an important preliminary hearing in this case. The purpose of the Markman Hearing is to define the meaning of the terms in the patent claims. The court s decision adopted ISCO s proposed claim construction on all substantive claim interpretation issues.

A number of motions are now pending in the litigation. The Company has filed motions for summary judgment that Superconductor Technologies internal projects are not prior art to the 215 patent and to dismiss the defendants claims of unfair competition and interference with business relations. The defendants have filed motions for summary judgment on the issues of infringement and validity of the 215 patent. In addition, Conductus has moved to limit the computation of damages available to the Company to a reasonable royalty for sales to Dobson Communications, Inc. The Company has filed an opposition to each of the defendants motions. The trial for this case has been rescheduled for March 17, 2003.

The Company intends to prosecute these claims vigorously against Conductus and Superconductor Technologies and defend against counterclaims in this litigation. The Company believes the patent to be valid, the counterclaims asserted against the Company to be without merit, and that it is in the best interests of the Company and its shareholders to pursue this matter vigorously.

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

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

**(a) Exhibits:** A list of exhibits is set forth in the Exhibit Index found on

page 14 of this report**.**

**(b) Reports on Form 8-K:**

On October 24, 2002, the Company filed a report on Form 8-K announcing that it had entered into an uncommitted line of credit from its two largest shareholders and also announcing that the Company received an order for Adaptive Notch Filters (ANF ) from a major network provider.

**Signatures**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on the 14th day of November, 2002.

**ISCO International, Inc.**

By: /s/ Amr Abdelmonem

Amr Abdelmonem
Chief Executive Officer (Principal
Executive Officer)

By: /s/ Frank J. Cesario

Frank J. Cesario
Acting Chief Financial Officer (Principal
Financial and Accounting Officer)

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**Certifications**

I, Amr Abdelmonem, certify that:

1. I have reviewed this quarterly report on Form 10-Q of ISCO International, 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;

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;

4. The registrant s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date ); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant s other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of registrant s board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ Amr Abdelmonem

Amr Abdelmonem
Chief Executive Officer

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I, Frank Cesario, certify that:

1. I have reviewed this quarterly report on Form 10-Q of ISCO International, 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;

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;

4. The registrant s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date ); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant s other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of registrant s board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ Frank Cesario

Frank Cesario
Acting Chief Financial Officer and Corporate Secretary

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**EXHIBIT INDEX**

| Exhibit Number | Description of Exhibit *(PH update)* |
|---|---|
| 10.1 | Loan Agreement dated October 23, 2002 between ISCO International, Inc., Manchester Securities Corporation, and Alexander Finance L.P. incorporated by reference to exhibit 10.1 of the Company s 8-K filed with the SEC on October 24, 2002. |
| 10.2 | Security Agreement dated October 23, 2002 between ISCO International, Inc., Spectral Solutions, Inc., Illinois Superconductor Canada Corporation, Manchester Securities Corporation, and Alexander Finance L.P. incorporated by reference to exhibit 10.2 of the Company s 8-K filed with the SEC on October 24, 2002. |
| 10.3 | Secured Grid Note dated October 23, 2002 between ISCO International, Inc. and Alexander Finance L.P. in the principal amount of $1,752,400 incorporated by reference to exhibit 10.3 of the Company s 8-K filed with the SEC on October 24, 2002. |
| 10.4 | Secured Grid Note dated October 23, 2002 between ISCO International, Inc. and Manchester Securities Corporation in the principal amount of $2,247,600 incorporated by reference to exhibit 10.4 of the Company s 8-K filed with the SEC on October 24, 2002. |
| 10.5 | Guaranty of Spectral Solutions, Inc. incorporated by reference to exhibit 10.5 of the Company s 8-K filed with the SEC on October 24, 2002. |
| 10.6 | Guaranty of Illinois Superconductor Canada Corporation incorporated by reference to exhibit 10.6 of the Company s 8-K filed with the SEC on October 24, 2002. |
| 10.7 | Registration Rights Agreement dated October 23, 2002 between ISCO International, Inc. Manchester Securities Corporation, and Alexander Finance L.P. incorporated by reference to exhibit 10.7 of the Company s 8-K filed with the SEC on October 24, 2002. |
| 10.8 | Common Stock Purchase Warrant Agreement dated October 23, 2002 between ISCO International, Inc. and Alexander Finance L.P. incorporated by reference to exhibit 10.8 of the Company s 8-K filed with the SEC on October 24, 2002. |
| 10.9 | Common Stock Purchase Warrant Agreement dated October 23, 2002 between ISCO International, Inc. and Manchester Securities Corporation incorporated by reference to exhibit 10.9 of the Company s 8-K filed with the SEC on October 24, 2002. |
| 99.1 | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |