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MEMS USA INC  
Form 10QSB  
February 23, 2006

U.S. SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-QSB

QUARTERLY REPORT PURSUANT TO SECTION 13 OR  
15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2005

Commission file number 0-4846-3

MEMS USA, INC.  
(Name of small business issuer in its charter)

Nevada	82-0288840
-----	-----
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)
5701 Lindero Canyon Road, Suite 2-100 Westlake Village, California	91362
-----	-----
(Address of principal executive offices)	(Zip code)

Issuer's telephone number, including area code (818) 735-4750  
-----

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act of 1934 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  No

The number of shares of the common stock outstanding as of February 10, 2006 was 18,768,744.

Documents incorporated by reference:

Form 8-K Dated April 29, 2005 Re. Can Am Ethanol One, Inc.

Form 8-K Dated December 21, 2005 Re. Hearst Ethanol One, Inc.

Form 10-KSB Dated February 2, 2006 Re. MEMS USA, Inc. Annual Report.

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FORM 10-QSB

For The Quarterly Period Ended December 31, 2005

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### ITEM 1. FINANCIAL STATEMENTS:

Consolidated Balance Sheets  
December 31  
(Unaudited)

	2005
A S S E T S	
Current Assets:	-----
Cash and cash equivalent	\$ 106,208
Accounts receivable, net allowance for uncollectible of \$46,196 and \$51,640 respectively	943,012
Inventories, net of provision for slow moving items of \$25,000 and \$45,000 respectively	768,194
Other current assets	98,064
	-----
Total current assets	1,915,478

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Plant, property and equipment, net	2,275,912
Other assets	364,906
Investment in Can Am Ethanol One, Inc.	71,765
Goodwill	915,373
	-----
Total assets	\$ 5,543,434
	=====
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Accounts payable and accrued expenses	\$ 1,400,710
Lines of credits	176,424
Notes payable	556,929
Current portion of long-term debt	36,843
Deferred revenue	--
Loans from shareholders	211,600
Convertible loan payable	150,000
Liability to be satisfied through the issuance of shares	1,005,000
	-----
Total current liabilities	3,537,506
	-----
Long-term liabilities	41,384
Other loans from shareholders	--
Liability due to a legal settlement	307,000
Common shares with mandatory redemption	1,400,000
Common shares payable under terms of acquisition agreement	809,966
	-----
Total Liabilities	6,095,856
Stockholders' equity (deficit):	
Common stock, \$0.001 par value; 100,000,000 shares authorized; 18,237,767 and 16,431,077 shares respectively issued and outstanding	20,937
Stock subscriptions receivable	(2,512,850)
Additional paid in capital	8,581,998
Shares to be redeemed (165,054 shares)	(231,076)
Accumulated deficit	(2,631,873)
Treasury stock (2,699,684 shares)	(3,779,558)
	-----
Total stockholders' equity (deficit)	(552,422)
	-----
Total liabilities and stockholders' equity	\$ 5,543,434
	=====

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

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MEMS USA, INC  
Consolidated Statement of Operations  
Three months ended December 31  
(Unaudited)

	2005	2004
	-----	-----
Revenues	\$ 2,626,519	\$ 3,014,697
Cost of revenues	2,071,744	2,154,487
	-----	-----

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Gross profit	554,775	860,210
Selling, general and administrative expenses	1,321,547	1,097,504
	-----	-----
Loss from operations	(766,772)	(237,294)
Other income	(23,281)	2,862
	-----	-----
Income due to legal settlement	3,703,634	--
	-----	-----
Net income (loss)	\$ 2,913,581	\$ (234,432)
	=====	=====
Net income (loss) per share, basic and diluted:		
Weighted average number of shares outstanding, basic	18,439,506	16,410,871
Net income (loss) per share, basic	\$ 0.16	\$ (0.01)
	=====	=====
Weighted average number of shares, outstanding, diluted	19,131,642	16,410,871
Net income (loss) per share, diluted	\$ 0.15	\$ (0.01)
	=====	=====

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

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MEMS USA, INC.  
CONSOLIDATED STATEMENT OF CASH FLOWS  
Three Months ended December 31  
(Unaudited)

	2005
	-----
Cash flows provided by (used for) operating activities:	
Net income (loss)	\$ 2,913,581
	-----
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:	
Depreciation	61,693
Common stock issued for services	10,000
Income due to legal settlement	(3,703,634)
Change in assets and liabilities:	
Accounts receivable	(186,172)
Inventories	112,176
Other current assets	72,133
Accounts payable and accrued expenses	5,445
Deferred revenue	--
	-----
Total adjustments	(3,628,359)
	-----
Net cash used in operating activities	(714,778)
	-----
Cash flows from investing activities:	
Purchase of property and equipment	(20,769)
Other assets	24,000
	-----
Net cash used for investing activities	3,231
	-----

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Cash flows from financing activities:	
(Repayment) proceeds from lines of credit and long term debts	(30,398)
Loan from shareholder	20,000
Cash balance net of payments for purchase of Bott and Gulfgate	--
	-----
Net cash provided by (used in) financing activities	(10,398)
	-----
Net increase (decrease) in cash and cash equivalents	(721,945)
Cash and cash equivalents, beginning of period	828,153
	-----
Cash and cash equivalents, end of period	\$ 106,208
	=====
Supplemental disclosure of cash flow information:	
Income taxes paid	\$ --
	=====
Interest paid	\$ 35,498
	=====
Supplemental disclosure of non-cash financing activities:	
Common stock (including \$1,400,000 of shares subject to mandatory redemption factor) issued for acquisition of Bott and Gulfgate	

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

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MEMS USA, INC  
Consolidated Statement of Equity  
December 31, 2005  
(Unaudited)

	Common stock	Subscriptions receivable	Additional paid in capital	Treasury stock	
	-----	-----	-----	-----	-----
Balance as of September 30, 2005	\$ 17,404	\$ (250)	\$ 5,956,932	--	\$
Common stock issued for service	4	--	9,995	--	
Common stock issued for cash received in prior year	129	--	105,871	--	
Common stock issued for subscriptions receivable	3,400	(2,512,600)	2,509,200	--	
Charges due to legal settlement	--	--	(231,076)	--	
Net income for the quarter					
Treasury stock due to legal settlement	--	--	--	(3,779,558)	
	-----	-----	-----	-----	-----
Balance as of December 31, 2005	\$ 20,937	\$ (2,512,850)	\$ 8,350,922	\$ (3,779,558)	\$

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

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Notes to consolidated financial statements:

(1) Company and Summary of Significant Accounting Policies:

Nature of Business:

MEMS USA, Inc. (the "Company") was incorporated in Nevada in 2002. The Company is comprised of three wholly owned subsidiaries, California MEMS USA, Inc., fka, MEMS USA, Inc., a California Corporation ("MEMS CA"), Bott Equipment Company, Inc. ("Bott") and Gulfgate Equipment, Inc. ("Gulfgate"). In December 2005, the Company incorporated Hearst Ethanol One, Inc., an Ontario corporation ("HEO") for the purpose of building, owning and operating an ethanol production facility in Canada. The Company owns ninety-nine point three percent (99.3%) of HEO. Dr. James A. Latty and Mr. Daniel Moscaritolo are presently the only directors and officers of HEO.

In November 2004, the Company formed a joint venture, Can Am Ethanol One, Inc. ("Can Am"). We presently own forty-nine point three percent (49.3%) of Can Am and maintain 50% of Can Am's voting rights.

MEMS CA is a California based professional engineered systems, products and services company serving the oil, petro-chemical, natural gas and electric utility industries.

Gulfgate produces particulate filtration equipment for the oil and power industries. Gulfgate also produces vacuum dehydration and coalescing systems that remove water from turbine engine oil. These same systems are used by electric power generation facilities to remove water from transformer oils. To help meet its customers' diverse needs, Gulfgate maintains and operates a rental fleet of filtration and dehydration systems.

Bott is a stocking distributor for lines of industrial pumps, valves and instrumentation. Bott specializes in the construction of aviation refueling systems for helicopter refueling on oil rigs throughout the world. Bott also constructs refueling systems for commercial marine vessels. Bott's customers include chemical manufacturers, refineries, power plants and other industrial customers.

MEMS CA, Bott and Gulfgate have a combined direct sales force as well as commissioned sales representatives that sell their products.

Can Am was created to manufacture, own and operate one ethanol production facility in British Columbia Canada. The plant was to utilize a synthetic biomass conversion process to convert wood waste materials into ethanol. Subject to receipt of the required funding several biomass-to-ethanol plants are planned for Canada that will also use a synthetic biomass conversion process.

We are continuing the process of vertically integrating our subsidiaries, which we believe will promote efficiency and lower operating costs. Each of our subsidiaries will remain a separate operating entity.

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### Accounts Receivable:

In the normal course of business, the Company provides credit to customers. We monitor our customers' payment history, and perform credit evaluation of their financial condition. We maintain adequate reserves for potential credit losses based on the age of the receivable and specific customer circumstance.

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### Inventories:

Inventories are valued at the lower of cost (first-in, first-out) or market value and have been reduced by an allowance for excess, slow-moving and obsolete inventories. The estimated allowance is based on Management's review of inventories on hand compared to historical usage and estimated future usage and sales. Inventories under long-term contracts reflect accumulated production costs, factory overhead, initial tooling and other related costs less the portion of such costs charged to cost of sales and any un-liquidated progress payments. In accordance with industry practice, costs incurred on contracts in progress include amounts relating to programs having production cycles longer than one year, and a portion thereof may not be realized within one year.

### Revenue Recognition

The majority of the Company's revenues are recognized when products are shipped to or when services are performed for unaffiliated customers. Other revenue recognition methods the Company uses include the following: revenue on production contracts is recorded when specific contract terms are fulfilled, which is when the product or service is delivered; revenue from cost reimbursement contracts is recorded as costs are incurred.

### Stock Based Compensation:

Pro forma information regarding net loss and loss per share, pursuant to the requirements of SFAS 123, as amended by FAS 148 Accounting For Stock-Base Compensation Transaction and Disclosure - An Amendment to FAS-123, for the three months ended December 31, 2005 and 2004 are as follows:

	2005	2004
	-----	-----
Net income (loss), as reported	\$ 2,913,581	\$ (23,000)
Deduct:		
Total stock-based employee compensation expenses determined under the fair value Black-Scholes method with a 128% and 80% volatility at December 31, 2005 and 2004 respectively and a 6% and 1.5% respectively risk free rate of return assumption	(175,664)	(1,000)
	-----	-----
Pro forma net loss	\$ 2,737,917	\$ (1,240)
	=====	=====
Income (loss) per share:		
Weighted average shares, basic	18,439,506	16,410
Basic, pro forma, per share	\$ 0.15	\$ (0.07)

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Weighted average shares, diluted	19,131,642	16,41
Diluted, pro forma, per share	\$ 0.14	\$

Interim Financial Statements:

The accompanying unaudited consolidated financial statements for the three months ended December 31, 2005 and 2004 include all adjustments (consisting of only normal recurring accruals), which, in the opinion of management, are necessary for a fair presentation of the results of operations for the periods presented. Interim results are not necessarily indicative of the results to be expected for a full year. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended September 30, 2005 and 2004 included in the Company's Form 10-KSB/A.

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Going Concern:

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplates the Company as a going concern. However, the Company has sustained substantial operating losses in recent years \$2,631,873 and has used substantial amounts of working capital in its operations. Realization of a major portion of the assets reflected on the accompanying balance sheet is dependent upon continued operations of the Company which, in turn, is dependent upon the Company's ability to meet its financing requirements and succeed in its future operations. Management believes that actions presently being taken to revise the Company's operating and financial requirements provide them with the opportunity for the Company to continue as a going concern. We will continue to raise additional cash through debt or equity financings in 2006 in order to meet our working capital requirements.

(2) Business Acquisition:

On October 26, 2004 ("Closing Date"), effective October 1, 2004, the Company purchased 100% of the outstanding shares of two Texas corporations, Bott Equipment Company, Inc. ("Bott") and Gulfgate Equipment, Inc. ("Gulfgate") from their president and sole shareholder, Mr. Mark Trumble.

Under the terms of the stock purchase agreement, the Company acquired 100% of the shares of Bott and Gulfgate from Mr. Trumble for \$50,000 in cash and 1,309,677 shares of the Company's newly issued common stock.

752,688 shares of the shares issued to Trumble are subject to a one time put. On or about October 26, 2005, Mr. Trumble exercised this put. Under the terms of the put, Trumble has elected to exchange all of the 752,688 shares for an amount equal to \$1.86 per share (which is the average price of the Company's stock on the OTC BBC for the thirty trading days comprising September 13, 2004 through October 22, 2004) times the number of shares exchanged by Trumble pursuant to the put. The Company shall have sixty (60) days from the date of exercise to pay off any sums due thereby. An extension for payment of the put has been negotiated between Mr. Trumble and the Company. The Company's performance under the terms of the put is secured by second deeds of trust with vendors' liens in favor of

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Trumble on certain parcels of the Companies' real estate.

The 752,688 shares subject to the put, have been properly treated as a \$1.4 million liability, pursuant to Statement of Financial Accounting Standards no. 150 (SFAS 150) Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity until the terms of the put expire.

The Company agreed to create an employee stock option plan for its employees and those of its affiliates, including Bott and Gulfgate. In connection with said plan, the Company agreed to file Form S-8 Registration Statement under The Security Act of 1933 (securities to be offered to employees in employee benefit plans) within 30 days of the Closing Date. The Company had also agreed that it would issue Trumble an additional 123,659 shares of the Company's restricted stock if it failed to achieve this milestone. The Company filed the Form S-8 Registration Statement within 30 days of the Closing Date thereby achieving this milestone and avoiding the issuance of penalty shares to Mr. Trumble.

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The Agreement also provided that Trumble will personally introduce the Company's officers and representatives to five (5) qualified Texas bankers and that the Company will utilize its best efforts to remove Trumble's name as guarantor from the Bott and Gulfgate lines of credit (See note 6 and 7) within 90 days of the fifth introduction. The Company has agreed that it will issue Trumble an additional 370,977 shares of restricted stock should it fail to achieve this milestone. Mr. Lawrence Weisdorn, Mr. Daniel Moscaritolo and Dr. James Latty have also agreed to join Trumble as guarantors on the Bott and Gulfgate credit lines. Mr. Weisdorn joined Trumble as guarantor on the Bott and Gulfgate credit lines in or around mid-November 2004. Mr. Moscaritolo and Mr. Latty have agreed to join as guarantors should the Company fail to recognize the milestone of removing Trumble's name as guarantor from the existing credit lines within the specified time period. As of the date of this report, only four qualified personal introductions have occurred. Thus, the 90 day milestone has not been triggered. The Company is committed to removing Mark Trumble as guarantor from the existing lines of credit and has submitted applications for credit lines with a number of financial institutions.

The Company agreed to secure a best efforts underwriting commitment letter from a qualified investment banker within 45 days of the Closing Date to raise a minimum of \$2 million in equity capital. An additional 123,659 shares of the Company's restricted stock were to be issued to Trumble should the Company fail to achieve this milestone. The Company obtained a commitment letter within 45 days of the Closing Date thereby achieving this milestone and avoiding the issuance of penalty shares to Mr. Trumble. The Company also agreed, in connection with the \$2 million equity raise, that the Company would receive \$2,000,000 in gross equity funding within 120 days of the Closing Date. The Company has agreed that it will issue Trumble an additional 123,659 shares of its restricted stock should it fail to achieve this milestone. The Company did not achieve this milestone and is obligated to issue 123,659 penalty shares to Mark Trumble.

Finally, the Company has recognized that Trumble shall sell 326,344 shares of his stock at a purchase price of approximately \$607,000 to private parties, including a related party Lawrence Weisdorn, Sr., the former CEO's father and a shareholder and/or Weisdorn Sr.'s assignees pursuant to a written agreement between Trumble and Weisdorn Sr.. Should Trumble fail to recognize \$607,000, through no fault of Trumble, the Company agreed to

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issue up to 494,636 shares of restricted stock to Trumble. The percentage of the Penalty Shares the Company shall issue, if any, shall be prorated in accordance with any monies received by Trumble during the 60-day period. It is further understood that the penalties are subject to the following schedule: (1) Trumble shall have recognized at least \$75,000 within 15 days of the Closing Date or he shall receive up to 61,829 Penalty Shares; (2) Trumble shall recognize an additional \$75,000 within 30 days of the Closing Date or he shall receive up to an additional 61,829 Penalty Shares; (3) Trumble shall recognize an additional \$150,000 within 45 days of the Closing Date or he shall receive up to an additional 123,659 Penalty Shares; and (4) Trumble shall recognize an additional \$307,000 within 60 days of Closing Date or he shall receive up to an additional 247,318 Penalty Shares. Each milestone is to be calculated as a stand-alone event. The obligations of items 1, 2, and 3 were met which avoided the associated penalty shares. All of the above Penalty Share calculations shall be subject to a pro-rata offset for monies received that fall short of the indicated milestones.

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On December 15, 2005, the Company assumed Weisdorn Sr.'s obligation to purchase 165,054 shares from Mr. Trumble at \$1.86 per share.

During the first quarter of fiscal year 2005, the Company, in order to avoid the issuance of 61,829 penalty shares, paid \$75,000 directly to Mr. Trumble. The Company has received approximately \$39,000 of the \$75,000 from Mr. Weisdorn Sr. The Company has recorded this payment as a reduction to additional paid-in capital.

Mr. Trumble did not recognize \$307,000 within 60 days of the closing date. As a result, the Company is obligated to issue 247,318 penalty shares to Mr. Trumble. Additionally, the covenant to remove Mr. Trumble from the lines of credit remains and may require us to issue up to 370,977 additional penalty shares in the event that we fail to satisfy that remaining covenant.

### Non-Competition Agreement:

The agreement also provides that Trumble shall not for a period of eighteen (18) months following his separation from the Company, unless permitted to do so by the Company, engage, directly or indirectly as an individual, representative or employee of others, in the business of designing, manufacturing or selling products in competition with the Company or any of its subsidiaries in any geographic area where the Company or its subsidiaries are doing business.

Management believes that the acquisition of Bott and Gulfgate will provide the Company with cost effective means to engineer, manufacture and distribute products for its customers in the energy sector. Bott and Gulfgate may also provide or construct products used in ethanol production facilities. The acquisition has been accounted for as a purchase transaction pursuant to Statement of Financial Accounting Standards No. 141 Business Combinations (SFAS 141) and accordingly, the acquired assets and liabilities assumed are recorded at their book values at the effective date of acquisition except for the real property which approximate the most current appraised value. Excess cost of \$915,373 over the appraised real property and book value of the other acquired assets and liabilities assumed was assigned to goodwill. Goodwill included 370,977 of penalty common shares valued at \$809,966.

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The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition.

Current assets	\$ 1,826,720
Plant, property, and equipment, net	2,237,749
	-----
Total asset acquired	4,064,469
Total liabilities assumed	(1,827,942)
	-----
Net assets acquired	2,236,527
Excess costs over fair value	915,373
	-----
Total purchase price	\$ 3,151,900
	=====

The \$3,151,900 purchase price was comprised of the following:

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Cash	\$ 50,000
Common Stock (370,977 penalty shares)	809,965
Common Stock (1,309,677 shares)	2,291,935
	-----
Total purchase price	\$3,151,900
	=====

(3) Accounts Receivable:

Accounts receivable has been reduced by an allowance for amounts that may become uncollectible. This estimated allowance is based primarily on Management's evaluation of the financial condition of the customer and historical bad debt experience. The Company has provided reserves for doubtful accounts as of December 31, 2005 and 2004 in the amount of \$46,196 and \$51,640 respectively that the Company believes are adequate.

(4) Inventories:

Inventories consist of finished goods of \$449,271 and \$323,323 at December 31, 2005 and 2004 respectively; and work in process in the amount of \$343,923 and \$278,800 respectively.

(5) Plant, Property and Equipment:

A summary at December 31, 2005 and 2004 are as follows:

	2005	2004
	-----	-----
Land	\$ 502,000	\$ 502,000
Buildings and improvements	1,073,000	1,452,419
Furniture, Machinery and equipment	790,360	167,996
Automobiles and trucks	180,651	91,700
Leasehold improvement	79,105	--
	-----	-----
	2,625,116	2,214,115
Less accumulated depreciation	(349,204)	(77,735)
	-----	-----
	\$ 2,275,912	\$ 2,136,380
	=====	=====

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Depreciation expense charged to operations totaled \$61,693 and \$30,811 respectively, for the three months ended December 31, 2005 and 2004.

(6) Business Lines of Credits - Bott:

Bott previously maintained three lines of credits with a bank in Houston, Texas. The credit lines were evidenced by three promissory notes, a Business Loan Agreement and certain commercial guarantees issued in favor of the bank. The material terms of these agreements follow:

In May 2004, Bott entered into a promissory note with a bank whereby Bott could borrow up to \$250,000 over a three year term. Bott could obtain credit line advances based upon its asset base. The note required monthly payments of one thirty-sixth (1/36) of the outstanding principal balance plus accrued interest at the Bank's prime rate plus 1.0 percent.

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In June 2004, Bott executed a promissory note ("Note") with a bank whereby Bott could borrow up to \$600,000, at an interest rate equal to the bank's prime rate. The Note provided for monthly payments of all accrued unpaid interest due as of the date of each payment. The Note further provided for a balloon payment of all principal and interest outstanding on the Note's one year anniversary. The Company informed the bank that it would not renew the line of credit and negotiated a long-term promissory note.

This promissory note was finalized in December 2005, for \$372,012 at a variable interest rate equal to the bank's prime rate. The note provides for five monthly principal payments of \$3,092 and a final payment of the remaining principal and interest in June 2006.

In October 2004, Bott executed a promissory note with a bank that allowed Bott to borrow up to \$200,000, at an interest rate equal to the bank's prime rate plus 1.0 percent. The note provided for monthly payments of all accrued unpaid interest due. The note also provided for the payment of \$66,666 in the months of December 2004 and January 2005 and payment of the remaining principal and interest in February 2005. The note was paid off in the second quarter.

All of the foregoing promissory notes contained the following common terms: The notes specified that no advances under the notes may be used for personal, family or household purposes and that all advances shall be used solely for business, commercial, agricultural or similar purposes. Bott could draw down on the lines of credit provided that: it was not in default under the note evidencing the particular line of credit or any other agreement that it might have with the bank; it was not insolvent; no guarantor had revoked or limited the terms of his or her guarantee respecting the note; Bott used the funds available under the particular note for an unauthorized purpose; and/or the bank believed that its interests under the note are not secured. The notes provided the following limitations on the use of methods and advancements respecting the credit line, and the bank may not honor requests for additional advances if: the requested advance would cause the amounts requested under the particular note to exceed its initial limit; Bott's checks or bank cards relating to the credit line are reported lost or stolen; the note is in default; or the amount requested is less than allowed under the note. The notes permit prepayment of all or part of the outstanding balances without penalty.

The Agreements and Notes are secured by the inventory, chattel paper, accounts receivable and general intangibles. The Agreements and Notes are

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also secured by the personal performance guarantees of Mr. Mark Trumble and Mr. Lawrence Weisdorn (Commercial Guarantees). The Commercial Guarantees require the guarantors to assure that all payments due under the Notes are timely made or to make such payments. All amounts related to Bott's outstanding promissory notes totaled \$544,311 and \$665,255 on December 31, 2005 and 2004 respectively.

(7) Business Line of Credit - Gulfgate:

In June 2002, Gulfgate executed a promissory note ("Note") with a bank that allowed Gulfgate to borrow up to \$200,000 at an interest rate equal to the bank's prime rate, or a minimum interest rate of 5.00% per annum, whichever was greater. Gulfgate could draw down on the line of credit provided: that it was not in default on this Note or any other agreement that it might have with the bank; it was not insolvent; no guarantor revoked or limited the terms of his guarantee; the Borrower used the funds available under the Note for an unauthorized purpose (i.e., other than for a business purpose without first obtaining the bank's written consent); and /or the bank believed that its interests are not secured. The Note provided the following limitations on the use of methods and advancements respecting the credit line, and the bank may not honor requests for advances if: the requested advance would cause the amounts requested under

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the Note to exceed \$200,000; Gulfgate's checks or bank cards relating to the credit line are reported lost or stolen; the Note was in default; or the amount requested is less than allowed under the Note. The Note provided for monthly payments of all accrued unpaid interest due as of the date of each payment. The Note remains in force and effect until the bank provides notice to Gulfgate that no additional withdrawals are permitted (Final Availability Date). Thereafter, payments equal to either \$250 or the outstanding interest plus one percent of the outstanding principal as of the Final Availability Date are due monthly until the Note is repaid in full. The Note allows for prepayment of all or part of the outstanding principal or interest without penalty. The Note is secured by Gulfgate's accounts with the bank, and by Gulfgate's inventory, chattel paper, accounts receivable, and general intangibles. The Agreement is also secured by the performance guarantees of Mr. Mark Trumble, Mr. Lawrence Weisdorn and the Company. The personal guarantees require the guarantors to assure that all payments due under the Note are timely made or to make such payments. Amounts outstanding at December 31, 2005 and 2004 totaled \$189,042 and \$182,466 respectively.

(8) Liability to be satisfied through the issuance of shares

The Company sold 670,000 shares of its common stock for \$1,005,000 via a private placement offering through SW Bach & Company, a New York securities dealer. The Company anticipates satisfying its obligations through issuance of common stock to shareholders in March 2006. Additional details concerning this transaction may be found in the Company's Form 10-KSB report filed February 2, 2006 (Sales Agency Agreement) which is hereby incorporated by reference.

(9) Long-Term Debts and other liabilities:

Promissory Notes:

In May 2003, Bott executed a promissory note with a bank in the amount of \$26,398 at an interest rate equals to four point fifty five percent

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(4.55%) for a vehicle purchase. The term of the note is for fifty-nine (59) months at \$494 per month. Balance outstanding at December 31, 2005 and 2004 were \$13,786 and \$18,660 respectively.

### Mortgage:

On May 31, 2002, Gulfgate entered into a \$140,000 promissory note ("Note") with a bank in connection with the refinancing of Gulfgate's real estate. The Note bears a fixed interest rate of seven percent (7.00%) per annum. The Loan provided for fifty-nine monthly payments of \$1,267 due beginning July 2002 and ending June 2007. The Note may be prepaid without fee or penalty and is secured by a deed of trust on Gulfgate's realty. Gulfgate is required under the terms of a separate agreement to provide replacement value fire and extended coverage insurance having a \$2,500 deductible. Balance outstanding at December 31, 2005 and 2004 were \$32,138 and \$76,091 respectively.

### Loans from shareholders:

Mr. Daniel K. Moscaritolo, COO and Director, and James A. Latty, CEO and Chairman, ("Lenders") each loaned the Company \$105,800; \$95,800 of which were received in September 2005, and \$10,000 received in October 2005 (collectively \$211,600). The transactions are evidenced by two notes dated November 1, 2005 (hereinafter, "Notes"). The terms of the Notes require repayment of the principal and interest, which accrues at a rate of ten percent (10%) per annum on May 1, 2006. The Notes are accompanied by Securities Agreements that grant the Lenders a security interest in all personal property belonging to the Company, as well as granting an undivided 1/2 security interest in all of the Company's right title and interest to any trademarks, trade names, contract rights, and leasehold interests.

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### Financing Lease Agreements:

In September 2002, Gulfgate entered into a non-cancelable debt financing agreement ("Agreement") with the bank's leasing corporation for the financing of certain equipment and a paint booth. The Agreement calls for the payment of forty-eight (48) monthly installment payments of \$1,556 beginning September 2002 at the interest rate of 6.90 percent per annum. Balance outstanding at December 31, 2005 and 2004 were \$12,136 and \$30,693 respectively.

### Convertible Loan Payable:

In September 2004, the Company entered into a convertible loan with an investor. The principal amount of the convertible loan payable is \$150,000 at an interest rate of 8% per annum paid quarterly. The loan is convertible into common stock at any time within two (2) years (24 months) starting September 3, 2004 at the conversion price of \$2.20 or 68,182 shares. Each share converted entitles the holder to purchase one additional share of stock at an exercise price of \$3.30 within the ensuing 12 months.

If at the end of the two year period the loan has not been converted into common stock, the principal amount becomes due and payable.

### (10) Employee Stock Options:

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In connection with the employment agreements, the Company has granted options to certain key executives to acquire common stock of the Company ("Options").

The number of weighted average exercise prices of all options granted for the three months ended December 31, 2005 and 2004 are as follows:

	2005		2004	
	Number of shares	Average Exercise Price	Number of shares	Average Exercise Price
Outstanding at beginning of the quarter	5,338,227	\$3.00	4,100,388	1.55
Granted during the quarter	--	\$ --	1,535,000	1.97
Outstanding at end of the quarter	4,488,727	\$1.95	5,635,388	1.76
Exercisable at end of the quarter	1,380,914	\$1.88	1,068,912	1.97
Exercised during the quarter	--	\$ --	--	--
Cancelled during the quarter	849,500	\$5.55	--	--

(11) Resignation of Executive Officer and Board Member:

On October 17, 2005, the Company and its officers filed a complaint against Lawrence Weisdorn, Jr. ("Weisdorn"), the Company's former Chief Executive Officer and Chairman of the Board of Directors, Lawrence Weisdorn, Sr. ("Weisdorn Sr." and together with Weisdorn, the "Weisdorn Parties"), Nathan Drage ("Drage") and Drage related parties in the Superior Court of the State of California for Los Angeles County, alleging

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claims for, among other things, breaches of Nevada and federal law and breach of fiduciary duty (the "Action"). The Company's claims were based in substantial part on allegations of the unauthorized issuance of shares of the Company's predecessor's common stock in December 2003, prior to the reverse acquisition and merger with MEMS-CA which was finalized in February, 2004. The Company sought an injunction preventing the Weisdorn Parties and Drage and his related parties from selling or transferring any of the shares of the Company's common stock issued in December 2003, the return of the shares to the Company for cancellation and monetary damages.

On November 3, 2005, the Weisdorn Parties filed a cross-complaint against the Company and its officers, alleging claims for, among other things, breach of employment agreement, libel and indemnification (the "Weisdorn Counterclaim"). The Weisdorn Parties' claims were based in part on assertions by Weisdorn that he was improperly terminated without cause from his positions with the Company in June 2005, and that he was entitled to indemnification pursuant to Nevada corporations law in connection with the Action. The Weisdorn Parties sought monetary damages.

On December 15, 2005, the Company and its officers entered into a Settlement Agreement and Release with the Weisdorn Parties and other Weisdorn related parties, effective as of July 1, 2005 (the "Settlement Agreement"), pursuant to which the parties agreed to, among other things, dismiss the Action as it related to the Weisdorn Parties, dismiss the Weisdorn Counterclaim, mutually release all claims and mutually indemnify the other parties from certain claims. Weisdorn also agreed to deliver a letter of resignation to the Company, confirming his resignation as Chief

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Executive Officer and Chairman of the Board of Directors of the Company as of June 25, 2005 and clarifying and confirming the terms of his separation from the Company. The Weisdorn Parties and other Weisdorn related parties further agreed to deliver to the Company all shares or rights to shares of the Company's common stock owned by such parties. The net stock returned to the Company by the Weisdorn parties was 2,699,684 shares, not including 670,000 shares of the Company's common stock to be held by the Company in an account for the benefit of the Weisdorn Parties (the "Retained Stock"), which Retained Stock will be sold for the benefit of the Weisdorn Parties pursuant to the terms set forth in the Settlement Agreement. The Company has the option to purchase any portion of the Retained Stock at a price determined according to the terms of the Settlement Agreement. The Company also agreed to assume the obligations of the Weisdorn Parties and other Weisdorn related parties to purchase certain shares of the Company's common stock from a third party, and the Weisdorn Parties assigned to the Company their interests in certain claims against a third party.

The Settlement Agreement did not in any way affect claims brought in the Action by the Company and its officers against Drage and the Drage-related entities. However, on January 13, 2006, Drage and Adrian Wilson verbally agreed to a settlement in principle with the Company, which the parties intend to memorialize shortly. In connection with the verbal agreement to a settlement, the Company and its officers filed a Request for Dismissal without prejudice of all claims against Drage and the Drage-related entities on January 13, 2006.

Income from legal settlement:

On December 15, 2005, the Company and its officers entered into a Settlement Agreement and Release with the Weisdorn Parties and other Weisdorn related parties, effective as of July 1, 2005 (the "Settlement Agreement"), pursuant to which the parties agreed to, among other things, the Weisdorn Parties and other Weisdorn related parties agreed to deliver to the Company all shares or rights to shares of the Company's common stock owned by such parties. The net common stock returned to the Company by the Weisdorn parties and other Weisdorn related parties was 2,699,684 shares. See note 11 for additional details.

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The fair value of 2,669,684 shares of the Company's common stock at December 15, 2005 was \$3,779,558. The per share closing price of the Company's stock at December 15, 2005 was \$1.40.

Assignment of the Trumble Claims:

The Company and the Weisdorn Parties further agreed the Weisdorn Parties, and each of them, assigned to the Company any and all rights or interest they, or any of them, have in or to the Trumble Claims. On December 15, 2005, the Company assumed Weisdorn Sr.'s obligation to purchase 165,054 shares from Mr. Trumble at \$1.86 per share for a total liability of \$307,000. The fair value of this obligation at December 15, 2005 is \$231,076 (165,054 shares at \$1.40 per share) with the difference charged to other income (\$75,924).

(12) Private placement of securities:

On November 10, 2005, the Company entered into a stock purchase agreement with Mercatus & Partners, Limited, a private limited company of the United Kingdom ("Mercatus Limited"), for the sale of 1,530,000 shares of the

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Company's common stock for a minimum purchase price of \$0.73 per share (the "SICAV One Agreement"), and another stock purchase agreement with Mercatus Limited also for the sale of 1,530,000 shares of the Company's common stock for a minimum purchase price of \$0.73 per share (the "SICAV Two Agreement" and together with the SICAV One Agreement, the "SICAV Agreements"). The shares offered and sold under the SICAV Agreements were offered and sold pursuant to a private placement that is exempt from the registration provisions of the Securities Act under Section 4(2) of the Securities Act pursuant to Mercatus Limited's exemption from registration afforded by Regulation S. Pursuant to the terms of the SICAV Agreements, the Company issued and delivered an aggregate number of 3,060,000 shares of the Company's common stock within five days of the execution of the respective SICAV Agreements to a custodial lock box on behalf of Mercatus Limited for placement into two European SICAV funds. The SICAV Agreements provided Mercatus Limited with up to 30 days after the delivery of the shares of the Company's common stock to issue payment to the Company. If payment for the shares was not received by the Company within 30 days of the delivery of the shares the Company had the right to demand the issued shares be returned. (The Company has not yet received payment for the shares issued pursuant to the SICAV Agreements but has not exercised its right to demand return of the shares.)

On November 12, 2005, the Company also entered into another private stock purchase agreement with Mercatus & Partners, Limited, a private limited company of the United Kingdom ("Mercatus Limited") for the sale of 170,000 shares of the Company's common stock for a minimum purchase price of \$0.82 per share (the "Private SICAV One Agreement") and another private stock purchase agreement with Mercatus LP also for the sale 170,000 shares of the Company's common stock for a minimum purchase price of \$0.82 per share (the "Private SICAV Two Agreement" and with the Private SICAV One Agreement, the "Private SICAV Agreements"). The shares offered and sold under the SICAV Agreements were offered and sold pursuant to a private

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placement that is exempt from the registration provisions of the Securities Act under Section 4(2) of the Securities Act pursuant to Mercatus Limited's exemption from registration afforded by Regulation S. Pursuant to the terms of the Private SICAV Agreements, the Company issued and delivered an aggregate amount of 340,000 shares of the Company's common stock within five days of the execution of the respective Private SICAV Agreements to a custodial lock box on behalf of Mercatus Limited for placement into a European bank SICAV fund. Subject to a valuation of the shares, Mercatus Limited had up to 30 days after the delivery of the shares of the Company's common stock to issue payment to the Company. If payment was not received by the Company within 45 days of the issuance of the shares to Mercatus LP, the Company had the right to demand the issued shares be returned. The Company has not yet received payment for the shares issued pursuant to the Private SICAV Agreements but has not exercised its right to demand return of the shares.

### (13) Subsequent Event:

In February 2006, MEMS USA received a \$1.5 million order to construct for an amine purification system which will be installed at a refinery with a large oil company. Amine is used in a refinery to remove Carbon Dioxide and Sulfur products from oil to produce cleaner burning fuels. There are three major components in the amine purification system. The first component is MEMS USA's Intelligent Backflushing Filtration System (IFS). This system removes particulates such as rust which gets dislodged from

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pipes and other components in the refinery and other hard particulates. The filtration system uses permanent filter elements which are backflushed periodically. The backflush waste material consists of water and the particulates which have been filtered by the permanent filter elements. The backflush waste is further concentrated in a decanting vessel. The second major system is a carbon bed filtration system which is used to remove chemical contaminants and hydrocarbons which will sometimes mix with the amine during its use in a refinery. The third major system is an Ion Exchange filtration system which removes heat stable salts which form in the amine, causing the amine to be less effective in removing Carbon Dioxide and Sulfur products. These systems will provide years of effective utilization of the amine fluids and extend the useful life of the refinery's amine process equipment.

This contract is cancelable subject to costs reimbursement and liquidated damages.

### ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATIONS

Unless otherwise indicated, all references to our company include our wholly-owned subsidiaries, MEMS USA, Inc. a California corporation, Bott Equipment Company, Inc., a Texas corporation, Gulfgate Equipment, Inc., a Texas corporation, our joint venture Can Am Ethanol One, Inc., a British Columbia corporation and Hearst Ethanol One, Inc., an Ontario corporation ("HEO").

#### Plan of Operations:

We are engaged in the business of developing and manufacturing advanced engineered products, systems and plants, mostly for the energy, oil and natural gas industries. Our business is divided into three operating divisions, including (i) the design, development and operation of ethanol facilities, (ii) the provision of systems and components to the energy sector, and (iii) the engineering applications and sale of micro electro mechanical systems (MEMS) for scientific and engineering companies. As related in our annual report, in October 2005, the Company acquired two Texas corporations, Bott Equipment Company, Inc. ("Bott") and Gulfgate Equipment, Inc. ("Gulfgate").

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In November 2004, the Company formed a joint venture, Can Am Ethanol One, Inc. ("Can Am"). As of the date of this report, the Company owns 49.3% of the outstanding shares of Can Am and has voting rights equal to 50%. Two of MEMS directors sit on the Can Am board. The purpose of this joint venture is to design, build and operate an ethanol production facility. In June 2005, the Company and its Canadian counterpart each made a CN\$25,000 at risk deposit to open escrow toward purchase of 2,150 acres of land intended to serve as a plant site in British Columbia, Canada ("Purchase Agreement").

Subsequently, the Company paid an additional at-risk deposit of CN\$50,000 for an extension of the Closing Date of the Purchase Agreement. As of the date of this report, the Purchase Agreement remains active, but has not closed. Due to the length of time that Purchase Agreement has remained pending, as well as other factors, the Company is contemplating selling its' interest to Accelon Energy System, Inc., the other owner of Can Am Ethanol One, Inc. We will continue to explore other potential plant sites in Canada.

In December 2005, the Company incorporated Hearst Ethanol One, Inc., an Ontario corporation ("HEO") for the purpose of building, owning and operating an ethanol production facility in Canada. As of the date of this report, the Company owns ninety-nine point three percent (99.3%) of HEO. Dr. James A. Latty and Mr.

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Daniel Moscaritolo are presently the only directors and officers of HEO.

On December 21, 2005, HEO entered into a land purchase agreement with C. Villeneuve Construction Company, Ltd. Upon successful completion of due diligence concerning 600 acres of land to be acquired near Hearst, Ontario, Canada and at the discretion of the Company to accept the results, the transaction is anticipated to close on or before May 1st, 2006. Additional details concerning this transaction may be found in the Company's Form 8K report filed December 27, 2005 which is hereby incorporated by reference.

We believe that these strategic acquisitions and alliances will allow us to grow our businesses. In January, 2006 the Company was approved for ISO 9001:2000 certification. This certification will provide the Company with worldwide recognition that we have high quality products and standards and will allow us a greater ability to compete on a national and International basis.

MEMS CA was incorporated in November 2000. MEMS CA is an engineering and design firm. MEMS CA has been engaged in the engineering and sale of instrumentation, blending skids and Intelligent Filtration Systems (IFS). During 2004, MEMS CA's engineers designed and constructed an acoustic viscometer. This instrument utilizes sound waves traveling through a fluid stream to determine the fluid's viscosity. To date, the Company has determined that the instrument may be utilized to measure the viscosity of a range of aqueous and organic fluids, including refined and crude oils. In May 2005 the Company filed a utility patent application respecting this device which replaces the previously filed provisional patent. MEMS CA is presently designing a multi-variant pressure, temperature and flow meter for use in industrial applications.

During 2004, MEMS CA's engineers also built a hydrocarbon blending system technology. One system we produced mixes three organic fluids, in differing percentages with accuracy. One of the Company's long term goals is to be able to build blending systems to mix ethanol with motor gasoline. When properly mixed, ethanol and gasoline provide a higher octane, cleaner burning fuel for automobiles.

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MEMS CA's engineers have also been charged by the Company to oversee the Company's IFS business. These systems are utilized to filter wastes from amine, oil or water streams. Unlike a typical canister filter system, such as the oil filter in an automobile, which needs to be periodically replaced and disposed of, the filters utilized in intelligent filtration systems can last for decades. Furthermore, the filter system is self cleaning. Once the system recognizes that its filter is becoming clogged by debris filtered from the fluid flow, it turns the fluid flow through the filter off and "back flushes" the debris caked on the filter into a collection vessel. The system then turns the fluid flow through the system back on through the freshly cleaned filter. The filter cleaning process takes only seconds to complete and repeats as necessary to assure optimum filtration. A facility utilizing IFS technology needn't dispose of contaminated filters, but only need dispose of the contaminate itself. Thus, while a filtration system based upon IFS technology typically requires a greater capital investment on the part of the purchaser, these costs are offset in the long run by savings in filter replacement and disposal costs. The Company anticipates that it may be able to utilize its intelligent filtration systems as an integral part of any ethanol production facility that it may design. The Company is presently aware of three competitors offering similar technologies to MEMS IFS technology. In February, 2006 MEMS received a purchase order for \$1.5 million for the engineering, manufacturing and installation of an automatic back flushable filtration system (ABF/IFS). This is the largest sale in the Company's history. The customer is a Fortune 50 energy company serving the major

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integrated oil and gas industry. (See subsequent events for more details.)

Presently, MEMS CA utilizes a combination direct sales force as well as commissioned sales representatives to market and distribute its products. MEMS CA targets niche business segments and is not dependent upon any one or a few major customers. A typical contract requires MEMS CA to engineer a product that previously did not exist or improve upon an existing technology using MEMS (Micro Electro Mechanical Systems) devices. The vast majority of the monies raised since the Company's acquisition of MEMS CA have been utilized to fund MEMS CA's acquisition and development of new technologies.

Gulfgate produces particulate filtration equipment utilized in the oil and power industries. Gulfgate also produces vacuum dehydration and coalescing systems that are utilized to remove water from ground based turbine engine oil. These same systems are used by electric power generation facilities to remove water from transformer oils. To help meet its customer's diverse needs, Gulfgate maintains and operates a rental fleet of filtration and dehydration systems. Presently, Gulfgate utilizes a combination direct sales force as well as commissioned sales representatives to market and distribute its products.

Bott is a stocking distributor for various lines of industrial pumps, valves and instrumentation such as those utilized in MEMS CA's IFS and blending skid systems. Bott specializes in the construction of aviation and refueling systems, including, but not limited to, helicopter refueling systems on oil rigs throughout the world. Bott also constructs refueling systems for commercial marine vessels. Bott's customers include chemical plants, refineries, power plants and other industrial applications. Bott utilizes a combination direct sales force as well as commissioned sales representatives to market and distribute its products.

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On April 25, 2005 the Company and Accelon Energy System, Inc. ("Accelon") entered into a contract with Can Am whereby the Company and Accelon agreed to provide certain services to Can Am on the condition that Can Am receives project funding on or before June 1st, 2005. Please refer to the Company's Form 8-K filing dated April 29, 2005 for details relating to this contract. The contract was amended on May 24, 2005 by the parties to extend the termination date from June 1, 2005 to October 31, 2005. Please see Exhibit 10.2 for details relating to this amendment.

Can Am was created to manufacture, own and operate one ethanol production facility in British Columbia Canada. The plant was to utilize a synthetic biomass conversion process to convert wood waste materials into ethanol. In June 2005, the Company and its Canadian counterpart each made a CN\$25,000 at risk deposit to open escrow toward purchase of 2,150 acres of land intended to serve as a plant site in British Columbia, Canada ("Purchase Agreement").

Subsequently, the Company paid an additional at-risk deposit of CN\$50,000 for an extension of the Closing Date of the Purchase Agreement. As of the date of this report, the Purchase Agreement remains active, but has not closed. Due to the length of time that Purchase Agreement has remained pending, as well as other factors, the Company is contemplating selling its' interest to Accelon Energy System, Inc., the other owner of Can Am Ethanol One, Inc.

HEO is a private Canadian corporation organized for the purpose of developing and operating a synthetic wood waste biomass-to-ethanol plant in Hearst, Ontario Canada. Subject to receipt of the required funding several biomass-to-ethanol plants are planned for Canada that will also use a synthetic biomass-to-ethanol conversion process. It is anticipated that the ethanol manufactured by these

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facilities will be sold to companies which blend ethanol with motor fuel. The blending of ethanol with motor fuel reduces emissions and will help countries such as Canada meet the Kyoto Accords for reduced greenhouse gas emissions. We estimate that each ethanol plant will require approximately \$150 million in capital. MEMS USA's engineering group, headquartered in Westlake Village, CA, will be entering into contract negotiations with HEO to develop the engineering data and direct the plant engineering and construction projects. It is anticipated that the Company's Texas subsidiaries will be called upon to supply instrumentation for the project and assist in its modular construction, subject to receipt of funding.

On December 21, 2005, HEO entered into a land purchase agreement with C. Villeneuve Construction Company, Ltd. Upon successful completion of due diligence concerning 600 acres of land to be acquired near Hearst, Ontario, Canada and at the discretion of the Company to accept the results, the transaction is anticipated to close on or before May 1st, 2006. Additional details concerning this transaction may be found in the Company's Form 8K report filed December 27, 2005 which is hereby incorporated by reference.

We are presently in the process of integrating and improving our subsidiaries, which we believe will promote efficiency and lower operating costs. While each of our subsidiaries will remain a separate operating entity, we intend to optimize the resources of each. MEMS CA's primary responsibility will be to design and engineer new products and systems for the energy sector. It is anticipated that Bott will supply component parts for these systems, which will be assembled in Texas under MEMS CA's supervision. We have already transferred our IFS and other technology to Texas in order to establish lines of communication and a working relationship. We also anticipate that once we obtain the necessary funding, the symbiotic relationship between our subsidiaries will allow us to engineer, design, and partially construct ethanol plants for our current and future Canadian joint ventures.

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### Comparison of Operations

Net sales decreased \$388,178 (12.9%) to \$2,626,519 for the first quarter of fiscal 2006 from \$3,014,697 for the first quarter of fiscal 2005. The sales decrease during the fiscal quarter ended December 31, 2005 as compared to the prior year quarter is mainly due to commercial aviation refueling systems shipments slipping to the second fiscal quarter. With the improving economy the Company finished the quarter ended December 31, 2005 with a record level of orders in sales backlog (\$3.6 million).

The Company computes gross profit as net sales less cost of sales. The gross profit margin is the gross profit divided by net sales, expressed as a percentage. The gross profit margin was 21.1% and 28.5% in the first quarter of fiscal 2006 and 2005, respectively. This decrease of 7.4% was mainly due to lower margins on commercial aviation refueling systems shipments. Margins for this segment of the business for the quarter ended December 31, 2005 reflect the significant competitive pressures encountered on bidding and winning several key customer jobs.

Selling, general and administrative (SG&A) expenses for the first quarter of fiscal 2006 were \$1,321,547, compared with \$1,097,504 for the prior year period. The increase in SG&A spending in the fiscal quarter ended December 31, 2005 as compared to the prior year period is mainly due to auditing fees associated with the acquisition of Gulfgate and Bott and legal costs (See Part II, Item 1, Legal Proceedings).

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We expect that over the near term, our selling, general and administration expenses will increase as a result of, among other things, increased legal and accounting fees associated with increased corporate governance activities in response to the Sarbanes-Oxley Act of 2002, recently adopted rules and regulations of the Securities and Exchange Commission, the filing of a registration statement with the Securities and Exchange Commission to register for resale the shares of common stock and shares of common stock underlying warrants issued in various private offerings, increased employee costs associated with planned staffing increases, increased sales and marketing expenses, increased activities related to the design, engineering and construction of the Hearst Ethanol One, Inc. ethanol production facility and increased activity in searching for and analyzing potential acquisitions.

For the quarter ended December 31, 2005, shareholder's deficit was \$552,422 as compared to equity of \$968,068 for the prior year period ended December 31, 2004. The decrease in shareholder equity is primarily attributable to net operating losses incurred over the past twelve months, and accruals to record an obligation to issue penalty shares of MEMS common stock related to the October, 2004 acquisition of Gulfgate and Bott (\$809,966) and a liability arising out of a legal settlement (\$307,000; See note 11).

Upon the anticipated receipt of funds (\$2.5 million) from Mercatus & Partners, Limited for a stock subscription receivable and upon the issuance of \$1.0 million for shares of MEMS common stock sold in a private placement offering in September, 2005 (See Part II, Item 2, Unregistered Sales of Equity Securities and Use of Proceeds), less the obligations due to Mr. Trumble (\$307,000), equity would increase \$4.0 million and represent a \$2.5 million increase over the prior year period ended December 31, 2004.

Interest expense, net was \$35,498 and \$19,286 for the fiscal quarters ended December 31, 2005 and 2004, respectively. The increase in interest expense is attributable to the interest payments made pursuant to the terms of the credit lines of Bott and Gulfgate.

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In summary, net income was \$2,913,581 and a net loss of \$234,432 for the fiscal quarters ended December 31, 2005 and 2004, respectively. The increased net income for the fiscal quarter ended December 31, 2005 as compared to the prior year was due to the favorable settlement of a legal dispute (\$3,703,634; See note 11). Excluding the income from the settlement agreement the Company would have reported a net loss of \$790,053. The increased net loss for the fiscal quarter ended December 31, 2005 as compared to the prior year was mainly due to lower sales and associated margins on commercial aviation refueling systems shipments and higher general and administrative expenses (See Selling, general and administrative expenses).

### Liquidity and Capital Resources

Our plan of operations over the next 12 months includes the continued pursuit of our goal to design, engineer, build and operate one or more ethanol plants. In that regard we are dependent upon Hearst Ethanol One, Inc.'s efforts to raise the necessary capital. We also intend to continue to develop our sensor technology. We believe that our working capital as of the date of this report will not be sufficient to satisfy our estimated working capital requirements at our current level of operations for the next twelve months. Our cash and cash equivalents were \$106,208 as of December 31, 2005, compared to cash and cash equivalents of \$64,269 as of December 31, 2004.

At our current cash "burn rate", we will need to raise additional cash through

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debt or equity financings during the first half of 2006 in order to fund our continued development of our sensor technology and devices and to finance possible future losses from operations as we expand our business lines and reach a profitable level of operations. Before considering Hearst Ethanol One, Inc., we believe that we require a minimum of \$2,500,000 in order to fund our planned operations over the next 12 months, in addition to the capital required for the establishment of any ethanol production facilities. We plan to obtain the additional working capital through private placement sales of our equity securities. As of the date of this report, we have one commitment for the sale of \$2.5 million of our securities but, as of the date of this report the Company has not received the funds. In the absence of this commitment there is no assurance that such funds will be available on commercially reasonable terms, if at all. Should we be unable to raise the required funds, our ability to finance our continued operations will be materially adversely affected.

### Subsequent Event

During the month of January 2006, the Company issued and delivered an aggregate amount of 370,977 shares of the Company's common stock pursuant to the stock purchase agreement dated October 26, 2004 between Mark Trumble and the Company (See Note 2).

In February 2006, MEMS USA received a \$1.5 million order to construct an amine purification system which will be installed at a refinery with a large oil company. Amine is used in a refinery to remove Carbon Dioxide and Sulfur products from oil to produce cleaner burning fuels. There are three major components in the amine purification system. The first component is MEMS USA's Intelligent Backflushing Filtration System (IFS). This system removes particulates such as rust which gets dislodged from pipes and other components in the refinery and other hard particulates. The filtration system uses permanent filter elements which are backflushed periodically. The backflush waste material consists of water and the particulates which have been filtered by the permanent filter elements. The backflush waste is further concentrated in a decanting vessel. The second major system is a carbon bed filtration system which is used to remove chemical contaminants and hydrocarbons which will sometimes mix with the amine during its use in a refinery. The third major system is an Ion Exchange filtration system which removes heat stable salts which form in the amine, causing the amine to be less effective in removing Carbon Dioxide and Sulfur products. These systems will provide years of effective utilization of the amine fluids and extend the useful life of the refinery's amine process equipment.

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### Cautionary Statement Regarding Future Results, Forward-Looking Information and Certain Important Factors

We make written and oral statements from time to time regarding our business and prospects, such as projections of future performance, statements of management's plans and objectives, forecasts of market trends, and other matters that are forward-looking statements. Statements containing the words or phrases "will likely result," "are expected to," "will continue," "is anticipated," "estimates," "projects," "believes," "expects," "anticipates," "intends," "target," "goal," "plans," "objective," "should" or similar expressions identify forward-looking statements, which may appear in documents, reports, filings with the Securities and Exchange Commission, news releases, written or oral presentations made by officers or other representatives made by us to analysts, stockholders, investors, news organizations and others, and discussions with management and other representatives of us.

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Our future results, including results related to forward-looking statements, involve a number of risks and uncertainties. No assurance can be given that the results reflected in any forward-looking statements will be achieved. Any forward-looking statement made by or on behalf of us speaks only as of the date on which such statement is made. Our forward-looking statements are based upon assumptions that are sometimes based upon estimates, data, communications and other information from suppliers, government agencies and other sources that may be subject to revision. Except as required by law, we do not undertake any obligation to update or keep current either (i) any forward-looking statement to reflect events or circumstances arising after the date of such statement, or (ii) the important factors that could cause our future results to differ materially from historical results or trends, results anticipated or planned by us, or which are reflected from time to time in any forward-looking statement which may be made by or on behalf of us.

In addition to other matters identified or described by us from time to time in filings with the SEC, there are several important factors that could cause our future results to differ materially from historical results or trends, results anticipated or planned by us, or results that are reflected from time to time in any forward-looking statement that may be made by or on behalf of us. Some of these important factors, but not necessarily all important factors, include those risk factors set forth in our 2005 Annual Report on Form 10-KSB/A filed with the SEC on February 2, 2006

### ITEM 3. Controls and Procedures

Our disclosure controls and procedures are designed to ensure that information required to be disclosed in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission and that such information is accumulated and communicated to our management, as appropriate, to allow timely decisions regarding required disclosure. Our President and Chief Financial Officer have reviewed the effectiveness of our disclosure controls and procedures and have concluded that the disclosure controls and procedures, overall, are effective as of the end of the period covered by this report. There has been no change in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the period covered by this report that have materially affected, or are reasonably likely to materially affected, the Company's internal control over financial reporting.

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## PART II - OTHER INFORMATION

### Item 1. Legal Proceedings

On October 17, 2005, the Company and its officers filed a complaint against Lawrence Weisdorn, Jr. ("Weisdorn"), the Company's former Chief Executive Officer and Chairman of the Board of Directors, Lawrence Weisdorn, Sr. ("Weisdorn Sr." and together with Weisdorn, the "Weisdorn Parties"), Nathan Drage ("Drage") and Drage related parties in the Superior Court of the State of California for Los Angeles County, alleging claims for, among other things, breaches of Nevada and federal law and breach of fiduciary duty (the "Action"). The Company's claims were based in substantial part on allegations of the unauthorized issuance of shares of the Company's predecessor's common stock in December 2003, prior to the reverse acquisition and merger with MEMS-CA which was finalized in February, 2004. The Company sought an injunction preventing the Weisdorn Parties and Drage and his related parties from selling or transferring any of the shares of the Company's common stock issued in December 2003, the return of the shares to the

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Company for cancellation and monetary damages.

On November 3, 2005, the Weisdorn Parties filed a cross-complaint against the Company and its officers, alleging claims for, among other things, breach of employment agreement, libel and indemnification (the "Weisdorn Counterclaim"). The Weisdorn Parties' claims were based in part on assertions by Weisdorn that he was improperly terminated without cause from his positions with the Company in June 2005, and that he was entitled to indemnification pursuant to Nevada corporations law in connection with the Action. The Weisdorn Parties sought monetary damages.

On December 15, 2005, the Company and its officers entered into a Settlement Agreement and Release with the Weisdorn Parties and other Weisdorn related parties, effective as of July 1, 2005 (the "Settlement Agreement"), pursuant to which the parties agreed to, among other things, dismiss the Action as it related to the Weisdorn Parties, dismiss the Weisdorn Counterclaim, mutually release all claims and mutually indemnify the other parties from certain claims. Weisdorn also agreed to deliver a letter of resignation to the Company, confirming his resignation as Chief Executive Officer and Chairman of the Board of Directors of the Company as of June 25, 2005 and clarifying and confirming the terms of his separation from the Company. The Weisdorn Parties and other Weisdorn related parties further agreed to deliver to the Company all shares or rights to shares of the Company's common stock owned by such parties. The net stock returned to the Company by the Weisdorn parties was 2,699,684 shares, not including 670,000 shares of the Company's common stock to be held by the Company in an account for the benefit of the Weisdorn Parties (the "Retained Stock"), which Retained Stock will be sold for the benefit of the Weisdorn Parties pursuant to the terms set forth in the Settlement Agreement. The Company has the option to purchase any portion of the Retained Stock at a price determined according to the terms of the Settlement Agreement. The Company also agreed to assume the obligations of the Weisdorn Parties and other Weisdorn related parties to purchase certain shares of the Company's common stock from a third party, and the Weisdorn Parties assigned to the Company their interests in certain claims against a third party.

The Settlement Agreement did not in any way affect claims brought in the Action by the Company and its officers against Drage and the Drage-related entities. However, on January 13, 2006, Drage and Adrian Wilson verbally agreed to a settlement in principle with the Company, which the parties intend to memorialize shortly. In connection with the verbal agreement to a settlement, the Company and its officers filed a Request for Dismissal without prejudice of all claims against Drage and the Drage-related entities on January 13, 2006.

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### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds:

On October 26, 2004 the Company issued 1,309,667 shares of its common stock to Mr. Mark Trumble in consideration for the purchase of 100% of the shares of Bott Equipment Company, Inc. and Gulfgate Equipment, Inc. in accordance with the Stock Purchase Agreement ("Agreement") entered into by the Company and Mr. Trumble. (A copy of the Agreement was filed as an Exhibit to our form 10KSB/A filed with the SEC on February 3, 2005.) The Agreement contains covenants in favor of Mr. Trumble that are secured with our promise to issue up to a total of 1,236,591 additional shares of our stock to Mr. Trumble in the event we fail to satisfy those covenants. As of the date of this report, the Company is obligated to issue 370,977 penalty shares to Mr. Trumble. Additionally, certain outstanding covenants may require us to issue up to 370,977 additional penalty shares in the event that we fail to satisfy those covenants.

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In its stock purchase agreement with Mr. Trumble, respecting the purchase of Gulfgate and Bott, the Company recognized that Trumble would sell 326,344 shares of its stock at a purchase price of approximately \$607,000 to private parties, including a related party Lawrence Weisdorn, Sr., the CEO's father and a shareholder and/or Weisdorn Sr.'s assignees pursuant to a written agreement between Trumble and Weisdorn Sr.. As part of the Company's agreement with Mr. Trumble, the Company agreed that if Mr. Trumble failed to recognize \$607,000, portions of which were due on specific dates following the closing date of the transaction, the Company agreed to issue up to 494,636 shares of restricted stock to Trumble.

In December 2004 the Company paid \$75,000 to Mr. Mark Trumble in order to avoid the issuance of 61,829 Penalty Shares to Mr. Trumble. In January 2005, the Company paid Mr. Trumble \$158,000 to avoid the issuance of 123,659 Penalty Shares to Mr. Trumble. Although the Company had no obligation to make these payments under its agreement with Mr. Trumble, it did have an obligation to issue penalty shares to Mr. Trumble if Mr. Trumble did not recognize these monies through the sale of stock. When the Company learned that the primary obligor, Mr. Lawrence Weisdorn Sr., was then unable to fulfill his contractual obligations to Mr. Trumble, the Company believed that it was in the shareholder's best interests to avoid dilution by making these payments and seeking to recoup the monies paid by the Company from Mr. Weisdorn Sr. at a later date. As of this date the company has received \$185,000 from Lawrence Weisdorn Sr. The Company believes that it will recover some or all of the remaining balance, \$48,000, before the close of the next quarter. The Company is obligated to issue to Mr. Trumble 247,318 Penalty Shares because Mr. Trumble did not recognize \$307,000 within 60 days of the close of the acquisition. Finally, the Company is obligated to issue to Mr. Trumble an additional 123,659 Penalty Shares since the Company did not receive \$2,000,000 in gross equity funding within 120 days of the Closing Date. In summary, the Company's obligation to issue penalty shares totaling 370,977 valued at \$810,000 to Mr. Trumble has significantly increased goodwill.

On November 10, 2005, the Company entered into a stock purchase agreement with Mercatus & Partners, Limited, a private limited company of the United Kingdom ("Mercatus Limited"), for the sale of 1,530,000 shares of the Company's common stock for a minimum purchase price of \$0.73 per share (the "SICAV One Agreement), and another stock purchase agreement with Mercatus Limited also for the sale of 1,530,000 shares of the Company's common stock for a minimum purchase price of \$0.73 per share (the "SICAV Two Agreement" and together with the SICAV One Agreement, the "SICAV Agreements"). The shares offered and sold under the SICAV Agreements were offered and sold pursuant to a private placement that is exempt from the registration provisions of the Securities Act under Section 4(2) of the Securities Act pursuant to Mercatus Limited's exemption from

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registration afforded by Regulation S. Pursuant to the terms of the SICAV Agreements, the Company issued and delivered an aggregate number of 3,060,000 shares of the Company's common stock within five days of the execution of the respective SICAV Agreements to a custodial lock box on behalf of Mercatus Limited for placement into two European SICAV funds. The SICAV Agreements provided Mercatus Limited with up to 30 days after the delivery of the shares of the Company's common stock to issue payment to the Company. If payment for the shares was not received by the Company within 30 days of the delivery of the shares, the Company had the right to demand the issued shares be returned. (The Company has not yet received payment for the shares issued pursuant to the SICAV Agreements but has not exercised its right to demand return of the shares.)

On November 12, 2005, the Company also entered into another private stock

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purchase agreement with Mercatus & Partners, Limited, a private limited company of the United Kingdom ("Mercatus Limited") for the sale of 170,000 shares of the Company's common stock for a minimum purchase price of \$0.82 per share (the "Private SICAV One Agreement") and another private stock purchase agreement with Mercatus LP also for the sale 170,000 shares of the Company's common stock for a minimum purchase price of \$0.82 per share (the "Private SICAV Two Agreement" and with the Private SICAV One Agreement, the "Private SICAV Agreements"). The shares offered and sold under the SICAV Agreements were offered and sold pursuant to a private placement that is exempt from the registration provisions of the Securities Act under Section 4(2) of the Securities Act pursuant to Mercatus Limited's exemption from registration afforded by Regulation S. Pursuant to the terms of the Private SICAV Agreements, the Company issued and delivered an aggregate amount of 340,000 shares of the Company's common stock within five days of the execution of the respective Private SICAV Agreements to a custodial lock box on behalf of Mercatus Limited for placement into a European bank SICAV fund. Subject to a valuation of the shares, Mercatus LP had up to 30 days after the delivery of the shares of the Company's common stock to issue payment to the Company. If payment was not received by the Company within 45 days of the issuance of the shares to Mercatus Limited, the Company had the right to demand the issued shares be returned. [The Company has not yet received payment for the shares issued pursuant to the Private SICAV Agreements but has not exercised its right to demand return of the shares.]

On December 13, 2005 the Company issued and delivered 125,000 shares of the Company's common stock for \$100,000.

During the month of December 2005, the Company issued and delivered an aggregate amount of 8,254 shares of the Company's common stock to three consultants for services valued at approximately \$16,000.

Exemption from the registration provisions of the Securities Act of 1933 for the transactions described above is claimed under Section 4(2) of the Securities Act of 1933, among others, on the basis that such transactions did not involve any public offering and the purchasers were sophisticated or accredited with access to the kind of information registration would provide.

Item 3. Defaults upon Senior Securities - None

Item 4. Submission of Matters to a Vote of Security Holders - None

Item 5. Other Information

### Principal Accountant Fees and Services

Our board of directors has selected Kabani & Company, Inc. as our independent accountants to audit our consolidated financial statements for the fiscal year 2005. Stonefield Josephson, Inc. previously audited our consolidated financial statements for the two fiscal years ended September 30, 2004 and 2003.

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Item 6. Exhibits

(a) Exhibits

31.1 Certification of President Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934 (Filed electronically herewith)

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- 31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934 (Filed electronically herewith)
- 32.2 Certification of President and Chief Financial Officer Pursuant to 18 U.S.C Section 1350 (Furnished electronically herewith).

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SIGNATURES

Pursuant to the requirements 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.

MEMS USA, Inc.  
(Registrant)

Date: February 22, 2006

/s/

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James A. Latty  
Chief Executive Officer

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