Convergence Ethanol, Inc.
Form 10QSB/A
March 01, 2007

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

FORM 10-QSB/A

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

For the quarterly period ended December 31, 2006

Commission file number 0-4846-3

CONVERGENCE ETHANOL, 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

Check whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)

Yes o No x

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

Common Stock Outstanding as of February 10, 2007 was 17,487,254.

Transitional Small Business Disclosure Format: Yes o No x

Explanatory Note:

This 10-QSB/A is filed to replace the 10-QSB filed on February 20, 2007, which inadvertently excluded the final version of the Notes to the Consolidated Financial Statements.

PART I
FINANCIAL INFORMATION

PART II
OTHER INFORMATION

ITEM 1 -- FINANCIAL STATEMENTS

CONVERGENCE ETHANOL, INC. (fka Mems USA, Inc.)
Consolidated Balance Sheet
(Unaudited)

		December 31, 2006
A S S E T S		
Current assets:		
Cash and cash equivalent	$	169,306
Accounts receivable, net allowance for uncollectible of $144,060		1,534,644
Inventories, net		1,177,066
Other current assets		730,719
Total current assets		3,611,735
Plant, property and equipment, net		2,548,235
Other assets		721,703
Total assets	$	6,881,673
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable and accrued expenses	$	1,667,038
Current portion of long-term debt		8,044
Other liabilities		142,812
Loans from shareholders		103,108
Liability to be satisfied through the issuance of shares		1,200,375
Derivative liability		3,953,337
Total current liabilities		7,074,714
Long-term liabilities		13,446
Liability related to convertible debenture payable		876,228
Total liabilities		7,964,388
Minority interests		101,125
Stockholders' Deficit :		
Common stock, $0.001 par value; 100,000,000 shares authorized; 20,256,938 shares issued and outstanding		20,257
Additional paid in capital		19,559,734
Accumulated deficit		(16,964,274)
Treasury stock (2,710,436 shares)		(3,799,558)
Total stockholders' deficit		(1,183,840)
Total liabilities and stockholders' deficit	$	6,881,673

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

CONVERGENCE ETHANOL, INC. (fka Mems USA, Inc.)
Consolidated Statement of Operations
Three month periods ended December 31, 2006 and 2005
(Unaudited)

	2006	2005
Net Revenue	$ 3,947,772	$ 2,626,519
Cost of revenue	3,281,511	2,071,744
Gross profit	666,261	554,775
Selling, general and administrative expenses	1,387,825	1,321,547
Loss from operations	(721,564)	(766,772)
Other income (expenses)		
Gain from change in derivative liability	543,469	-
Income due to legal settlement	-	3,703,634
Interest expense	(249,869)	(35,498)
Other income (expense)	(65,093)	12,217
Total other income	228,507	3,680,353
Income (loss) before minority interest	(493,057)	2,913,581
Loss attributable to minority interest	2,806	-
Net income (loss)	$ (490,251)	$ 2,913,581
Net income (loss) per share, basic and diluted:		
Weighted average number of shares outstanding, basic & diluted	17,610,368	18,439,506
Net income (loss) per share, basic & diluted	$ (0.03)	$ 0.16

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

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CONVERGENCE ETHANOL, INC. (fka Mems USA, Inc.)
CONSOLIDATED STATEMENT OF CASH FLOWS
Three Month Periods ended December 31, 2006 & 2005
(Unaudited)

	2006	2005
Cash flows used for operating activities:		
Net income (loss)	$ (490,251)	$ 2,913,581
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Income due to legal settlement	-	(3,703,634)
Depreciation and amortization	64,989	61,693
Stock base compensation, director and employee	85,894	-
Amortization of prepaid loan fees	47,864	-
Amortization of discount on convertible debenture	178,593	
Gain from derivative liability	(543,469)	-
Common stock issued for services	6,000	10,000
Loss attributable to minority interest	(2,805)	
Change in assets and liabilities:		
Accounts receivable	(252,646)	(186,172)
Inventories	862,622	112,176
Other current assets	287,750	72,133
Accounts payable and accrued expenses	(1,714,428)	5,445
Other current liabilities	63,533	-
Total adjustments	(916,103)	(3,628,359)
Net cash used for operating activities	**(1,406,354)**	**(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**
Cash flows from financing activities:		
Proceeds from convertible loan	3,177,000	-
Debts issuance cost	(476,370)	-
Lines of credit	(325,114)	-
Promissory notes payable	(365,245)	-
Current portion of long-term debt	(43,860)	(30,398)
Convertible loan	(150,000)	-
Payment due to legal settlement	(307,000)	-
Repayment of loan from shareholders	(64,300)	20,000
Net cash provided by (used in) financing activities	**1,445,111**	**(10,398)**
Net increase (decrease) in cash and cash equivalents	38,756	(721,945)
Cash and cash equivalents, beginning of period	130,550	828,153
Cash and cash equivalents, end of period	**$ 169,306**	**$ 106,208**
Supplemental disclosure of cash flow information:		
Interest paid	$ 71,276	$ 35,498
Income taxes paid	$ -	$ -
Supplemental disclosure of non-cash financing activities:		
Common stock issued for finder's fees for HEO property	$ 38,500	$ -

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

CONVERGENCE ETHANOL, INC. (fka MEMS USA, Inc.)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1) Organization and Summary of Significant Accounting Policies:

Organization

Convergence Ethanol, Inc. formerly known as MEMS USA, Inc. (the "Company" or "we") has been incorporated in November, 2002; The Company changed its name to Convergence Ethanol, Inc. in November 2006. The Company's mission is to support the energy industry in producing cleaner burning fuels. Each of our subsidiaries has a specific eco-energy focus: (1) development of a woodwaste to bio-renewable fuel-grade alcohol/ethanol project (HEO); (2) selling engineered products (Bott); and (3) engineering, fabrication and sale of eco-focused energy systems (Gulfgate).

Subsidiaries:

The Company is comprised of three wholly owned subsidiaries, California MEMS USA, Inc., a California Corporation ("CA MEMS"), Bott Equipment Company, Inc. ("Bott"), a Texas Corporation, and Gulfgate Equipment, Inc. ("Gulfgate") a Texas Corporation, and a majority interest (87%) of Hearst Ethanol One, Inc, a Federal Canadian Corporation ("HEO").

CA Mems

CA MEMS engineers, designs and oversees the construction of "Intelligent Filtration Systems" ("IFS") for the gas and oil industry. The Company's IFS systems are fully integrated and are composed of a "Smart Backflush Filtration System" with an integral electronic decanting system, a carbon bed filter and an ion-exchange resin bed system.

Bott

Bott is a stocking distributor for premier 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 and Gulfgate have a combined direct sales force as well as commissioned sales representatives that sell their products.

Gulfgate

Gulfgate engineers, designs, fabricates and commissions eco-focused energy systems including particulate filtration equipment for the oil and power industries. Gulfgate also makes and sells vacuum dehydration and coalescing systems that remove water from hydrocarbon oils. Gulfgate maintains and operates a rental fleet of filtration and dehydration systems.

HEO - Hearst Ethanol One

In December 2005, the Company incorporated Hearst Ethanol One, Inc., a Federal Canadian Corporation ("HEO"). Since that time, HEO has acquired 720 acres in Hearst, Ontario, Canada together with approximately 1.3 million cubic meters of woodwaste. The property was purchased to provide the site and the biomass material to produce bio-renewable fuel-grade alcohol/ethanol from woodwaste. HEO has obtained construction and zoning permits. The Company currently owns 87% of HEO.

Fair Value of Financial Instruments:

The Company measures its financial assets and liabilities in accordance with accounting principles generally accepted in the United States of America. For certain of the Company's financial instruments, including accounts receivable (trade and related party), notes receivable and accounts payable (trade and related party), and accrued expenses, the carrying amounts approximate fair value due to their short maturities.

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

Concentration of Credit Risk:

The Company's financial instruments that are exposed to concentrations of credit risk consist primarily of cash and accounts receivable. The Company maintains cash with various major financial institutions and performs evaluations of the relative credit standing of these financial institutions in order to limit the amount of credit exposure with any institution. The Company extends credit to customers based upon an evaluation of the customer's financial condition and credit history and generally requires no collateral. The Company's customers are principally located throughout North America, and their ability to pay amounts due to the Company may be dependent on the prevailing economic conditions of their geographic region. Management performs regular evaluations concerning the ability of its customers to satisfy their obligations and records a provision for doubtful accounts based on these evaluations. The Company's credit losses for the periods presented are insignificant and have not significantly exceeded management's estimates.

Cash and Cash Equivalents:

All highly liquid investments maturing in three months or less when purchased are considered as cash equivalents.

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.

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.

Property and Equipment:

Property and equipment are stated at cost. Depreciation of equipment is provided for by the straight-line method over their estimated useful lives ranging from three to ten years for equipment and 28 to 30 years for plants.

Impairment of Long-Lived Assets

The Company adopted Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"), which addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes SFAS No. 121,"Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of," and the accounting and reporting provisions of APB Opinion No. 30, "Reporting the Results of Operations for a Disposal of a Segment of a Business." The Company periodically evaluates the carrying value of long-lived assets to be held and used in accordance with SFAS 144. SFAS 144 requires impairment losses to be recorded on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amounts. In that event, a loss is recognized based on the amount by which the carrying amount exceeds the fair market value of the long-lived assets. Loss on long-lived assets to be disposed of is determined in a similar manner, except that fair market values are reduced for the cost of disposal.

Accounts Payable and accrued expenses:

Accounts payable and accrued expenses includes trade accounts payable of $1,132,980 for the three month periods ended December 31, 2006 and accrued expenses of $534,059 respectively.

Revenue Recognition:

The Company’s revenue recognition policies are in compliance with Staff accounting bulletin (SAB) 104. Sales revenue is recognized at the date of shipment to customers when a formal arrangement exists, the price is fixed or determinable, the delivery is completed, no other significant obligations of the Company exist and collectibility is reasonably assured. Payments received before all of the relevant criteria for revenue recognition are satisfied are recorded as unearned revenue.

Advertising Costs:

The Company expenses the cost of advertising as incurred. The advertising expense charged against operations for the three month periods ended December 31, 2006 and 2005 were $3,798 and $5,561 respectively.

Income Taxes:

The Company accounts for income taxes under the provisions of Statement of Financial Accounting Standards No. 109 ("SFAS 109"). Under SFAS 109, deferred income tax assets or liabilities are computed based on the temporary difference between the financial statement and income tax bases of assets and liabilities using the currently enacted marginal income tax rate. Deferred income tax expenses or credits are based on the changes in the deferred income tax assets or liabilities from period to period. Deferred tax assets may be recognized for temporary differences that will result in deductible amounts in future periods and for loss carry forwards. A valuation allowance is established if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax asset will not be realized.

Earnings Per Share:

Basic earnings (loss) per share are computed by dividing net income (loss) attributable to common stockholders by the weighted average number of common shares outstanding. Diluted earnings (loss) per share is computed similar to basic earnings (loss) per share except that the denominator is increased to include the number of additional shares of common stock that would have been outstanding if the potential shares of common stock equivalents had been exercised and issued and if the additional common shares were dilutive. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company. There were 87,919 shares of common stock equivalents for the three month period ended December 31, 2006 which were excluded because they are not dilutive. Common stock equivalents includes, but is not limited to warrants, stock options, convertible debentures, etc.

Stock-based compensation

The Company adopted SFAS No. 123 (Revised 2004), Share Based Payment ("SFAS No. 123R"), under the modified-prospective transition method on October 1, 2006. SFAS No. 123R requires companies to measure and recognize the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value. Share-based compensation recognized under the modified-prospective transition method of SFAS No. 123R includes share-based compensation based on the grant-date fair value determined in accordance with the original provisions of SFAS No. 123, Accounting for Stock-Based Compensation, for all share-based payments granted prior to and not yet vested as of October 1, 2006 and share-based compensation based on the grant-date fair-value determined in accordance with SFAS No. 123R for all share-based payments granted after October 1, 2006. SFAS No. 123R eliminates the ability to account for the award of these instruments under the intrinsic value method prescribed by Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued to Employees, and allowed under the original provisions of SFAS No. 123. Prior to the adoption of SFAS No. 123R, the Company accounted for our stock option plans using the intrinsic value method in accordance with the provisions of APB Opinion No. 25 and related interpretations.

As of December 31, 2006, the Company has adopted one share-based compensation plan which is described below:

MEMS USA, Inc. 2004 Stock Incentive Plan

The MEMS USA, Inc. 2004 Stock Incentive Plan, which was approved by the board of directors and stockholders, permits the grant of share options to officers, directors, employees, and consultants of the Company for up to 1,850,000 shares of common stock. The board of directors has the right to amend, suspend or terminate the MEMS USA, Inc. 2004 Stock Incentive Plan at any time. Unless sooner terminated by the board of directors, the MEMS USA, Inc. 2004 Stock Incentive Plan will terminate on December 31, 2007. As of December 31, 2006, under the 2004 plan the Company has granted options to purchase 1,297,500 shares of common stock under the MEMS USA, Inc. 2004 Incentive Plan, 345,000 of which have been forfeited leaving 952,500 outstanding, of which, 587,250 have vested.

The fair value of each option and warrant award is estimated on the date of grant using the Black-Scholes option-pricing model that uses the assumptions noted in the following table. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's stock options and warrants have characteristics significantly different from those of traded options, and because changes in the subjective assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its stock options and warrants. The expected dividend yield assumption is based on the Company's expectation of dividend payouts. Expected volatilities are based on historical volatility of the Company's stock. The average risk-free interest rate is based on the U.S. treasury yield curve in effect as of the grant date. The expected life is primarily determined using guidance from SAB 107. As such, the expected life of the options and warrants is the average of the vesting term and the full contractual term of the options and warrants. In addition to the assumptions in the table, the Company applies a forfeiture-rate assumption in its estimate of fair value that is primarily based on historical annual forfeiture rates of the Company.

	Three Months Ended December 31, 2006
Expected dividend yield	0.00%
Expected volatility	92.5% to 93.6%
Average risk-free interest rate	4.52% to 4.81%
Expected life (in years)	2.5 to 6

The Company did not issue stock options or warrants during the three months ended December 31, 2005.

During the three months ended December 31, 2006, $163,677 of employee and director compensation cost has been recognized from the grant and vesting of options, $85,893 of which has been charged against income, and $77,784 of which represents the unamortized portion of deferred director compensation cost. Deferred director compensation cost is being amortized on a straight-line basis over two years.

Stock Options and Warrants Issued to Third Parties for Services

The Company accounts for stock options and warrants issued to third parties for services in accordance with the provisions of the Emerging Issues Task Force ("EITF") Issue No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services". Under the provisions of EITF 96-18, because none of the Company's agreements have a disincentive for nonperformance, the Company records a charge for the fair value of the portion of the stock options and warrants earned from the point in time when vesting of the stock options and warrants becomes probable. Final determination of fair value of the stock options and warrants occurs upon actual vesting.

The Company did not issue stock options or warrants to third parties for services during the three months ended December 31, 2006 and 2005.

Stock Options Issued to Employees and Directors for Compensation

Following is the Company's stock option activity during the three months ended December 31, 2006:

On October 1, 2006, the date the Company adopted SFAS 123R, the Company had outstanding options to purchase 1,884,358 shares of common stock with officers, directors and employees. Of these options, 1,000,000 vested immediately and the remainder vest over 3 years. The options have exercise prices ranging from $0.90 to $2.70 per share, and expire in 10 years. Of these options, 539,324 were unvested on October 1, 2006 with an unrecognized unvested grant date fair value of $527,858. During the three months ended December 31, 2006, $328,887 of the unrecognized unvested fair value of these options was forfeited, the Company recorded officer, director and employee compensation of $71,609 relating to these options, and $127,363 remained unrecognized as of December 31, 2006.

On October 18, 2006, the Company issued options to purchase 300,000 shares of common stock to a director. The options vested upon issuance, have an exercise price of $0.51 per share, and expire in 5 years. The fair value of these options on the date of grant amounted to $86,829, was recorded as deferred director compensation, and is being amortized over two years on the straight-line method. Amortization of this deferred director compensation amounted to $9,045 during the three months ended December 31, 2006. The unamortized deferred director compensation amounted to $77,784 at December 31, 2006.

On November 1, 2006, the Company issued options to purchase 300,000 shares of common stock to an officer. The options vest over 3 years, have an exercise price of $0.45 per share, expire in 10 years, and also vest the day before any merger or acquisition of more than 50% of the Company's capital stock, or the purchase of substantially all of the Company's assets, by a third-party. The fair value of these options on the date of grant amounted to $104,792 and is being recognized on a straight-line basis over the requisite service period. The Company recorded officer compensation of $5,240 relating to these options during the three months ended December 31, 2006.

The Company did not issue stock options to employees and directors for compensation during the three months ended December 31, 2005.

Prior to October 1, 2006, the Company accounted for its stock options in accordance with the intrinsic value provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). Under APB 25, the difference between the quoted market price as of the date of grant and the contractual purchase price of shares was recognized as compensation expense over the vesting period on a straight-line basis. The Company did not recognize compensation expense in its consolidated financial statements for stock options as the exercise price was not less than 100% of the fair value of the underlying common stock on the date of grant.

The following table illustrates the effect on net income and net income per share had the Company recognized compensation expense consistent with the fair value provisions of SFAS No. 123 "Accounting for Stock-Based Compensation", as amended by SFAS 148 "Accounting for Stock-Based Compensation Transaction and Disclosure - An Amendment to SFAS 123, prior to the adoption of SFAS 123R:

		Three Months Ended December 31, 2005
Net income, as reported	$	2,913,581
Deduct: Total stock-based employee compensation expenses determined under the fair value Black-Scholes method with a 128% volatility at December 31, 2005 and a 6% risk free rate of return assumption		(175,664)
Pro forma net income	$	2,737,917
Income per share:		
Weighted average shares, basic		18,439,506
Basic, pro forma, per share	$	0.15
Weighted average shares, diluted		19,131,642
Diluted, pro forma, per share	$	0.14

A summary of option activity relating to employee and director compensation as of December 31, 2006, and changes during the three months then ended is presented below:

Options	Shares		Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term		Aggregate Intrinsic Value
Outstanding at October 1, 2006	1,884,358	$	1.85		$	20,000
Granted	600,000		.48			-
Exercised	-		-			-
Forfeited	(345,000)		1.50			-
Converted	-		-			-
Expired	-		-			-
Canceled	-		-			-
Outstanding at December 31, 2006	2,139,358	$	1.52	7.60	$	132,000
Exercisable at December 31, 2006	1,758,696	$	1.65	7.25	$	64,500

A summary of the status of the Company's non-vested option shares relating to employee and director compensation as of December 31, 2006, and changes during the three months then ended is presented below:

Non-vested Options	Shares	Weighted-Average Grant-Date Fair Value

Non-vested at October 1, 2006	539,324	$	1.25
Granted	300,000	$	0.35
Vested	(143,662)	$	1.16
Forfeited	(315,000)	$	1.09
Non-vested at December 31, 2006	380,662	$	0.70

As of December 31, 2006, there was approximately $227,000 of total unrecognized compensation cost related to non-vested option share-based compensation arrangements. Of the amount, $133,000 is expected to be recognized throughout the remainder of fiscal year ending September 30, 2007, and $49,000 and $45,000 is expected to be recognized throughout fiscal years ending September 30, 2008 and 2009, respectively.

A summary of warrant activity relating to compensation to consultants as of December 31, 2006, and changes during the three months then ended is presented below:

Warrants	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at October 1, 2006	822,000	$ 2.61		$ -
Granted	-	$ -		-
Exercised	-	$ -		-
Forfeited	-	$ -		-
Converted	-	$ -		-
Expired	-	$ -		-
Canceled	-	$ -		-
Outstanding at December 31, 2006	822,000	$ 2.61	2.13	$ -
Exercisable at December 31, 2006	822,000	$ 2.61	2.13	$ -

All of the Company's warrants were fully vested as of October 1, 2006.

Interim Financial Statements:

The accompanying unaudited consolidated financial statements for the three months ended December 31, 2006 and 2005 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, 2006 included in the Company's 2006 Annual Report.

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 net losses of $16,964,274 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 2007 in order to meet our working capital requirements.

Derivative Instruments

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133, as amended by SFAS No. 137, is effective for fiscal years beginning after June 15, 2000. SFAS No. 133 requires the Company to recognize all derivatives as either assets or liabilities and measure those instruments at fair value. It further provides criteria for derivative instruments to be designated as fair value, cash flow and foreign currency hedges and establishes respective accounting standards for reporting changes in the fair value of the derivative instruments. After adoption, the Company is required to adjust hedging instruments to fair value in the balance sheet and recognize the offsetting gains or losses as adjustments to be reported in net income or other comprehensive income, as appropriate.

Reclassifications

Certain reclassifications have been made to prior year amounts to conform to the current year presentation. These changes had no effect on reported financial positions or results of operations.

Recent Accounting Pronouncements:

In September 2006, FASB issued SFAS 158 Employers Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R). This Statement improves financial reporting by requiring an employer to recognize the over-funded or under-funded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity or changes in unrestricted net assets of a not-for-profit organization. This Statement also improves financial reporting by requiring an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions An employer with publicly traded equity securities is required to initially recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after December 15, 2006. An employer without publicly traded equity securities is required to recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after June 15, 2007. However, an employer without publicly traded equity securities is required to disclose the following information in the notes to financial statements for a fiscal year ending after December 15, 2006, but before June 16, 2007, unless it has applied the recognition provisions of this Statement in preparing those financial statements. The disclosures include a brief description of the provisions of this Statement; the date that adoption is required; and the date the employer plans to adopt the recognition provisions of this Statement, if earlier.

This statement is effective for fiscal year ending after December 15, 2008 Management has not determined the effect if any, the adoption of this statement will have on the financial statements.

(2) Investments in Hearst Ethanol One, Inc.:

Hearst Ethanol One Inc. Agreement:

In December 2005, the Company incorporated Hearst Ethanol One, Inc., a Federal Canadian Corporation (“HEO”). On April 21, 2006 the Company completed the acquisition of 720 acres of real property, together with all biomass material located thereon. The site is located in the Township of Kendall, District of Cochrane, Canada, The property was purchased from C. Villeneuve Construction Co. LTD., a Canadian Corporation to provide the site and the biomass material for the construction and operation of bio-renewable woodwaste-to-fuel-grade alcohol/ethanol refinery to be owned by HEO.

Pursuant to the provisions of the Agreement, HEO issued ten point five percent (10.5%) of HEO’s common shares to Villeneuve as consideration for the transfer of the Property. At the close of the transaction, the Company owned 87% of the common stock of HEO.

Pursuant to a Memorandum of Understanding entered into on April 20, 2006 between HEO and Villeneuve to clarify the Agreement, Villeneuve shall be entitled to appoint one member of HEO’s board of directors for so long as Villeneuve is at least a ten percent (10%) shareholder of HEO.

Hearst Ethanol One Inc. Valuation:

The valuation based on the residual property valuation of the land is $253,070, building $88,574, raw material (mature timber) of $647,953 and Forest Waste Disposal license Bond $67,780. Also included in the valuation was the residual value of the biomass on the HEO site of US$11,461,362.

The other tangible and intangible assets owned by HEO include: a small rock quarry (and associated mineral rights) on the property, as well as a landfill license and permits as issued by the Government of Ontario Ministry of the Environment (“MOE”).

Writing off Inventory:

During the fourth quarter of last year the company wrote off the value of HEO’s inventory to a nominal amount. After conducting an asset evaluation review it was determined that no known market for the materials other than utilization in the Company’s planned manufacturing facility currently exists.

At September 30, 2006, HEO’s inventory with a gross value of US $11,461,362 was fully written off.

(3) 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.

The Company also agreed, to raise $2,000,000 in gross equity funding within 120 days of the Closing Date. The Company failed to achieve this milestone and issued Trumble an additional 123,659 shares of its restricted stock

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. As of the date of this report 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.

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

First amended stock purchase agreement with Mark Trumble

Effective May 8, 2006, the Company and its officers entered into a First Amended Stock Purchase Agreement and Release (“Agreement”) with Mark Trumble, amending that certain Stock Purchase Agreement dated September 1, 2004 (the “SPA”), pursuant to which the parties agreed to, among other things, Trumble agreed to release the Company from its obligations under the put, including any obligation to make the interest payment or to pay interest on any sum whatsoever, and release any security interest he claims in the real estate owned by Gulfgate and/or Bott, and the Company, within 60 days, shall secure a funding commitment in which Trumble shall be paid the sum of $307,000 at the time of the closing of the funding. This sum shall be used to purchase 165,053 shares of the common stock of the Company from Trumble at the price of $1.86 per share. The Company shall also pay from the funding all amounts of bank or other indebtedness owed by the Company, Bott or Gulfgate, which is personally guaranteed by Trumble. The Company shall issue Trumble, upon closing of the funding, 60,000 shares of the Company’s common stock. This additional issuance of shares of the common stock of the Company shall be in full and final satisfaction of all claims that Trumble has or may have to additional shares of the Company’s common stock as a result of any breach of, or failure to meet a milestone under, the SPA.

(4) 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, 2006 in the amount of $144,060 that the Company believes are adequate.

(5) Inventories:

Inventories consist of finished goods of $568,070, raw material of mature timber of $647,953, and work in process in the amount of $362,497 at December 31, 2006. The inventory reserves in the books is $401,454.

(6) Plant, Property and Equipment:

A summary at December 31, 2006 are as follows:

Land	$	817,108
Buildings and improvements		1,244,453
Furniture, Machinery and equipment		1,025,414
Automobiles and trucks		47,508
		3,134,483
Less accumulated depreciation		(586,248)
	$	2,548,235

Depreciation expense charged to operations totaled $64,989 and $61,693 respectively, for the three months ended December 31, 2006 and 2005.

We evaluate impairment of long-lived assets in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* We assess the impairment of long-lived assets, including property and equipment and purchased intangibles subject to amortization, when our review of events, or changes in circumstances suggest the fair value of assets could be less then their net book value. In such event, we would assess long-lived assets for impairment by determining their fair value based on the forecasted, undiscounted cash flows the assets are expected to generate plus the net proceeds expected from the sale of the asset. An impairment loss would be recognized when the fair value is less than the related asset’s net book value, and an impairment expense would be recorded in the amount of the difference. Forecasts of future cash flows are judgments based on our experience and knowledge of our operations and the industries in which we operate. These forecasts could be significantly affected by future changes in market conditions, the economic environment, and capital spending decisions of our customers and inflation. We have not recognized any impairment losses on long-lived assets for the period ended December 31, 2006.

(7) 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.

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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. 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.

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 replacement 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.

The Agreements and Notes are secured by the inventory, chattel paper, accounts receivable and general intangibles. The Agreements and Notes are also secured by the personal performance guarantees of certain executives of the Company (Commercial Guarantees). All amounts related to Bott’s outstanding promissory notes totaled $496,877 on September 30, 2006 and were paid in full on October 31, 2006.

(8) 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. 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. Amounts outstanding at September 30, 2006 totaled $171,539 and were paid in full on October 31, 2006.

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

As of December 31, 2006, the Company incurred a liability for stock subscribed in the amount of $1,200,376. 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 private placement obligations through issuance of common stock to shareholders as soon as the Company completes its SB-2 registration with the Securities & Exchange Commission.

The Company sold 277,978 shares of its common stock for $180,000 via another private placement offering from June through August 2006. The balance of the liability ($15,376 / 12,298 shares) was for services rendered during 2006. The Company intends to satisfy these obligations through issuance of common stock to shareholders in February 2007.

(10) Long-Term Debts:

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 (4.55%) for a vehicle purchase. The term of the note is for fifty-nine (59) months at $494 per month. Balance outstanding at September 30, 2006 was $10,143 and was paid in full on October 31, 2006.

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. Balance outstanding at September 30, 2006 was $19,724 and was fully paid for on October 31, 2006.

Loans from shareholders:

At December 31, 2006 the Company owes James A. Latty, President, CEO and Chairman, the sum of $91,534 in loan and accrued interest. The Company also owes Mr. Latty reimbursement for business travel expenses of $11,574. .

In September 2005, Daniel K. Moscaritolo, then COO and Director, and James A. Latty, CEO and Chairman, ("Lenders") each loaned the Company, $95,800 (collectively, $191,600). 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 Security Agreements that grant the Lenders a security interest in all personal property belonging to the Company, as well as granting an undivided ½ security interest in all of the Company's right title and interest to any trademarks, trade names, contract rights, and leasehold interests. Balance outstanding at September 30, 2006 was $147,163. The interest recorded was $17,563 for the year ended September 30, 2006.

On October 31, 2006 the Company paid Mr. Daniel Moscaritolo a sum of $54,358 of which $8,558 was for accrued interest. As of October 31, 2006 Mr. Moscaritiolo's loan was paid in full.

Convertible Loan Payable:

A. Securities Purchase Agreement with an Individual Investor:

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.

The loan plus accrued interest was paid in full on October 31, 2006.

B. Securities Purchase Agreement with GCA Strategic Investment Fund Limited:

On October 31, 2006, the Company closed its Securities Purchase Agreement (the “Agreement”) with GCA Strategic Investment Fund Limited (“Purchaser”). The Company issued a $3,530,000 Convertible Note due October 31, 2009 (the “Note”), and the purchase price of the Note was $3,177,000 (ninety per cent of the principal amount of the Note). The Note does not bear interest except upon an event of default, at which time interest shall accrue at the rate of 18% per annum.

Security-The Note is secured by a first security position in all assets of the Company and its subsidiaries, Bott Equipment Company, Inc., a Texas corporation, and Gulfgate Equipment, Inc., in their inventory, equipment, furniture and fixtures, rental fleet equipment and any other of their assets wherever located except accounts receivable and assets solely attributable to their alternative fuel projects.

Registration Rights-The Company agreed to use its best efforts to file a registration statement to register the resale of the common shares issuable upon the conversion of the Note and exercise of the warrants (the “Conversion Shares”) by December 31, 2006. The Company will also use its best efforts to cause the registration statement to become effective within by January 31, 2007 If the registration statement is not timely filed, the Company owes Purchaser liquidated damages in the amount of 1% of the principal amount of the then outstanding balance due under the Note for each 60-day period, prorated, until the registration statement is filed. If the registration statement is not declared effective within such 90 day period, the Company will owe Purchaser liquidated damages in the amount of 2% of the principal amount of the then outstanding balance of the Note for each 30-day period, prorated, until the registration statement is declared effective.

Conversion Price: The Note may be converted into Company's common shares. The conversion price will be 85% of the trading volume weighted average price, as reported by Bloomberg LP (the “VWAP”), for the five trading days immediately prior to the date of notice of conversion. During the first 30 days after the registration statement is effective registration the conversion price will not be less than $0.47 (the “Floor Conversion Price”), nor greater than $061 (the “Ceiling Conversion Price”). For the ninety (90) day period following the Initial Pricing Period and each successive ninety (90) day period thereafter (each a “Reset Period”), the Floor Conversion Price shall be reduced by an amount equal to 40% of the lesser of (i) the Floor Conversion Price or (ii) the Closing Bid Price as reported by Bloomberg on the trading day immediately following the Initial Pricing Period or Reset Period, as the case may be, and the Ceiling Conversion Price shall be increased by an amount equal to 40% of the lesser of (y) the current Ceiling Conversion Price or (z) the closing bid price as reported by Bloomberg on the trading day immediately following the Initial Pricing Period or Reset Period as the case may be.

Prepayment-For so long as Company is not in default and Company is not in receipt of a notice of conversion from the holder of the Note, Company may, at its option, prepay, in whole or in part, this Convertible Note for a pre-payment price (the “Prepayment Price”) equal to the greater of (i) 110% of the outstanding principal amount of the Note plus all accrued and unpaid interest if any, and any outstanding liquidated damages, if any, or (ii) (x) the number of Company's common shares into which the Notes is then convertible, times (y) the average VWAP of Company's common shares for the five (5) trading days immediately prior to the date that the Note is called for redemption, plus accrued and unpaid interest.

Redemption-The Company may be required under certain circumstances to redeem any outstanding balance of the Note and the warrants. The redemption price under these circumstances of the outstanding balance due under the Note is equal to the greater of: (i) the Prepayment Price or (ii) (x) the number of Company's common shares into which the unpaid balance due under the Note is then convertible, times (y) the five (5) day VWAP price of Company's common shares for the five trading days immediately prior to the date that the unpaid balance due under the Note is called for redemption, plus accrued and unpaid interest, if any.

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Warrant-The Company issued warrants to purchase 1,000,000 shares of its common stock. These warrants are callable if the common stock trades at a price equal to 200% of the strike price of the warrants based on any consecutive five day trading average VWAP value. The warrants have a term of five years and an exercise price of $0.66 (120% of the average five day VWAP price for Company's common stock for the five trading days immediately prior to October 31, 2006).

Company paid an application fee to Global Capital Advisors, LLC ("Adviser"), Purchaser's adviser, from the proceeds of the funding in an amount equal to one percent of the funding, excluding warrants. Additionally, Company issued to Adviser on warrant to purchase 500,000 shares of Company's common stock. These warrants have a term of five years and have an initial fixed exercise price of $0.66 (120% of the five day VWAP for the five trading days immediately prior to October 31, 2006).

The proceeds received from this agreement were used to pay off all notes payable to third party listed under Footnotes 9, 10 and 12. Major disbursements included three notes payable to a bank (Notes 9 and 10) totaling $668,030; auto and property loans totaling $40,561; convertible loan $150,000; and $307,000 related to the First amended stock purchase agreement with Mark Trumble (Note 3), and Daniel Moscaritolo.

Per EITF 00-19, paragraph 4, these convertible debentures do not meet the definition of a "conventional convertible debt instrument" since the debt is not convertible into a fixed number of shares. The debt can be converted into common stock at a conversions price that is a percentage of the market price; therefore the number of shares that could be required to be delivered upon "net-share settlement" is essentially indeterminate. Therefore, the convertible debenture is considered "non-conventional," which means that the conversion feature must be bifurcated from the debt and shown as a separate derivative liability. This beneficial conversion liability has been calculated to be $2,254,258 at December 31, 2006. In addition, since the convertible debenture is convertible into an indeterminate number of shares of common stock, it is assumed that the Company could never have enough authorized and unissued shares to settle the conversion of the warrants into common stock. Therefore, the warrants issued in connection with this transaction have been reported as a liability at December 31, 2006 in the accompanying balance sheet with a fair value of $1,076,138. The value of the warrant was calculated using the Black-Scholes model using the following assumptions: Discount rate of 4.64%, volatility of 93.54% and expected term of five year. The redemption liability was $622,941 as at December 31, 2006. The fair value of the beneficial conversion feature, redemption liability and the warrant liability will be adjusted to fair value each balance sheet date with the change being shown as a component of net income.

The fair value of the beneficial conversion feature and the warrants at the inception of these convertible debentures were $2,414,852 and $406,229, respectively. $2,821,081 has been recorded as a discount to the convertible debentures which will be amortized over the term of the debentures.

Principal payments on these convertible debentures are as follows:

Year ending September 30,		
2007	$	-0-
2008		-0-
2009		-0-
2010		3,530,000
	$	3,530,000

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(11) Warrants:

Warrants outstanding as of December 31, 2006 are as follows:

		Warrants		Wt Avg Exercise Price
Outstanding as of October 1, 2006	$	1,569,262	$	2.39
Granted		1,561,729	$	0.66
Exercised		-		
Forfeited		-		
Outstanding as of December 31, 2006	$	3,130,991	$	1.53

	Outstanding			Exercisable		
Price range:	Warrants	Weighted Price	Weighted Life	Warrants	Weighted Price	Weighted Life
$0.61-$3.75	3,130,991	1.53	3.74	3,130,991	1.53	3.74
Total	3,130,991	1.53	3.74	3,130,991	1.53	3.74

All of the Company's warrants were fully vested as of October 1, 2006.

(12) Stockholders' Equity

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 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.

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 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.

In a letter to Mercatus dated April 13, 2006 the Company declared Mercatus to be in material breach of the above Private Purchase Agreements due to non-payment, terminated the Agreements in their entirety and exercised its right to demand the return of all the shares. All 3,400,000 shares were returned to the Company's treasury in August 2006.

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.

During the month of October 2006, the Company issued and delivered 70,000 shares of the Company's common stock to one consultant for services valued at approximately $38,500.

(13) 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 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.

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.

(14) 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). This liability was paid in full as of December 31, 2006.

(15) Commitments :

The fees payable to the Director of the company is as follows:

For the year ended September 30,	
2007	$ 44,000
2008	$ 48,000
2009	$ 48,000

(16) Amendments to Articles of Incorporation and Bylaws

On December 5, 2006, the Company filed Articles of Merger with the Secretary of State of Nevada in order to effectuate a merger whereby the Company (as MEMS USA, Inc.) would merge with a newly formed wholly-owned subsidiary, Convergence Ethanol, Inc., as a parent/ subsidiary merger with the Company as the surviving corporation. This merger, which became effective as of December 5, 2006, was completed pursuant to Section 92A.180 of the Nevada Revised Statutes. Shareholder approval to this merger was not required under Section 92A.180. The purpose of this merger was to change the Company's name to "Convergence Ethanol, Inc."

(17) Contingencies and Subsequent Events:

On February 12, 2007 the United States District Court, Central District of California, Western Division entered a preliminary injunction in favor of the Company.

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

The following discussion and analysis should be read in conjunction with our consolidated financial statements and notes to consolidated financial statements included elsewhere in this report. This report and our consolidated financial statements and notes to consolidated financial statements contain forward-looking statements, which generally include the plans and objectives of management for future operations, including plans and objectives relating to our future economic performance and our current beliefs regarding revenues we might generate and profits we might earn if we are successful in implementing our business strategies. The forward-looking statements and associated risks may include, relate to or be qualified by other important factors, including, without limitation:

- quarterly variations in our revenues and operating expenses;
- announcements of new products or services by us;
- fluctuations in interest rates;
- significant sales of our common stock, including "short" sales;
- the operating and stock price performance of other companies that investors may deem comparable to us; and
- news reports relating to trends in our markets or general economic conditions;
- anticipated trends in our financial condition and results of operations; and
- our ability to successfully develop, finance, construct and operate our planned ethanol production facilities;

We do not undertake to update, revise or correct any forward-looking statements.

Any of the factors described above or in the "Risk Factors" section of this report could cause our financial results, including our net income or loss or growth in net income or loss to differ materially from prior results, which in turn could, among other things, cause the price of our common stock to fluctuate substantially.

Overview

We are engaged in the business of developing bio-renewable energy projects and providing professional engineered systems to the energy industry. The Company's mission is to support the energy industry in producing cleaner burning fuels. Each of three company-operating divisions has a specific eco-energy focus: (1) development of a woodwaste to bio-renewable fuel-grade alcohol/ethanol project, (2) selling engineered products; and (3) engineering, fabrication and sale of eco-focused energy systems. ISO 9001:2000-certified, operating divisions have served customers throughout the energy sector since 1952.

We were incorporated in the State of Nevada on April 12, 2002. On November 29, 2006, we incorporated a wholly-owned Nevada subsidiary for the sole purpose of effecting a name change of our company through a merger with our subsidiary. On December 5, 2006, we merged our subsidiary with and into our company, with our company carrying on as the surviving corporation under the name Convergence Ethanol, Inc. Our name change was effected with NASDAQ on December 13, 2006 and our ticker symbol on the OTC Bulletin Board was changed to "CETH".

California-based Convergence Ethanol, Inc. is comprised of three wholly owned subsidiaries, California MEMS USA, Inc., (“CA MEMS”) a California Corporation, Bott Equipment Company, Inc. (“Bott”), Gulfgate Equipment, Inc. (“Gulfgate”) and a fourth majority-owned subsidiary, Hearst Ethanol One, Inc., a Federal Canadian Corporation (“HEO”).

CURRENT BUSINESS SUMMARY

We are a renewable energy company with a mission to support the energy industry’s production of cleaner burning fuels, through the development of profitable, bio-renewable energy projects and through the engineering, fabrication and sale of environmentally focused systems and equipment.

Our subsidiary, Hearst Ethanol One Inc. (HEO), is working on plans for a woodwaste-to-ethanol refinery to be built in Hearst Ontario Canada. The company owns 87% of HEO. We intend that the refinery will use modern catalytic processing, as used in oil refineries, to synthetically convert cellulosic woodwaste into ethanol. Given the high and rising price of corn, we believe that the conversion of low-cost woodwaste will be important in future ethanol production. Our plan of operation is to focus in geographic areas which offer abundant supplies of cellulosic woodwaste, superior transportation infrastructure, expedited permitting processes, high local demand for Ethanol and favorable, provincial and federal tax incentives. The Company's ability to complete this project is wholly dependent, however, on the successful fulfillment of several conditions, including receipt of all necessary environmental and other permits and the acquisition of capital for the development and construction of the plant.

OUR OPERATING SUBSIDIARIES:

HEO

The Company is currently developing a project that is expected to produce 120 million gallons a year of bio-renewable fuel-grade alcohol/ethanol. In December 2005, the Company incorporated Hearst Ethanol One, Inc., a Federal Canadian Corporation (“HEO”). HEO, which owns 720 acres in Hearst, Ontario, Canada and nearly 1.3 million cubic meters of woodwaste.

HEO plans to build an ecologically sound woodwaste refinery to produce bio-renewable, fuel-grade alcohol or ethanol. Organic woodwaste (organic chips or fiber), the raw material for fuel-grade alcohol/ethanol, is an overabundant waste stream of the Canadian forest products industries. The proposed refinery will use modern catalytic processing, as used in oil refineries, to synthetically convert organic woodwaste into fuel-grade alcohol or ethanol. We believe the convergence of technologies will enable the continuous production of bio renewable fuel-grade alcohol in high volume, at low cost. Currently, HEO is 87% owned by parent.

Fuel-grade alcohol/ethanol is the world's most used alternative liquid fuel. Worldwide demand is more than double production capacity and grows at over 25% per year. Next year’s market for fuel-grade alcohol/ethanol in Canada is eight times greater than last year’s production capability.

The Province of Ontario where our HEO facility will be located has mandated that all motor gasoline sold in Ontario must contain at least 5% ethanol by 2007, with the goal of 10% by 2010. We believe this will provide an assured market for fuel-grade alcohol/ethanol. HEO, owns 720 acres in Hearst, Ontario, has obtained forest resources, acquired construction permits, acquired a quarry for construction aggregate and owns a woodwaste repository containing nearly 1.5 million tons of woodwaste. We believe that the existing woodwaste on site will be sufficient to run the future plant for more than one year for production of 120 million gallons of fuel-grade alcohol/ethanol.

Formation of HEO

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. On December 21, 2005, HEO entered into a land purchase agreement with C. Villeneuve Construction Company, Ltd. The transaction closed on April 7, 2006 and the Company owns 87% of HEO.

CA MEMS

Our CA MEMS subsidiary engineers, designs and oversees the construction of "Intelligent Filtration Systems" ("IFS") for the gas and oil industry. These systems filter solids from oil or water. Our IFS™ systems are fully integrated and are composed of a "Smart Backflush Filtration System" with an integral electronic decanting system, a carbon bed filter and an ion-exchange resin bed system. This equipment will purify the amine fluid by removing particulate, chemical contaminants, and heat stable salts to allow the amine to more effectively remove carbon dioxide and sulfur compounds during refining. 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 decanter. 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 U.S. EPA and California CARB requirements for cleaner burning fuels have opened up additional opportunities for our IFS. We believe our IFS product can help our customers achieve lower operating costs and minimize wastes while enhancing their ability to meet the more stringent government requirements for cleaner burning fuels. The system dramatically reduces hazardous waste 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 CA MEMS IFS technology.

GULFGATE

Our Gulfgate subsidiary engineers, designs, fabricates and commissions eco-focused energy systems including particulate filtration equipment for the oil and power industries. Gulfgate also makes and sells vacuum dehydration and coalescing systems that remove water from turbine engine oils. 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. All Convergence Ethanol is ISO 9001:2000 certified and is a qualified international vendor to the oil and gas industries. Gulfgate has served customers throughout the energy sector since 1957; we acquired Gulfgate in 2004.

BOTT

Our Bott subsidiary is a stocking distributor for premier lines of industrial pumps, compressors, flow meters, valves and instrumentation. Bott specializes in the construction of aviation refueling systems for helicopter refueling on oil rigs throughout the world. Bott and Gulfgate have a combined direct sales force as well as commissioned sales representatives that sell their products. Gulfgate also constructs refueling systems that Bott sells for commercial marine vessels. Bott's customers include chemical manufacturers, refineries, power plants and other industrial customers.

Bott has served customers throughout the energy sector since 1952; we acquired Bott in 2004.

MARKETING

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

Former Subsidiary

We created Can Am to manufacture, own and operate one ethanol production facility in British Columbia Canada. 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.

Subsequently, the Company paid an additional at-risk deposit of CN$50,000 for an extension of the closing date of the purchase agreement. This project was discontinued upon the death of one of the principals.

Company History:

We were incorporated in the State of Nevada on April 12, 2002. Prior to the reverse acquisition described below, our corporate name was Lumalite Holdings, Inc. and we had not generated significant revenues and were considered a development stage company as defined in Statement of Financial Accounting Standards No. 7.

Pursuant to a Merger Agreement and Plan of Reorganization dated January 28, 2004 between us and MEMS USA, Inc., a California corporation ("CA MEMS"), we acquired all of the outstanding capital shares of CA MEMS in exchange for 10 million shares of our common stock. Since the stockholders of CA MEMS acquired approximately 75% of our issued and outstanding shares and the CA MEMS management team and board of directors became our management team and board of directors, according to FASB Statement No. 141 - "Business Combinations," this acquisition has been treated as a recapitalization for accounting purposes, in a manner similar to reverse acquisition accounting. In accounting for this transaction:

· CA MEMS is deemed to be the purchaser and surviving company for accounting purposes. Accordingly, its net assets are included in our consolidated balance sheet at their historical book values and the results of operations of CA MEMS have been presented for all prior periods; and

· Control of the net assets and business of our company were acquired effective February 18, 2004. This transaction has been accounted for as a purchase of our assets and liabilities by CA MEMS. The historical cost of the net liabilities assumed was $-0-.

Pursuant to the transaction described above, we changed our name from Lumalite Holdings, Inc to MEMS USA, Inc. As described above, in 2006, we merged into a wholly owned subsidiary to change our name to Convergence Ethanol, Inc.

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.

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

Delivery of Intelligent Filtration System™ (IFS) - a $1.6 million contract

On December 1, 2006 the Company delivered of its first Intelligent Filtration System (IFS) to a major Los Angeles-area oil refinery. This advanced filtration system enables the production of cleaner-burning, reduced-sulfur motor fuel, supporting refinery environmental improvement goals.

The IFS integrates previously separate units into a dynamic filtration system Engineered for ease of operation and maintenance, it gives the refinery exceptional and coordinated control. Direct ecological benefits of the energy-efficient design include reduced greenhouse emissions and a dramatic reduction in the volume of hazardous waste.

Comparison of Operations

Net sales for the three-month periods ended December 31, 2006 and 2005 were $3,947,772 and $2,626,519, respectively. The sales increase for the three months (503%) ended December 31, 2006 as compared to the prior year were due primarily to the delivery of the Company's first Intelligent Filtration System. The Company recognized 95% of the IFS contract value or sales of $1.5 million during the month of December, 2006. The remaining sales (5%) are expected to be recognized during the second fiscal quarter ended March 31, 2007. This represents system commissioning and documentation. We have received several requests for quotes for our IFS system products which we're currently responding to We also continue to experience strong customer demand for our industrial pumps, equipment rentals and repairs services.

The Company computes gross profit as net sales less cost of sales. Gross profit for the three-month periods ended December 31, 2006 and 2005 were $666,261 and $554,775 respectively. The gross profit increase for the three months ended December 31, 2006 as compared to the prior year was due primarily to the delivery of an IFS system. The gross profit margin is the gross profit divided by net sales, expressed as a percentage. Gross profit margin for the three-month periods ended December 31, 2006 and 2005 were 16.9% and 21.1% respectively. This decrease of 4.2% was primarily due to a combination of lower margins on commercial aviation refueling systems shipments and the IFS System. Also impacting the margins were higher physical inventory adjustments and material costs as compared to the prior year. Margins for this segment of the business continue to reflect the significant competitive pressures encountered on bidding and winning this business.

Selling, general and administrative (SG&A) expenses were $1,387,825 and $1,321,547 for the three months ended December 31, 2006 and 2005, respectively. The increase in SG&A spending for the three months ended December 31, 2006 as compared to the prior year were due primarily to legal costs (See Part I, Item 3, Legal Proceedings), consulting fees and commissions.

We expect that over the near term, our selling, general and administration expenses will increase as a result of, among other things, increased 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 (replacements), 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, 2006, shareholder's deficit was $1,183,840 as compared to equity of $577,844 for the prior year period ended September 30, 2006. The decrease in shareholder equity is primarily attributable to the change in derivative liability.

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Other expense (income), net for the three-month periods ended December 31, 2006 and 2005 were $(228,508) and $(3,680,353), respectively. The decrease in other income is attributable to proceeds from a legal settlement (see note 18) in the prior year partially offset by a gain from a change in the derivative liability associated with the Global note and warrants outstanding at December 31, 2006. (See note 12).

Net loss for the three-month period ended December 31, 2006 and 2005 was $490,251 versus net income of $2,913,581, respectively.

The Company launched a profit improvement - cost savings initiative in the second half of 2006. The initiative is significantly improving operations efficiency, increasing competitiveness and improving business profitability. The cost savings initiative includes: administrative workforce reduction, phase out of low margin products, tighter control of travel costs and a decrease in external costs across the company. The initiative is expected to deliver over $1,200,000 in annualized savings, for only a one-time $200,000 related pre-tax charge. On an annualized basis, the company expects to increase profitability by more than $2,000,000 as a combined result of cost savings and business growth.

This initiative reflects our ongoing commitment to improve our rate of return on invested capital and deliver stronger bottom-line performance. Senior management is focused on ensuring that our cost structure is competitive and that it is aligned with the company's strategic market opportunities, such as our development of a woodwaste-to-ethanol refinery in Ontario, Canada."

Workforce reductions were made in non-revenue generating areas, with the greatest reductions in corporate headquarters administrative jobs and outside consulting. The company has not reduced sales, marketing, engineering, manufacturing, finance or audit capabilities.

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 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 $169,306 as of December 31, 2006, compared to cash and cash equivalents of $130,550 as of September 30, 2006.

At our current cash "burn rate", we will need to raise additional cash through debt or equity financings during 2007 in order to fund our continued development and marketing of our IFS product line 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 $1,800,000 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 the Company has no firm commitment for additional 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 - None

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.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

As a normal incident of the businesses in which the Company is engaged, various claims, charges and litigation are asserted or commenced from time to time against the Company. The Company believes that final judgments, if any, which might be rendered against the Company in current litigation are adequately reserved, covered by insurance, or would not have a material adverse effect on its financial statements. In addition, we are subject to the following proceedings:

On December 12, 2006, the Company filed a Form 8-K with the Securities and Exchange Commission disclosing the resignation and termination of Daniel Moscaritolo as a director and officer of the Company.

On December 13, 2006, Mr. Moscaritolo presented management with a purported action by written consent of the shareholders of the Company indicating that the shareholders had elected to remove the current board of directors and elect Daniel Moscaritolo and Thomas Hemingway as directors in their place. Mr. Moscaritolo also presented management with two separate purported actions by written consent of the new purported board of directors indicating that the Company's current officers, James A. Latty and Richard W. York, were terminated and that Mr. Moscaritolo was elected to serve as Secretary of the Company and Mr. Hemingway was elected to serve as President and Chief Executive Officer of the Company. The Company rejected the purported shareholder action on the grounds that, on its face, the purported action showed an insufficient number of votes had been obtained to approve the requested action, and on the further grounds that the consent of shareholders was solicited and obtained in violation of the proxy rules set forth in Section 14 of the Securities Exchange Act of 1934, as amended (the “Act”). As a consequence of the invalidity of the purported shareholder action, the Company also rejected the actions of the new purported board of directors terminating and replacing the officers of the Company.

On December 14, 2006, the Company filed a lawsuit in the United States District Court, Central District of California, Western Division (Case No.: CV06-07971) against Daniel Moscaritolo for violations of the Act, declaratory relief, breach of fiduciary duty, intentional interference with contract, and conversion (the “Company Action”). Specifically, the Company alleged that Mr. Moscaritolo's actions to wrest control of the board of directors were invalid and unlawful. On February 8, 2007, a default was entered against Mr. Moscaritolo after he failed to timely file a responsive pleading to the Complaint. On February 12, 2007, the Court entered an Order granting the Company’s Motion for a Preliminary Injunction. Pursuant to the Order, the Court ruled that: (1) the attempted shareholder action initiated by Mr. Moscaritolo and his purported proxies was void as the proxies were solicited and obtained in violation of federal securities laws; (2) Mr. Moscaritolo and those acting in his control or direction were enjoined from (a) attempting to vote any of the illegally obtained proxies; (b) purporting to act as directors of officers of the Company or its subsidiaries; (c) further soliciting shareholder proxies in violation of federal securities laws; and (d) disclosing any confidential or proprietary information of the Company.

On December 15, 2006, Mr. Moscaritolo and Mr. Hemingway, individually, and purporting to act derivatively on behalf of the shareholders of the Company, filed a lawsuit in Nevada State Court, County of Washoe (Case No.: CV0603002) against Mr. Latty and Mr. York for injunctive relief, declaratory relief, receivership, and accounting relating to the failed effort to remove them from the Board of Directors of the Company and seeking a court order approving their removal (the “Moscaritolo Action”). In January 2007, Mr. Moscaritolo and Mr. Hemingway voluntarily dismissed the Moscaritolo Action.

On January 10, 2007, Mr. Moscaritolo and Charles L. Christensen filed a lawsuit in the First Judicial District Court of the State of Nevada in and for Carson City (Case No.: 07-00035A) against the Company, Dr. Latty, and Mr. Newsom for injunctive relief to hold an Annual Shareholders Meeting. On February 9, 2007, the Company filed a Motion to Dismiss or Stay the Action based upon the Company Action pending in the United States District Court, Central District of California, Western Division.

ITEM 1A. RISK FACTORS

An investment in our common stock involves a high degree of risk. In addition to the other information in this report and in our other filings with the Securities and Exchange Commission, you should carefully consider the following risk factors before deciding to invest in shares of our common stock or to maintain or increase your investment in shares of our common stock. If any of the following risks actually occur, it is likely that our business, financial condition and results of operations could be seriously harmed. As a result, the trading price of our common stock could decline, and you could lose part or all of your investment.

Risks Related to our Business

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 within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Statements containing the words or phrases “will likely result,” “are expected to,” “will continue,” “is anticipated,” “estimates,” “projects,” “believes,” “expects,” “anticipates,” “intends,” “target,” “goal,” “pl “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.

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 the following:

We are an emerging growth company with limited operating history, accordingly there is limited historical information available upon which you can judge the merits of an investment in our company.

We have generated net losses since inception, which may continue for the foreseeable future as we try to grow our business, which means that you may be unable to realize a return on your investment for a long period of time, if ever. Our present business operation's commenced in February, 2004. >From inception through December 31, 2006, incurred a cumulative net loss of $16,964,274 which included non-cash net asset impairment charges of $10,900,000 and gains from a change in derivative liability of $543,469. We expect to continue incurring operating losses until we are able to derive meaningful revenues from our proposed business relating to ethanol production, energy generation and supply.

We have limited available working capital and require significant additional capital in order to sustain our operations, and if we cannot obtain additional financing we might cease to continue. As of December 31, 2006, we had total current assets of $ 3,611,735 and working capital of $1,690,733 before including a liability for common stock subscribed of $1,200,375 and the derivative liability of $3,953,337. We believe that we require a minimum of $1,800,000 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. We have not received any funds, nor can there be any assurance that such funds will be forthcoming. Should we be unable to raise the required funds, our ability to finance our continued operations will be materially adversely affected.

Our independent auditors' report raises substantial doubt about our ability to continue as a going concern. Our independent auditors have prepared their report on our 2006 financial statements assuming that we will continue as a going concern. Their report has an explanatory paragraph stating that our recurring losses from operations since inception, limited operating revenue and limited capital resources raise substantial doubt about our ability to continue as a going concern. 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.

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts, or amounts and classification of liabilities that might be necessary, should the Company be unable to continue as a going concern.

Because we have few proprietary rights, others can provide products and services substantially equivalent to ours. We hold a provisional patent application relating to our MEMS operations, however we hold no patents or patents applications relating to our energy generation and supply business or our proposed ethanol production business. We believe that most of the technology used in the design and building of ethanol production facilities and in the area of the energy generation and supply business is generally known and available to others. Consequently, others will be able to compete with us in these areas. We rely on a combination of confidentiality agreements and trade secret law to protect our confidential information. In addition, we restrict access to confidential information on a ‘‘need to know’’ basis. However, there can be no assurance that we will be able to maintain the confidentiality of our proprietary information. If our proprietary rights are violated, or if a third party claims that we violate their trademark or other proprietary rights, we may be required to engage in litigation. Proprietary rights litigation tends to be costly and time consuming. Bringing or defending claims related to our proprietary rights may require us to redirect our human and monetary resources to address those claims.

We may not be able to compete effectively or competitive pressures faced by us may materially adversely affect our business, financial condition, and results of operations. We expect to face significant competition in our ethanol production, energy generation and supply and MEMS operations. Virtually all of our competitors have greater marketing and financial resources than us and, accordingly, there can be no assurance that we will be able to compete effectively or that competitive pressures faced by us will not materially adversely affect our business, financial condition, and results of operations.

We are dependent upon our key personnel. Our performance is substantially dependent on the continued services and on the performance of our senior management and other key personnel. We plan to obtain "key person" life insurance for our key personnel, however, at this time, no such policies are in effect. Our performance will also depend upon our ability to retain and motivate other officers and key employees. The loss of the services of any of our executive officers or other key employees could have a material adverse effect on our business, prospects, financial condition and results of operations. Our future success also depends on our ability to identify, attract, hire, train, retain and motivate other highly skilled technical and managerial personnel. Competition for such personnel is intense, and there can be no assurance that we will be able to successfully attract, assimilate or retain sufficiently qualified personnel. The failure to retain and attract the necessary technical, and managerial personnel could have a material adverse effect on our business, prospects, financial condition and results of operations.

Because we are smaller and have fewer financial and other resources than many ethanol producers, we may not be able to successfully compete in the very competitive ethanol industry. Ethanol is a commodity. There is significant competition among existing ethanol producers. Our business faces competition from a number of producers that can produce significantly greater volumes of ethanol than we can or expect to produce, producers that can produce a wider range of products than we can, and producers that have the financial and other resources that would enable them to expand their production rapidly if they chose to. These producers may be able to achieve substantial economies of scale and scope, thereby substantially reducing their fixed production costs and their marginal productions costs. If these producers are able to substantially reduce their marginal production costs, the market price of ethanol may decline and we may be not be able to produce ethanol at a cost that allows us to operate profitably. Even if we are able to operate profitably, these other producers may be substantially more profitable than us, which may make it more difficult for us to raise any financing necessary for us to achieve our business plan and may have a materially adverse effect on the market price of our common stock.

Competition from large producers of petroleum-based gasoline additives and other competitive products may impact our profitability. Our success depends substantially upon continued demand for ethanol from major oil refiners. There are other gasoline additives that have octane and oxygenate values similar to those of ethanol but which currently cannot be produced at a cost that makes them competitive. The major oil refiners have significantly greater financial, technological and personal resources than we have to reduce the costs of producing these alternative products or to develop other alternative products that may be produced at lower cost. The major oil refiners also have significantly greater resources than we have to influence legislation and public perception of ethanol. If the major oil refiners are able to produce ethanol substitutes at a cost that is lower than the cost of ethanol production, the demand for ethanol may substantially decrease. A substantial decrease in the demand for ethanol will reduce the price of ethanol, adversely affect our profitability and decrease the value of your stock.

If ethanol and gasoline prices drop significantly, we will also be forced to reduce our prices, which potentially may lead to losses. Prices for ethanol products can vary significantly over time and decreases in price levels could adversely affect our profitability and viability. The price of ethanol has some relation to the price of gasoline. The price of ethanol tends to increase as the price of gasoline increases, and the price of ethanol tends to decrease as the price of gasoline decreases. Any lowering of gasoline prices will likely also lead to lower prices for ethanol and adversely affect our operating results. We cannot assure you that we will be able to sell our ethanol profitably, or at all.

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Lax enforcement of environmental and energy policy regulations may adversely affect the demand for ethanol. Our success will depend, in part, on effective enforcement of existing environmental and energy policy regulations. Many of our potential customers are unlikely to switch from the use of conventional fuels unless compliance with applicable regulatory requirements leads, directly or indirectly, to the use of ethanol. Both additional regulation and enforcement of such regulatory provisions are likely to be vigorously opposed by the entities affected by such requirements. If existing emissions-reducing standards are weakened, or if governments are not active and effective in enforcing such standards, our business and results of operations could be adversely affected. Even if the current trend toward more stringent emissions standards continues, our future prospects will depend on the ability of ethanol to satisfy these emissions standards more efficiently than other alternative technologies. Certain standards imposed by regulatory programs may limit or preclude the use of our products to comply with environmental or energy requirements. Any decrease in the emission standards or the failure to enforce existing emission standards and other regulations could result in a reduced demand for ethanol. A significant decrease in the demand for ethanol will reduce the price of ethanol, adversely affect our profitability and decrease the value of your stock.

Price increases or interruptions in needed energy supplies could cause loss of customers and impair our profitability. Ethanol production requires a constant and consistent supply of energy. If there is any interruption in our supply of energy for whatever reason, such as availability, delivery or mechanical problems, we may be required to halt production. If we halt production for any extended period of time, it will have a material, adverse effect on our business. Natural gas and electricity prices have historically fluctuated significantly. We purchase significant amounts of these resources as part of our ethanol production. Increases in the price of natural gas or electricity would harm our business and financial results by increasing our energy costs.

Our common stock may be thinly traded, so you may be unable to sell at or near ask prices or at all if you need to sell your shares to raise money or otherwise desire to liquidate your shares. Our common stock is thinly traded and we will be required to undertake efforts to develop market recognition for us and support for our shares of common stock in the public market. The price and volume for our common stock that will develop cannot be assured.

The number of persons interested in purchasing our common stock at or near ask prices at any given time may be relatively small or non-existent. This situation may be attributable to a number of factors, including the fact that we are a small company which is relatively unknown to stock analysts, stock brokers, institutional investors and others in the investment community that generate or influence sales volume, and that even if we came to the attention of such persons, they tend to be risk-averse and would be reluctant to follow an unproven company such as ours or purchase or recommend the purchase of our shares until such time as we became more seasoned and viable. As a consequence, there may be periods of several days, weeks, months, or more when trading activity in our shares is minimal or non-existent, as compared to a seasoned issuer which has a large and steady volume of trading activity that will generally support continuous sales without an adverse effect on share price. We cannot give you any assurance that a broader or more active public trading market for our common stock will develop or be sustained. While we are trading on the OTC Bulletin Board, the trading volume we will develop may be limited by the fact that many major institutional investment funds, including mutual funds, as well as individual investors follow a policy of not investing in Bulletin Board stocks and certain major brokerage firms restrict their brokers from recommending Bulletin Board stocks because they are considered speculative, volatile and thinly traded.

Our common stock is subject to the "penny stock" rules which could limit the trading and liquidity of the common stock, adversely affect the market price of our common stock and increase your transaction costs to sell those shares. The trading price of our common stock is below $5 per share; and therefore, the open-market trading of our common stock will be subject to the "penny stock" rules, unless we otherwise qualify for an exemption from the "penny stock" definition. The "penny stock" rules impose additional sales practice requirements on certain broker-dealers who sell securities to persons other than established customers and accredited investors (generally those with assets in excess of $1,000,000 or annual income exceeding $200,000 or $300,000 together with their spouse). These regulations, if they apply, require the delivery, prior to any transaction involving a penny stock, of a disclosure schedule explaining the penny stock market and the associated risks. Under these regulations, certain brokers who recommend such securities to persons other than established customers or certain accredited investors must make a special written suitability determination regarding such a purchaser and receive such purchaser's written agreement to a transaction prior to sale. These regulations may have the effect of limiting the trading activity of our common stock, reducing the liquidity of an investment in our common stock and increasing the transaction costs for sales and purchases of our common stock as compared to other securities.

The market price for our common stock may be particularly volatile given our status as a relatively unknown company with a small and thinly traded public float and lack of history as a public company which could lead to wide fluctuations in our share price. The market for our common stock may be characterized by significant price volatility when compared to seasoned issuers, and we expect that our share price could continue to be more volatile than a seasoned issuer for the indefinite future. The potential volatility in our share price is attributable to a number of factors. First, as noted above, our shares of common stock may be sporadically and thinly traded. As a consequence of this lack of liquidity, the trading of relatively small quantities of shares by our stockholders may disproportionately influence the price of those shares in either direction. The price for our shares could, for example, decline precipitously in the event that a large number of our shares of common stock are sold on the market without commensurate demand, as compared to a seasoned issuer which could better absorb those sales without adverse impact on its share price. Many of these factors will be beyond our control and may decrease the market price of our common shares, regardless of our operating performance. We cannot make any predictions or projections as to what the prevailing market price for our common stock will be at any time.

In addition, the market price of our common stock could be subject to wide fluctuations in response to:

- quarterly variations in our revenues and operating expenses;
- announcements of new products or services by us;
- fluctuations in interest rates;
- significant sales of our common stock, including "short" sales;
- the operating and stock price performance of other companies that investors may deem comparable to us; and
- news reports relating to trends in our markets or general economic conditions

The stock market, in general, and the market prices for penny stock companies in particular, have experienced volatility that often has been unrelated to the operating performance of such companies. These broad market and industry fluctuations may adversely affect the price of our stock, regardless of our operating performance.

Stockholders should be aware that, according to SEC Release No. 34-29093, the market for penny stocks has suffered in recent years from patterns of fraud and abuse. Such patterns include (1) control of the market for the security by one or a few broker-dealers that are often related to the promoter or issuer; (2) manipulation of prices through prearranged matching of purchases and sales and false and misleading press releases; (3) boiler room practices involving high-pressure sales tactics and unrealistic price projections by inexperienced sales persons; (4) excessive and undisclosed bid-ask differential and markups by selling broker-dealers; and (5) the wholesale dumping of the same securities by promoters and broker-dealers after prices have been manipulated to a desired level, along with the resulting inevitable collapse of those prices and with consequent investor losses. Our management is aware of the abuses that have occurred historically in the penny stock market. Although we do not expect to be in a position to dictate the behavior of the market or of broker-dealers who participate in the market, management will strive within the confines of practical limitations to prevent the described patterns from being established with respect to our securities. The occurrence of these patterns or practices could increase the volatility of our share price.

Limitations on director and officer liability and indemnification of our officers and directors by us may discourage stockholders from bringing suit against a director. Our bylaws provide, with certain exceptions as permitted by governing state law, that a director or officer shall not be personally liable to us or our stockholders for breach of fiduciary duty as a director, except for acts or omissions which involve intentional misconduct, fraud or knowing violation of law, or unlawful payments of dividends. These provisions may discourage stockholders from bringing suit against a director for breach of fiduciary duty and may reduce the likelihood of derivative litigation brought by stockholders on our behalf against a director. In addition, our articles of incorporation and bylaws may provide for mandatory indemnification of directors and officers to the fullest extent permitted by governing state law.

We do not expect to pay dividends for the foreseeable future, and we may never pay dividends. We currently intend to retain any future earnings to support the development and expansion of our business and do not anticipate paying cash dividends in the foreseeable future. Our payment of any future dividends will be at the discretion of our board of directors after taking into account various factors, including but not limited to our financial condition, operating results, cash needs, growth plans and the terms of any credit agreements that we may be a party to at the time. In addition, our ability to pay dividends on our common stock may be limited by state law. Accordingly, investors must rely on sales of their common stock after price appreciation, which may never occur, as the only way to realize their investment.

Our management owns 29.7% and an investment group may own a significant percentage of our outstanding common stock, which may limit your ability and the ability of our other shareholders, whether acting alone or together, to propose or direct the management or overall direction of our Company. Such concentrated control of the Company may adversely affect the price of our common stock. Our principal stockholders may be able to control matters requiring approval by our shareholders, including the election of directors, mergers or other business combinations. Such concentrated control may also make it difficult for our shareholders to receive a premium for their shares of our common stock in the event we merge with a third party or enter into different transactions which require shareholder approval. These provisions could also limit the price that investors might be willing to pay in the future for shares of our common stock. Accordingly, if all of our officers and directors exercise outstanding option this shareholder together with our directors and executive officers could have the power to control the election of our directors and the approval of actions for which the approval of our shareholders is required. If you acquire shares, you may have no effective voice in the management of the Company.

Future sales of our equity securities could put downward selling pressure on our securities, and adversely affect the stock price. There is a risk that this downward pressure may make it impossible for an investor to sell his securities at any reasonable price, if at all. Future sales of substantial amounts of our equity securities in the public market, or the perception that such sales could occur, could put downward selling pressure on our securities, and adversely affect the market price of our common stock.

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ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

During the month of October 2006, the Company issued and delivered 70,000 shares of the Company’s common stock to one consultant for services valued at approximately $38,500.

The company issued warrants to the underwriters to purchase 310,000 shares of its common stock at a price of $1.60 per share. The proceeds from the issuance of the 2,013,510 shares were recorded net of the fair value of the warrants and the underwriter’s fees. The fair value of the warrants, $419,639 was calculated using the Black Scholes option pricing model using the following assumptions: risk free rate of return of 6%, volatility of 145%, dividend yield of 0% and expected life of 3 years.

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

There were no material defaults with respect to any of our indebtedness during the first quarter of 2007.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS - None

ITEM 5. OTHER INFORMATION

Departure of Directors or Principal Officers; Election of Directors; Appointment of Principal Officers:

A. Appointment of Director

Effective October 18, 2006, Mr. Steven Newsom was appointed to the Board of Directors of the Company. As of November 15, 2006, the Board of Directors is comprised of two members, Mr. Newsom and James A. Latty.

Pursuant to his appointment, Mr. Newsom and the Company entered into a Consulting Agreement. Pursuant to the Consulting Agreement, Mr. Newsom shall receive the following: (i) the sum of $20,000, (ii) the sum of $4,000 per month payable on the first day of each month during his tenure as a member of the Company's Board of Directors, (iii) an additional $2,000 per trip, if Mr. Newsom makes more than three trips (per quarter) to attend meetings on Company's business, (iv) $250 per hour for work performed for the Company over and above time spent on trips to attend meetings on Company's business, (v) travel expenses for trips to attend meetings on Company's business, and (vi) options for the purchase of up to 300,000 shares of common stock of the Company at an exercise price of $0.51 per share. The option period shall be 60 months from October 18, 2006.

B. Resignation and termination of Daniel Moscaritolo as a director and officer:

On December 14, 2006, the Company filed a lawsuit in the United States District Court, Central District of California, Western Division (Case No.: CV06-07971) against Daniel Moscaritolo for violations of the Securities Exchange Act of 1934, declaratory relief, breach of fiduciary duty, intentional interference with contract, and conversion arising out of Mr. Moscaritolo's improper actions to wrest control of the Company by soliciting proxies for a shareholder vote to take over the Company.

On December 15, 2006, Mr. Moscaritolo and Mr. Hemingway, individually, and purporting to act derivatively on behalf of the shareholders of the Company, filed a lawsuit in Nevada State Court, County of Washoe (Case No.: CV0603002) against Dr. Latty and Mr. York for injunctive relief, declaratory relief, receivership, and accounting relating to the failed effort to remove them from the Board of Directors of the Company and seeking a court order approving their removal (the “Moscaritolo Action”). The Moscaritolo action has been dismissed, but on January 9, 2007 he filed a second lawsuit in Nevada State Court against the Company, Dr. Latty, and Mr. Newsom for injunctive relief to hold Annual Shareholders Meeting.

The Company intends to pursue the claims set forth in the Company Action and to oppose the claims set forth in the Second Moscaritolo Action.

ITEM 6. EXHIBITS

(a) Exhibits

3.1 Articles of Incorporation, as amended, of Convergence Ethanol, Inc.

3.2 Bylaws, as amended, of Convergence Ethanol, Inc.

10.1 Securities Purchase Agreement dated as of October 27, 2006 between the Company and Global Capital Advisors, LLC.

10.2 Form of Convertible Note Agreement dated as of October 27, 2006 between the Company and Global Capital Advisors, LLC.

10.3 Form of Registration Rights Agreement dated as of October 27, 2006 between the Company and Global Capital Advisors, LLC.

10.4 Deed of Trust and Security Agreement dated as of October 27, 2006 between the Company and Global Capital Advisors, LLC.

10.5 Form of Escrow Agreement dated as of October 27, 2006 between the Company and Global Capital Advisors, LLC.

10.6 Form of Common Stock Warranty Agreement dated as of October 27, 2006 between the Company and Global Capital Advisors, LLC. (Exhibit F)

10.7 Form of Common Stock Warranty Agreement dated as of October 27, 2006 between the Company and Global Capital Advisors, LLC. (Exhibit G)

10.8 Promissory Note dated as of November 1, 2005 between the Company and Daniel K. Moscaritolo.

10.9 Promissory Note dated as of November 1, 2005 between the Company and James A. Latty.

10.10 Offer letter of employment dated July 1, 2002 between the Company and James A. Latty.

10.11 Offer letter of employment dated July 1, 2002 between the Company and Daniel K. Moscaritolo.

10.12 Executive employment agreement dated November 1, 2006 between the Company and Richard W. York.

10.13 Agreement dated October 18, 2006 between the Company and Steven Newsom

10.14 Factoring agreement dated November 22, 2006 between the Company (Gulfgate Equipment, Inc.) and BLX Funding, LLC.

10.15

Factoring agreement dated November 22, 2006 between the Company (Bott Equipment Company, Inc.) and BLX Funding, LLC.

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

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).

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.

CONVERGENCE ETHANOL, INC.
(Registrant)

Date: February 23, 2007	/s/ James A. Latty
	James A. Latty
	Chief Executive Officer