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SENSOR SYSTEM SOLUTIONS INC

Form 10QSB

November 15, 2005

U.S. Securities and Exchange Commission  
Washington, D.C. 20549

FORM 10-QSB

(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, 2005

or

Transition Report Pursuant to Section 13 of 15(d) of the Securities Exchange Act of 1934

For the Transition Period From \_\_\_\_\_ to \_\_\_\_\_

Commission File number 0-024828

SENSOR SYSTEM SOLUTIONS, INC.  
(Exact name of small business issuer as specified in its charter)

NEVADA (State or other jurisdiction of incorporation or organization) 98-0226032 (IRS Employer Identification No.)

45 Parker Avenue, Suite A  
Irvine, California 92618

(Address of principal executive offices)

(949) 855-6688

(Issuer's telephone number)

Check 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

As of November 15, 2005 there were 61,705,019 shares of Common Stock outstanding.

Transitional Small Business Disclosure Format

Yes  No

=====

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PART I  
FINANCIAL INFORMATION

Item 1. Financial Statements.

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## CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NINE MONTHS ENDED SEPTEMBER 30, 2005 AND 2004 (UNAUDITED)

### SENSOR SYSTEM SOLUTIONS, INC. AND SUBSIDIARY

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### SENSOR SYSTEM SOLUTIONS, INC. AND SUBSIDIARY CONDENSED CONSOLIDATED BALANCE SHEETS As of September 30, 2005 (Unaudited) and December 31, 2004

		September 30, 2005 (Unaudited) -----
ASSETS		
CURRENT ASSETS		
Cash		\$ 11,981
Accounts receivable, net		139,230
Inventory		278,788
Prepays and other current assets		14,148
		-----
Total current assets		444,147
Property and equipment, net		255,753
Other assets		54,112
		-----

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Total assets		\$ 754,012
		=====
LIABILITIES AND STOCKHOLDERS' DEFICIENCY		
CURRENT LIABILITIES		
Accounts payable and accrued expenses		\$ 1,250,821
Notes payable		505,347
Notes payable, related parties		358,076
Current portion of capital lease obligations		7,819
Current portion of deferred rent concession		4,757
		-----
Total current liabilities		2,126,820
		-----
LONG-TERM LIABILITIES		
Capital lease obligations, net of current portion		28,429
Deferred rent concession, net of current portion		6,514
		-----
		34,943
		-----
Commitments and contingencies		--
STOCKHOLDERS' DEFICIENCY		
Preferred stock, \$.001 par value, 20,000,000		
shares authorized, none outstanding		--
Common stock, \$.001 par value, 180,000,000		
shares authorized, 59,279,241 and 3,976,868 shares issued and outstanding		59,279
Common stock to be issued (15,404,871 and 7,700,000 shares)		878,512
Additional paid-in capital		6,661,002
Deferred compensation		(39,612)
Accumulated deficit		(8,966,933)
		-----
Total stockholders' deficiency		(1,407,752)
		-----
Total liabilities and stockholders' deficiency		\$ 754,012
		=====

See accompanying notes to condensed financial statements.

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SENSOR SYSTEM SOLUTIONS, INC. AND SUBSIDIARY  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
For three and nine months ended September 30, 2005 and 2004 (Unaudited)

	For three months ended September 30,		For ni Se
	2005	2004	2005
	-----	-----	-----
Sales, net	\$ 347,061	\$ 161,726	\$ 855,3

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Cost of goods sold	191,545	211,701	565,3
	-----	-----	-----
Gross profit (loss)	155,516	(49,975)	289,9
	-----	-----	-----
Operating expenses	405,733	355,494	1,169,9
Amortization of discount on notes payable and finance costs	86,876	197,267	278,3
	-----	-----	-----
Total operating expenses	492,609	552,761	1,448,3
	-----	-----	-----
Net loss	\$ (337,093)	\$ (602,736)	\$ (1,158,3)
	=====	=====	=====
Loss per common share, basic and diluted	\$ (.01)	\$ (.01)	\$ (.01)
	=====	=====	=====
Weighted average shares outstanding, basic and diluted, including effects of in-kind stock splits.	59,279,241	59,279,241	59,279,2
	=====	=====	=====

See accompanying notes to condensed financial statements.

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SENSOR SYSTEM SOLUTIONS, INC. AND SUBSIDIARY  
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' DEFICIENCY  
For nine months ended September 30, 2005 (Unaudited)

	Common Stock		Common Stock to be issued	
	Shares	Amount	Shares	Amount
	-----	-----	-----	-----
Balance January 1, 2005	3,976,868	\$ 3,977	7,700,000	\$ 2,100,000
Forfeiture of stock options	--	--	--	--
Compensatory stock issued	7,500,000	7,500	(7,500,000)	(1,800,000)
Warrants exercised by shareholders from merger	47,802,373	47,802	--	--
Common stock to be issued for settlement of debt	--	--	14,793,290	262,500

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Common stock to be issued for settlement of debt	--	--	411,581	316,012
Intrinsic value of common stock warrants issued with note payable	--	--		--
Amortization of deferred Compensation	--	--		--
Net loss	--	--		--
	-----	-----	-----	-----
Balance September 30, 2005	<u>59,279,241</u>	<u>\$ 59,279</u>	<u>15,404,871</u>	<u>\$ 878,512</u>

	Additional paid-in capital	Deferred compensation	Accumulated deficit	Total
	-----	-----	-----	-----
Balance January 1, 2005	\$ 4,867,790	\$ (186,400)	\$ (7,808,558)	\$ (1,023,191)
Forfeiture of stock options	(112,200)	112,200	--	--
Compensatory stock issued	1,792,500	--	--	--
Warrants exercised by shareholders from merger	(47,802)	--	--	--
Common stock to be issued for settlement of debt	--	--	--	262,500
Common stock to be issued for settlement of debt	--	--	--	316,012
Intrinsic value of common stock warrants issued with note payable	160,714	--	--	160,714
Amortization of deferred Compensation	--	34,588	--	34,588
Net loss	--	--	(1,158,375)	(1,158,375)
	-----	-----	-----	-----
Balance September 30, 2005	<u>\$ 6,661,002</u>	<u>\$ (39,612)</u>	<u>\$ (8,966,933)</u>	<u>\$ (1,407,752)</u>

See accompanying notes to condensed financial statements.

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CONDENSED NOTES TO FINANCIAL STATEMENTS  
FOR NINE MONTHS ENDED SEPTEMBER 30, 2005 AND 2004 (UNAUDITED)

	2005
	-----
	(Unaudited)
Cash flows from operating activities:	
Net loss	\$(1,158,375)
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization	71,464
Amortization of discount on notes payable	270,837
Amortization of deferred compensation	34,588
Net loss from assets held for disposal	--
Changes in operating assets and liabilities:	
Accounts receivable	(38,700)
Inventory	(58,343)
Prepays and other current assets	10,404
Deferred rent	(4,500)
Accounts payable and accrued expenses	581,017
	-----
Net Cash Used In Operating Activities	(291,608)
	-----
Cash flows from investing activities:	
Deposit	--
Purchase of property and equipment	(6,500)
	-----
Net Cash Used In Investing Activities	(6,500)
	-----
Cash flows from financing activities:	
Proceeds from notes payable	298,744
Principal payments on capital leases	(5,770)
	-----
Net Cash Provided By Financing Activities	292,974
	-----
Net (decrease) increase in cash and cash equivalents	(5,134)
Cash and cash equivalents, beginning of period	17,115
	-----
Cash and cash equivalents, end of period	\$ 11,981
	=====
Supplemental disclosure of cash flow information Cash paid for:	
Interest	\$ 9,914
	=====
Taxes	\$ 800
	=====
Non-cash investing and financing activities:	
Forfeiture of stock options	\$ 112,200
Compensatory stock issued	1,800,000
Warrants exercised by shareholders from merger	47,802
Conversion of notes payable to common stock to be issued	578,512
Accrued interest added to notes payable principal	51,012
Discount related to warrants and convertible notes	160,714
Acquisition of equipment through capital lease obligations	--

SENSOR SYSTEMS SOLUTIONS, INC.  
CONDENSED NOTES TO FINANCIAL STATEMENTS  
FOR NINE MONTHS ENDED SEPTEMBER 30, 2005 AND 2004 (UNAUDITED)

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial information included herein is unaudited. The interim consolidated financial statements have been prepared on the same basis as the annual financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, considered necessary for a fair presentation of the Company's consolidated financial position and results of operations for the periods presented. Certain information and footnote disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes presented in the Company's Form 10-KSB for the year ended December 31, 2004. Interim operating results are not necessarily indicative of operating results expected for the entire year.

Description of business

The Company is a manufacturer and assembler of sensors and micro systems, and its products include thin film sensors, thin film pressure sensors and micro-machined pressure sensors, and micro systems that may include sensors, signal conditioning circuits, LCD display, computer interface and molded housing specifically designed to the customers needs.

Going concern

The Company incurred a net loss of \$1,158,375 and a negative cash flow from operations of \$291,608 for nine months ended September 30, 2005, and had a working capital deficiency of \$1,682,673 and a stockholders' deficiency of \$1,407,752 at September 30, 2005. These matters raise substantial doubt about its ability to continue as a going concern. Without realization of additional capital, it would be unlikely for the Company to continue as a going concern. Management believes that actions are presently being taken to revise the Company's operating and financial requirements in order to improve the Company's financial position and operating results. However, given the levels of its cash resources and working capital deficiency at September 30, 2005, management believes cash to be generated by operations will not be sufficient to meet anticipated cash requirements for operations, working capital, and capital expenditures during 2005.

The Company had a substantial working capital deficit. On October 6, 2005, the Company has secured a total of \$15,600,000 in financing with Cornell Capital Partners, LP (Cornell) to support the continued development and growth of the Company.

Under the agreement, Cornell has committed to provide up to \$15 million of funding in the form of a Standby Equity Distribution Agreement (SEDA) to be drawn down over a 24-month period at the Company's discretion. In addition, the Company sold an aggregate of \$600,000 of fixed price Secured Convertible Debentures to Cornell.

The Company is seeking additional \$1,000,000 bridge financing to further develop into a fully-equipped public company in order to take advantage of the SEDA funding for its long-term plan. However, no assurance can be given



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that such funds will be available or the term thereof. The accompanying condensed consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

### Principles of consolidation

The consolidated financial statements for the nine months ended September 30, 2005 and 2004 include the accounts and operations of Sensor Systems Solutions Inc. and its wholly owned subsidiary. Intercompany accounts and transactions have been eliminated in consolidation.

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SENSOR SYSTEMS SOLUTIONS, INC.  
CONDENSED NOTES TO FINANCIAL STATEMENTS  
FOR NINE MONTHS ENDED SEPTEMBER 30, 2005 AND 2004 (UNAUDITED)

### Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### Stock - based compensation

The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards (SFAS) No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosures" as well as those outlined in SFAS No. 123, "Accounting for Stock-Based Compensation". As permitted by SFAS 148 and SFAS 123, the Company continues to apply the provisions of Accounting Principles Board Opinion (APB) No. 25, "Accounting for Stock issued to Employees" and related interpretations in accounting for the Company's stock option plan. Accordingly, compensation cost for stock options is measured as the excess, if any, of the estimated fair value of the Company's stock at the date of the grant, over the amount an employee must pay to acquire the stock. Stock based awards for non-employees are accounted for at fair value equal to the excess of the estimated fair value of the Company's stock over the option price using an estimated interest rate to calculate the fair value of the option. There were no stock based awards to non-employees for the nine months ended September 30, 2005.

Had compensation cost for all stock option grants been determined based on their fair value at the grant dates, consistent with the method prescribed by SFAS 148 and SFAS 123, our net loss and loss per share would have been adjusted to the pro forma amounts indicated below:

	Nine months ended September 30:	
	2005	2004
Net loss	\$ (1,158,375)	\$ (1,134,805)
Add: Stock-based expense included in net loss	34,588	58,204
Deduct: Fair value based stock-based expense	(39,160)	(26,900)
Pro forma net loss	\$ (1,162,947)	\$ (1,219,909)

Basic and diluted earnings per share:

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As reported	\$	(.02)	\$	(.04)
Pro forma under SFAS No. 123	\$	(.02)	\$	(.04)

### Earnings (loss) per share

Basic earnings (loss) per common share (EPS) are based on the weighted average number of common shares outstanding during each period. Diluted earnings per common share are based on shares outstanding (computed as under basic EPS) and potentially dilutive common shares. As of September 30, 2005 and 2004, the Company had granted stock options for 96,500 and 136,500 shares of common stock, respectively, that are potentially dilutive common shares but are not included in the computation of loss per share because their effect would be anti-dilutive. The exercise of the shareholder warrants was accounted for in earnings per share as a stock split retroactive to the May 24, 2004 merger as discussed in Note 5.

### Recent Accounting Pronouncements

In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151, "Inventory Costs". This Statement amends the guidance in ARB No. 43 Chapter 4 Inventory Pricing, to require items such as idle facility costs, excessive spoilage, double freight and rehandling costs to be expensed in the current period, regardless if they are abnormal amounts or not. This Statement will become effective for us in the first quarter of 2006. The adoption of SFAS No. 151 is not expected to have a material impact on the Company's consolidated financial statement.

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In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard ("SFAS") No. 123 (R), "Share-Based Payment" ("SFAS 123(R)"). SFAS No. 123 (R) revises SFAS 123, "Accounting for Stock-Based Compensation" and supersedes Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS 123 (R) focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS 123 (R) requires companies to recognize in the statement of operations the cost of employee services received in exchange for awards of equity instruments based on the grant-date fair value of those awards (with limited exceptions). SFAS 123 (R) is effective as of the first interim or annual reporting period of the first fiscal year that begins after June 15, 2005 for small business issuers. Accordingly, the Company will adopt SFAS 123 (R) in its quarter ending March 31, 2006.

As permitted by SFAS 123, the Company currently accounts for share-based payments to employees using APB 25's intrinsic value method. Accordingly, adoption of SFAS 123R's fair value method will have an effect on results of operations, although it will have no impact on overall financial position. The impact of adoption of SFAS 123R cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, had SFAS 123R been adopted in prior periods, the effect would have approximated the SFAS 123 pro forma net loss and loss per share disclosures as shown above. SFAS 123R also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as currently required, thereby reducing net operating cash flows and increasing net financing cash flows in periods after adoption.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections." This Statement replaces APB No. 20, "Accounting Changes" and

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FASB No. 3, "Reporting Accounting Changes in Interim Financial Statements", and changes the requirements for the accounting for and reporting of a change in accounting principle. This Statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement includes specific transition provisions, those provisions should be followed. This Statement requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. The adoption of SFAS No. 154 did not have an impact on the Company's consolidated financial statements.

### NOTE 2 INVENTORY

Inventory consists of the following:

	September 30, 2005 (unaudited)	December 31, 2004
	-----	-----
Raw materials	\$ 154,390	\$ 149,840
Work in process	--	1,749
Finished goods	124,398	68,856
	-----	-----
	\$ 278,788	\$ 220,445
	=====	=====

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### NOTE 3 NOTES PAYABLE

Notes payable consist of the following :

	September 30, 2005 (unaudited)	Dec ---
	-----	---
Two lines of credit, unsecured, interest payable monthly at 9.25% and 10.0% per annum, due on demand	\$ 92,984	\$
Note payable, unsecured, interest payable monthly at prime + 3% per annum (prime rate at September 30, 2005 was 6.75%), due on demand	40,000	
Note payable, unsecured, interest payable monthly at 10% per annum, payable as a percentage of any future private or public stock offerings	90,000	
Note payable, unsecured, interest payable at 8% per annum, due on maturity date	48,745	
Three notes payable, secured by all assets of the Company, interest at 8%		

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per annum, payable at various maturities through February 21, 2006. At December 31, 2004, there were two notes payable totaling \$ 90,000. On February 22, 2005, a note payable for \$200,000 was issued. At maturity, the notes are convertible at the holder's option at a conversion price equal to 70% of the weighted average price of the common stock for the 30 trading days immediately preceding the conversion date. In addition, each note has warrants attached that, once the note is converted into stock, allow the holder to purchase stock at 85% of the weighted average price of the common stock for the 30 trading days immediately preceding the conversion date. The aggregate intrinsic value of the beneficial conversion feature of the notes and warrants, valued at \$186,571 (of which \$128,571 is related to the note issued in 2005), has been recorded as loan discount costs and are being amortized over the life of the respective note as additional interest cost

Less remaining debt discount

290,000

(56,382)

-----  
\$ 505,347  
=====

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NOTE 4 NOTES PAYABLE, RELATED PARTIES

Notes payable to related parties consist of the following:

September 30,  
2005  
(unaudited)  
-----

Note payable to the sister of the Company's Chief Executive Officer, secured by all assets of the Company, interest at 14.25% per annum, due December 31, 2004. The note payable was originally issued by Advanced Custom Sensors, Inc. (ACSI), which merged with the company in 2004. In connection with the note payable, the ACSI issued warrants expiring September 17, 2008, to purchase 190,665 shares of ACSI's common stock at \$.50 per share (The ACSI warrant is convertible into 5,372,940 shares of the Company's stock). The intrinsic value of the warrants (\$190,665) has been recorded as loan discount costs and is being amortized over the life of the note as additional interest cost. The Company is currently negotiating an extension of this note.

\$ 190,665

Note payable to the sister of the Company's Chief Executive Officer, secured by all assets of the Company, interest at 10.0% per annum, due March 15, 2005. The note payable was originally issued by ACSI in 2003, at which time ACSI issued a warrant expiring September 17, 2008, to purchase 100,000 shares of stock at \$.50 per share (the ACSI warrant is convertible into 2,817,215 shares of the Company's common stock). The intrinsic value of the original warrant (\$100,000) recorded as a loan discount cost, and was amortized over the life of the original note as additional interest cost. The original note was due September 16, 2004. On September 16, 2004, a new note was issued to replace the original note. At maturity, the new note is convertible at the holder's option at a conversion price equal to 80% of the weighted average price of the common stock for the 30 trading days

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immediately preceding the conversion date. In addition, the note has warrants attached that, once the note is converted into stock, allow the holder to purchase stock at 85% of the weighted average price of the common stock for the 30 trading days immediately preceding the conversion date. The intrinsic value of the beneficial conversion feature of the note and warrants, valued at \$48,125, has been recorded as loan discount costs and is being amortized over the life of the note as additional interest cost. The Company is currently negotiating an extension of this note. 110,000

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Note payable to an employee of the Company, secured by all assets of the Company, interest at 8.0% per annum, due November 11, 2005. At maturity, the note is convertible at the holder's option at a conversion price equal to 70% of the weighted average price of the common stock for the 30 trading days immediately preceding the conversion date. In addition, the note has warrants attached that, once the note is converted into stock, allow the holder to purchase stock at 85% of the weighted average price of the common stock for the 30 trading days immediately preceding the conversion date. The intrinsic value of the beneficial conversion feature of the note and warrants, valued at \$12,857, has been recorded as loan discount costs and is being amortized over the life of the note as additional interest cost. 20,000

Note payable to shareholder, secured by all assets of the Company, interest at 8.0% per annum, due February 3, 2006. At maturity the note is convertible at the holder's option at a conversion price equal to 70% of the weighted average price of the common stock for the 30 trading days immediately preceding the conversion date. In addition, the note has warrants attached that, once the note is converted into stock, allow the holder to purchase stock at 85% of the weighted average price of the common stock for the 30 trading days immediately preceding the conversion date. The intrinsic value of the beneficial conversion feature of the note and warrants, valued at \$32,143, has been recorded as loan discount costs and is being amortized over the life of the note as additional interest cost. 50,000

Note payable, secured by accounts receivable of the Company, interest at 10%, due February 11, 2005. The note payable was originally issued by ACSI in connection with the note payable, ACSI issued a warrant to purchase 500,000 shares of stock at \$.50 per share (the ACSI warrant is convertible into 14,088,865 shares of the Company's common stock). The note was payable to Sino-American, Inc., a company controlled by Mr. Hanlin Chen, a director of the Company. On March 15, 2005, the warrant was exercised for \$250,000 of the debt outstanding. The balance of the note payable and accrued interest (\$300,000) was exchanged for 390,228 shares of the Company's common stock at approximately \$0.77 per share, which approximated the market value of the stock on March 15, 2005. --

Notes payable, secured by all assets of the Company, interest at 8% per annum, due October 1, 2005. The note payable was originally issued by ACSI in 2003, at which time ACSI issued a warrant to purchase 25,000 shares of stock at \$.50 per share (the ACSI shares are convertible into 704,425 shares of the Company's common stock). The intrinsic value of the original warrant was valued at \$25,000, recorded as loan discount cost, and was amortized over the life of the original note as additional interest cost. The original note was due September 16, 2004. On October 2, 2004, a new note was issued to replace the original note. The intrinsic value of the beneficial conversion feature of

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the new note and new warrant, valued at \$17,679, has been recorded as loan discount costs and is amortized over the life of the new note. On March 18, 2005, the ACSI warrant was exercised for \$12,500 of the debt outstanding. The balance of the note payable and accrued interest (\$16,012) was exchanged for 21,353 shares of the Company's common stock at approximately \$0.77 per share, which approximated the market value of the stock on March 15, 2005

Less remaining debt discount	(12,589)	
	-----	-----
	\$ 358,076	\$
	=====	=====

### NOTE 5 STOCKHOLDERS' EQUITY

On May 29, 2003, Advanced Custom Sensors, Inc. (ACSI) signed an agreement with Duke Capital to retain its consulting service for merger transaction with Spectre Industries and to obtain a \$250,000 unsecured bridge financing in order to finance all the expense in merger. However, Duke failed to perform to ACSI's expectation; ACSI decided to cancel its agreement with Duke before the merger was completed. On September 3, 2004, the Company agreed to issue 200,000 shares of common stock for the settlement this agreement. As an agreement was consummated and an exchange of debt had taken place, the Company recorded the stock to be issued as an equity transaction. This is a fixed number and will not change with market value.

On May 24, 2004, Sensor System Solutions (formerly known as Spectre Industries, Inc.,) a Nevada corporation, entered into an agreement and plan of merger with ACSI. Sensor issued 2,584,906 shares of its common stock and warrants to purchase up to 47,802,373 shares of its common stock to the shareholders of ACSI in exchange for all the issued and outstanding shares of ACSI. On January 29, 2005, warrants for the 47,802,464 shares of common stock were exercised. The Company recorded the par value of the stock issued (\$47,802) as an increase in common stock and a reduction to additional paid in capital in the accompanying financial statements.

### NOTE 6 COMMITMENTS AND CONTINGENCIES

The Company leases its office and facility through 2007 under a long term operating lease agreement. The office and warehouse facility is shared with TransOptix Inc. (TransOptix), who signed the lease as co-tenant with the Company. The Company and TransOptix had entered into an agreement stipulating each entity's share of the rent. The Company owns 7.5% of TransOptix. The Company's Chief Executive Officer is also the Chief Executive Officer of TransOptix and owns 12% of TransOptix. On August 26, 2006, TansOptix filed for Chapter 7 bankruptcy and the Company has taken over the whole facility and is liable for the full amount of the lease. The total lease commitment as of September 30, 2005 for which the Company was liable with the default of TransOptix increased from approximately \$196,000 to approximately \$463,000.

### NOTE 7 SUBSEQUENT EVENT

On October 6, 2005, the Company secured a total of \$15,600,000 in financing with Cornell Capital Partners, LP ("Cornell") to support the continued development and growth of the Company. Under the agreement, Cornell has committed to provide up to \$15 million of funding in the form of a Standby Equity Distribution Agreement ("SEDA") to be drawn down over a 24-month

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period at the Company's discretion. In addition, the company sold an aggregate of \$600,000 of fixed price Secured Convertible Debentures to Cornell. The Company is seeking an additional \$1,000,000 in bridge financing to further develop into a fully-equipped public company in order to take advantage of the SEDA funding for its long-term plan. However, no assurance can be given that such funds will be available or the term thereof.

On October 19, 2005, the Company issued the 200,000 shares of common stock to a lender as part of the Company's payment agreement with the lender in 2004.

On October 19, 2005, the Company issued 725,778 shares of common stock to a lender for warrants exercised by the lender in March 2005. The shares are shown as common stock to be issued at September 30, 2005.

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Item 2. Management's Discussion and Analysis or Plan of Operation.

### Cautionary Statement

Statements in this report on Form 10-QSB that are forward-looking are based on current expectations. Actual results may differ materially. Forward-looking statements involve numerous risks and uncertainties including, but not limited to, the possibility that the demand for our products may decline as a result of possible changes in general and industry specific economic conditions, the effects of competitive pricing and such other risks and uncertainties as are described in this report on Form 10-QSB and other documents previously filed or hereafter filed by us from time to time with the Securities and Exchange Commission. All forward-looking statements speak only as of the date made, and we undertake no obligation to update these forward-looking statements.

The following discussion and analysis should be read in conjunction with the consolidated financial statements and the notes thereto, included as part of this Quarterly Report.

### OVERVIEW

Sensor System Solutions, Inc. (3S) was founded by an engineering management team with over 50 years of Micro-electro-mechanical-systems or "MEMS" transducer experience. Its objective is to provide high quality sensors and transducers at an economical price by employing innovative designs and creative manufacturing methods. 3S offers a variety of Digital Pressure Gauges, Pressure Transducers, Pressure Sensors, Force Beams, Load Cells, Strain Gauges and Sensor Kits.

3S commenced operations as a private company in September of 1996. 3S is headquartered in Irvine, California where 3S occupies a 25,000 square foot facility fully equipped with fabrication capability.

3S has fifteen (15) employees in the United States, and utilizes a network of independent contractors and consultants throughout the United States and Asia. 3S produces or supplies a family of nearly thirty (30) distinctive products. 3S set up a volume production line with an ISO 9000 partner in Taiwan in 2002. This allows 3S to penetrate high-volume consumer markets that are very price sensitive. 3S also signed a Joint Venture agreement with China Automotive Systems, Inc. (NASDAQ: CAAS) in April of 2005 to establish a joint venture in

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China targeting its automotive sensor market.

3S is a supplier of thin-film and micro-machined force and pressure sensors to the medical, chemical, oil, and gas industries. 3S believes that its technology will enable it to become a global supplier of advanced MEMS/Microelectronic products in myriad developing markets. 3S's strategic plan is to focus on developing custom MEMS pressure sensor devices and forming strategic partnerships where its strategic partners dominate the sales channels in industries accepting MEMS sensor applications.

### PLAN OF OPERATION

We plan to grow our business in four areas.

- |X| Increase the revenue of existing sensor component business. The majority of our sensor component manufacturing will be moved to our joint venture in China to help reduce the cost of our products. We will invest to increase our production capacity and will qualify offshore suppliers to meet the increasing demands. Substantial efforts will be invested in sales and marketing in order to expand our customer base and to secure more OEM projects.
- |X| Develop sensor solution business. With the rapid advance in technology and huge investment in wireless and telecommunication in the last decades, we can now offer total sensor solutions at a very affordable price. These sensor solutions are modules containing sensing elements, signal conditioning circuitry, software for calibration and interface, and capability of wireless and/or networking. These sensor solutions will provide information continuously to decision makers in all phases of business operation.
- |X| Penetrate automotive sensor market through China. By leveraging the marketing channel of our joint venture partner, we will have access to the automotive market in China immediately. We plan use the next three years to build up our production capacity, product offerings, and technical team there. We plan to import automotive sensors produced by our joint venture to North America and Europe around 2008.
- |X| Strategic acquisitions: Being a public company and having better access to the capital markets that this affords, provides us with the means to grow our business through acquisitions as well as through internal growth. We will actively seek equity or debt funding to bring in the necessary resources to execute this plan.

### RESULTS OF OPERATIONS

Three Months Ended September 30, 2005 and 2004

#### Revenues

We generated revenues of \$347,061 for the three months ended September 30, 2005, which was an increase of \$185,335 or 115% from the \$161,726 for the three months ended September 30, 2004. The increase is the result of the continuing sales efforts, the addition of new sales representatives and the introduction of new products.

#### Gross Profit



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Gross profit for the three months ended September 30, 2005, was \$155,516 or 44.8% of revenues, compared to (\$49,975) or (30.9%) for the three months ended September 30, 2004. The \$205,491 increase in gross profit was mainly due to the increase in sales and lower fixed costs included in cost of goods sold for the current quarter versus the third quarter in the prior year.

### Total Operating Expenses

#### Operating expenses

Operating expenses increased 14% to \$405,733 for the three months ended September 30, 2005 compared to \$355,494 for the three months ended September 30, 2004. The expenses increased \$50,239, primarily as a result of an increase in payroll costs.

#### Amortization of discount on notes payable and finance costs

Amortization of discount on notes payable and finance costs decreased to \$86,876 for the three months ended September 30, 2005 compared to \$197,267 for the three months ended September 30, 2004. The expense decreased \$110,391, or 56%, primarily due to the settlement of two notes payable, Sino-American, Inc and Pei Jen Hsu.

#### Net Loss

Net loss from operations decreased to (\$337,093) for the three months ended September 30, 2005 compared to (\$602,736) for the three months ended September 30, 2004. The \$265,643 decrease in net loss was primarily due to the increase in revenue and resulting improvement in gross profit.

### Nine Months Ended September 30, 2005 and 2004

#### Revenues

We increased revenues 84% to \$855,332 for the nine months ended September 30, 2005, which was an increase of \$390,130, when compared to revenues of \$465,202 for the same period last year. The increase was the result of the continuing sales efforts, the addition of new sales representatives and the introduction of new products.

#### Gross Profit

Gross profit for the nine months ended September 30, 2005 grew to \$289,943 or 34% of revenues, compared to \$41,718 or 9% for the nine months ended September 30, 2004. The \$248,225 increase in gross profit was generated by the increase in revenues and higher utilization of production capacity.

### Total Operating Expenses

#### Operating expenses

Operating expenses increased to \$1,169,982 for the nine months ended September 30, 2005 compared to \$760,810 for the nine months ended September 30, 2004. The expenses increased \$409,172, primarily as a result of an increase in interest expense and additional investment in R&D personnel and development, and professional fees for a public company.

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Amortization of discount on notes payable and finance costs

Amortization of discount on notes payable and finance costs decreased to \$278,336 for the nine months ended September 30, 2005 compared to \$415,713 for the nine months ended September 30, 2004. The expense decreased \$137,377, or 33%, primarily due to the settlement of two notes payable, Sino-American, Inc and Pei Jen Hsu.

Net Loss

Net loss increased to (\$1,158,375) for the nine months ended September 30, 2005 compared to (\$1,134,805) for the nine months ended September 30, 2004. The small increase of \$23,570 in net loss was primarily due to the \$224,230 increase in gross profit, an \$137,377 decrease in finance cost expense, and offset by increases in interest expense, additional investment in R&D, and professional fees associated with being a public company.

### FINANCIAL CONDITION, LIQUIDITY, CAPITAL RESOURCES

Going Concern

The Company incurred a net loss of \$1,158,375 and a negative cash flow from operations of \$291,608 for the nine months ended September 30, 2005, and had a working capital deficiency of \$1,682,673 and a stockholders' deficiency of \$1,407,752 at September 30, 2005. At September 30, 2005, cash was \$11,981 as compared to \$17,115 at December 31, 2004. The decrease is due to the increase in operating expense.

The Company had a substantial working capital deficit. On October 6, 2005, the Company secured a total of \$15,600,000 in financing with Cornell Capital Partners, LP ("Cornell") to support the continued development and growth of the Company.

Under the agreement, Cornell has committed to provide up to \$15 million of funding in the form of a Standby Equity Distribution Agreement ("SEDA") to be drawn down over a 24-month period at 3S' discretion. In addition, 3S sold an aggregate of \$600,000 of fixed price Secured Convertible Debentures to Cornell.

The Company is seeking an additional \$1,000,000 in bridge financing to further develop into a fully-equipped public company in order to take advantage of the SEDA funding for its long-term plan. However, no assurance can be given that such funds will be available or the term thereof.

Commitments and Contingencies

We have the following material contractual obligations and capital expenditure commitments:

The Company leases certain equipment under two capital leases with monthly payments of \$360 and \$701, respectively, including interest at 12.75% per annum.

Future minimum annual rental payments for capitalized leases are as follows:

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	Amount
-----	-----
Three months ended December 31, 2005	\$3,183
2006	12,732
2007	12,732
2008	12,732
2009	3,543
	-----
	44,922
Amount representing interest	(8,674)
	-----
Present value of minimum lease payments	36,248
Less: Current portion	(7,819)
	-----
	\$ 28,429
	=====

The Company leases its office and facility through 2007 under a long term operating lease agreement. Under terms of the lease, the Company pays the cost of repairs and maintenance. The office and warehouse facility was shared with TransOptix, which signed the lease as co-tenant with the Company. The Company and TransOptix had entered into an agreement stipulating each entities share of the rent. However, TransOptix has filed for Chapter 7 bankruptcy and the Company has taken over the whole facility and is liable for the full amount of the lease.

Future minimum lease commitments for this lease at September 30, 2005 are as follows:

	Amount
Three months ended December 31, 2005	\$ 61,275
2006	250,900
2007	151,095
	-----
	\$463,270
	=====

### Inflation and Changing Prices

We do not foresee any adverse effects on our earnings as a result of inflation or changing prices.

### CRITICAL ACCOUNTING POLICIES

#### Revenue Recognition

The Company recognizes revenue when risk of loss and title to the product is transferred to the customer, which occurs at shipment.

#### Stock - based compensation

The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards (SFAS) No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosures" as well as those outlined in SFAS No. 123, "Accounting for Stock-Based Compensation". As permitted by SFAS 148 and SFAS 123, the Company continues to apply the provisions of Accounting Principles Board Opinion (APB) No. 25, "Accounting for Stock issued to Employees" and related interpretations in accounting for the Company's stock option plan. Accordingly, compensation cost for stock

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options is measured as the excess, if any, of the estimated fair value of the Company's stock at the date of the grant, over the amount an employee must pay to acquire the stock. Stock based awards for non-employees are accounted for at fair value equal to the excess of the estimated fair value of the Company's stock over the option price using an estimated interest rate to calculate the fair value of the option

### Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market.

### Recent Accounting Pronouncements

In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151, "Inventory Costs". This Statement amends the guidance in ARB No. 43 Chapter 4 Inventory Pricing, to require items such as idle facility costs, excessive spoilage, double freight and rehandling costs to be expensed in the current period, regardless if they are abnormal amounts or not. This Statement will become effective for us in the first quarter of 2006. The adoption of SFAS No. 151 is not expected to have a material impact on the company's consolidated financial statements.

In December 2004, Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard ("SFAS") No. 123(R), "Share-Based Payment" ("SFAS 123 (R)"). SFAS 123 (R) revises SFAS No. 123, "Accounting for Stock-Based Compensation" and supersedes Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS 123 (R) focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS 123 (R) requires companies to recognize in the statement of operations the cost of employee services received in exchange for awards of equity instruments based on the grant-date fair value of those awards (with limited exceptions). SFAS 123 (R) is effective as of the first interim or annual reporting period of the first fiscal year that begins after June 15, 2005 for non-small business issuers, and after the first fiscal year that begins after December 15, 2005 for small business issuers. Accordingly, the Company will adopt SFAS 123 (R) in its quarter ending March 31, 2006.

As permitted by SFAS 123, the Company currently accounts for share-based payments to employees using APB 25's intrinsic value method. Accordingly, adoption of SFAS 123R's fair value method will have an effect on results of operations, although it will have no impact on overall financial position. The impact of adoption of SFAS 123R cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, had SFAS 123R been adopted in prior periods, the effect would have approximated the SFAS 123 pro forma net loss and loss per share disclosures as shown above. SFAS 123R also requires the benefits of tax deductions in excess of

recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as currently required, thereby reducing net operating cash flows and increasing net financing cash flows in periods after adoption

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections. This Statement replaces APB No. 20, Accounting Changes and FASB No. 3, Reporting Accounting Changes in Interim Financial Statements, and changes the requirements for the accounting for and reporting of a

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change in accounting principle. This Statement applies it all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement includes specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. This Statement requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. The adoption of SFAS No. 154 is not expected to have an impact on the Company's consolidated financial statements.

### RISKS RELATED TO OUR BUSINESS

We have had negative cash flows from operations. Our business operations may fail if our actual cash requirements exceed our estimates, and we are not able to obtain further financing.

Our company has had negative cash flows from operations. To date, we have incurred significant expenses in product development and administration in order to ready our products for market. Our business plan calls for additional significant expenses necessary to bring our products to market. Even with the \$15,600,000 financing agreement signed with Cornell on October 6, 2005, we believe that we still do not have sufficient funds to satisfy our short-term cash requirements. There is no assurance that actual cash requirements will not exceed our estimates, in which case we will require additional bridge financing to bring our products into commercial operation, finance working capital and pay for operating expenses and capital requirements until we can take advantage of the SEDA funding from Cornell. In particular, additional capital may be required in the event that:

- o we incur unexpected costs in completing the development of our technology or encounter any unexpected technical or other difficulties;
- o we incur delays and additional expenses as a result of technology failure;
- o we are unable to create a substantial market for our product and services; or
- o we incur any significant unanticipated expenses.

We may not be able to obtain additional equity or debt financing on acceptable terms if and when we need it. Even if financing is available it may not be available on terms that are favorable to us or in sufficient amounts to satisfy our requirements. If we require, but are unable to obtain, additional financing in the future, we may be unable to implement our business plan and our growth strategies, respond to changing business or economic conditions, withstand

adverse operating results, and compete effectively. More importantly, if we are unable to raise further financing when required, our continued operations may have to be scaled down or even ceased and our ability to generate revenues would be negatively affected.

A decline in the price of our common stock could affect our ability to raise further working capital and adversely impact our operations.

A prolonged decline in the price of our common stock could result in a reduction in the liquidity of our common stock and a reduction in our ability to

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raise capital. Because our operations have been primarily financed through the sale of equity securities, a decline in the price of our common stock could be especially detrimental to our liquidity and our continued operations. Any reduction in our ability to raise equity capital in the future would force us to reallocate funds from other planned uses and would have a significant negative effect on our business plans and operations, including our ability to develop new products and continue our current operations. If the stock price declines, there can be no assurance that we can raise additional capital or generate funds from operations sufficient to meet our obligations.

If we issue additional shares in the future this may result in dilution to our existing stockholders.

Our Amended Certificate of Incorporation authorizes the issuance of 200,000,000 shares of common stock. Our board of directors has the authority to issue additional shares up to the authorized capital stated in the certificate of incorporation. Our board of directors may choose to issue some or all of such shares to acquire one or more businesses or to provide additional financing in the future. The issuance of any such shares may result in a reduction of the book value or market price of the outstanding shares of our common stock. It will also cause a reduction in the proportionate ownership and voting power of all other stockholders. Further, any such issuance may result in a change of control of our corporation.

We have a history of losses and negative cash flows, which is likely to continue unless our products gain sufficient market acceptance to generate a commercially viable level of sales.

From inception through September 30, 2005, we have incurred aggregate net losses. There is no assurance that we will operate profitably or will generate positive cash flow in the future. In addition, our operating results in the future may be subject to significant fluctuations due to many factors not within our control, such as market acceptance of our products, the unpredictability of when customers will order products, the size of customers' orders, the demand for our products, and the level of competition and general economic conditions.

Although we anticipate that we will be able to increase revenues during the next 9 months, we also expect an increase in development and operating costs. Consequently, we expect to incur operating losses and net cash outflow unless and until our existing products, and/or any new products that we may develop, gain market acceptance sufficient to generate a commercially viable and sustainable level of sales.

Unless we can establish significant sales of our current products, our potential revenues may be significantly reduced.

We expect that a substantial portion, if not all, of our future revenue will be derived from the sale of our sensor products. We expect that these product offerings and their extensions and derivatives will account for a majority, if not all, of our revenue for the foreseeable future. The successful introduction and broad market acceptance of our sensor products - as well as the development, introduction and market acceptance of any future enhancements - are, therefore,

critical to our future success and our ability to generate revenues. Unfortunately, there can be no assurance that we will be successful in marketing our current product offerings, or any new product offerings, applications or enhancements. Failure to achieve broad market acceptance of our sensor products, as a result of competition, technological change, or otherwise, would significantly harm our business.

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We could lose our competitive advantages if we are not able to protect any proprietary technology and intellectual property rights against infringement, and any related litigation could be time-consuming and costly.

Our success and ability to compete depends to a significant degree on our proprietary technology incorporated in our products. We have taken limited action to protect our proprietary technology and proprietary computer software. If any of our competitors copies or otherwise gains access to our proprietary technology or software or develops similar technologies independently, we would not be able to compete as effectively.

Further, the laws of foreign countries may provide inadequate protection of such intellectual property rights. We may need to bring legal claims to enforce or protect such intellectual property rights. Any litigation, whether successful or unsuccessful, could result in substantial costs and diversions of resources. In addition, notwithstanding any rights we have secured in our intellectual property, other persons may bring claims against us that we have infringed on their intellectual property rights, including claims based upon the content we license from third parties or claims that our intellectual property right interests are not valid. Any claims against us, with or without merit, could be time consuming and costly to defend or litigate, divert our attention and resources, result in the loss of goodwill associated with our service marks or require us to make changes to our website or other of our technologies.

Our products may become obsolete and unmarketable if we are unable to respond adequately to rapidly changing technology and customer demands.

Our industry is characterized by rapid changes in technology and customer demands. As a result, our products may quickly become obsolete and unmarketable. Our future success will depend on our ability to adapt to technological advances, anticipate customer demands, develop new products and enhance our current products on a timely and cost-effective basis. Further, our products must remain competitive with those of other companies with substantially greater resources. We may experience technical or other difficulties that could delay or prevent the development, introduction or marketing of new products or enhanced versions of existing products. Also, we may not be able to adapt new or enhanced products to emerging industry standards, and our new products may not be favorably received.

If we fail to effectively manage our growth our future business results could be harmed and our managerial and operational resources may be strained.

As we proceed with the commercialization of our products, we expect to experience significant and rapid growth in the scope and complexity of our business. We will need to add staff to market our products, manage operations, handle sales and marketing efforts and perform finance and accounting functions. We will be required to hire a broad range of additional personnel in order to successfully advance our operations. This growth is likely to place a strain on our management and operational resources. The failure to develop and implement effective systems, or to hire and retain sufficient personnel for the performance of all of the functions necessary to effectively service and manage our potential business, or the failure to manage growth effectively, could have a materially adverse effect on our business and financial condition.

### OFF BALANCE SHEET ARRANGMENTS

There are no Off-Balance Sheet Arrangements to report.

### Item 3. Controls And Procedures

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### (a) Evaluation of Disclosure Controls and Procedures.

Our management evaluated, with the participation of our Chief Executive and Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-QSB. Based on this evaluation, our Chief Executive and Financial Officer has concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)) are ineffective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms. We are developing a plan to ensure that all information will be recorded, processed, summarized and reported on a timely basis. This plan is dependent, in part, upon reallocation of responsibilities among various personnel, possibly hiring additional personnel and additional funding. It should also be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

### (b) Changes in Internal Controls.

During the period covered by the Quarterly Report on Form 10-QSB, there were no significant changes in our internal controls over financial reporting or in other factors that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

## PART II OTHER INFORMATION

### Item 1. Legal Proceedings.

None.

### Item 2. Changes In Securities and Small Business Issuer Purchases of Equity Securities.

None.

### Item 3. Defaults Upon Senior Securities.

The \$190,665 promissory note due to Tina Young matured on December 31, 2004. The Company is currently negotiating a settlement.

The \$110,000 convertible loan due to Tina Young matured on March 16, 2005. The Company is currently negotiating a settlement.

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

None.

### Item 5. Other Information.

None.

### Item 6. Exhibits



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- 31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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.

Dated: November 15, 2005

SENSOR SYSTEM SOLUTIONS, INC.

/s/ Michael Young

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Name: Michael Young  
Title: Chief Executive Officer and Principal  
Accounting Officer