CHROMATICS COLOR SCIENCES INTERNATIONAL INC
Form 10-Q
November 14, 2001

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2001

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _________ to _________

Commission file number 0-21168

CHROMATICS COLOR SCIENCES INTERNATIONAL, INC.
(Exact Name of Registrant as Specified in Its Charter)

New York	13-3253392
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

5 East 80th Street, New York, New York 10021
(Address of principal executive offices)

(212) 717-6544
(Registrant's Telephone Number, Including Area Code)

n/a
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by court. Yes [ ] No [ ] N/A

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of November 14, 2001: 19,991,952

-1-

PART I -- FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CHROMATICS COLOR SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	September 30, 2001	December 31, 2000
	(unaudited)	(Notes 1 and 3)
ASSETS		
CURRENT ASSETS:		
Cash and equivalents	$ 157,700	$ 1,379,000
Accounts receivable	72,900	72,900
Inventories	714,000	747,100
Prepaid expenses and other current assets	67,300	296,900
Subscriptions receivable	310,000	-
Deferred financing costs	680,500	-
Total Current Assets	2,002,400	2,495,900
PROPERTY AND EQUIPMENT - NET	178,400	244,100
SOFTWARE DEVELOPMENT COSTS - NET	104,600	261,400
PATENT COSTS - NET	505,700	581,100
NET ASSETS OF DISCONTINUED OPERATIONS	-	1,000,000
OTHER ASSETS	306,600	331,700
	$ 3,097,700	$ 4,914,200
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable and accrued expenses:		
Attorneys and accountants	$ 1,021,100	$ 458,900
Consultants	385,600	141,700
Trade	294,300	260,100
Severance payable	700,000	-
Notes payable (including $325,000 payable to an affiliate)	1,260,000	-
Total Current Liabilities	3,661,000	860,700
LONG TERM DEBT:		
Amount payable for purchase of Gordon	-	653,000

	-	653,000
COMMITMENTS AND CONTINGENCIES		
REDEEMABLE PREFERRED STOCK:		
Class A, Par Value $.01 per share:		
Authorized - 1,400,000 shares		
Issued and outstanding - 1,380,000 shares at par value and redemption value	13,800	13,800
	13,800	13,800
SHAREHOLDERS' EQUITY (DEFICIENCY)		
Preferred Stock, authorized 10,000,000 shares, issued and outstanding 113,769 shares	12,344,800	11,510,800
Subscribed stock (8,333,334 shares of common stock)	500,000	
Common Stock, par value $.001 per share:		
Authorized - 50,000,000 shares		
Issued and outstanding - 19,991,952, (2001) and 19,033,308 (2000) shares	20,000	19,100
Capital in excess of par value	46,718,500	45,934,400
Accumulated deficit	(60,160,400)	(54,077,600)
Total Shareholders' Equity (Deficiency)	(577,100)	3,386,700
	$ 3,097,700	$ 4,914,200

See accompanying notes to consolidated financial statements

CHROMATICS COLOR SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended Sept. 30,	
	2001	2000
Sales	$ 6,000	$ 600
COSTS AND EXPENSES:		
Cost of sales	-	100
Sales, marketing and trade show costs	28,100	496,400
Medical regulatory expenses	26,000	193,400
Research and development	142,500	283,400
Patent application costs	7,900	65,900
Compensation costs relating to (non cash) options granted	-	225,000

Provision for estimated payments for terminated employees	-	-
General and administrative:		
Compensation - Officers, employees and consultants	198,900	519,100
Legal fees	132,100	133,500
Accounting fees	20,700	17,500
Rent and storage	82,000	91,400
Insurance	47,300	74,900
Repairs and maintenance	17,600	40,800
Depreciation and amortization	101,300	194,500
Taxes	1,300	13,600
Stock administrative fees	20,000	11,600
Public relations	1,000	49,300
Other	25,200	120,200
	851,900	2,530,600
OPERATING LOSS	(845,900)	(2,530,000)
OTHER INCOME (EXPENSE):		
Interest income	-	21,800
Interest expense and non-cash financing costs including $285,500 and $834,200 in non-cash OID costs in 2001 and 2000, respectively	(210,900)	(181,800)
	(210,900)	(160,000)
LOSS FROM CONTINUING OPERATIONS	(1,056,800)	(2,690,000)
LOSS FROM DISCONTINUED OPERATIONS (Note 3)	-	(333,300)
NET LOSS	$ (1,056,800)	$ (3,023,300)
NET LOSS TO COMMON STOCKHOLDERS:		
LOSS FROM CONTINUING OPERATIONS	$ (1,056,800)	$ (2,690,000)
DEEMED DIVIDEND FOR CLASS B, SERIES 2 AND 3 CONVERTIBLE PREFERRED STOCK	278,000	278,000
LOSS FROM CONTINUING OPERATIONS TO COMMON STOCKHOLDERS	(1,334,800)	(2,968,000)
LOSS FROM DISCONTINUED OPERATIONS (Note 3)	-	(333,300)
NET LOSS TO COMMON SHAREHOLDERS	$ (1,334,800)	$ (3,301,300)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	19,991,952	17,034,726
BASIC AND DILUTED LOSS PER SHARE:		
LOSS FROM CONTINUING OPERATIONS	$ (0.07)	$ (0.17)
LOSS FROM DISCOUNTINUED OPERATIONS	-	(0.02)
NET LOSS TO COMMON STOCKHOLDERS	$ (0.07)	$ (0.19)

See accompanying notes to consolidated financial statements

-3-

CHROMATICS COLOR SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY (DEFICIENCY)
(UNAUDITED)

	Preferred Stock	Common Stock Number of Shares Outstanding	Common Stock Par Value
Balances, December 31, 2000	$ 11,510,800	19,033,308	$ 19,100
Nine Months Ended September 30, 2001:			
Net Loss	-	-	-
Issuance of common stock - Gordon		22,894	-
Issuance of common stock - Private investor		935,750	900
Warrants issued in connection with bridge notes			
Deemed dividend on Class B, convertible preferred stock	834,000		
Balances, September 30, 2001	$ 12,344,800	19,991,952	$ 20,000

See accompanying notes to consolidated financial statements

-4-

CHROMATICS COLOR SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine Months Ended Septembe	
	2001	200
CASH FLOWS FROM OPERATING ACTIVITIES:		

Loss from continuing operations	$ (5,082,800)	$ (9,03
Loss from discontinued operations	(1,000,000)	(37
Adjustments to reconcile net loss to net cash flows from operating activities:		
Non-cash impairment charge and net change in net assets of discontinued operations	1,000,000	37
Depreciation and amortization	353,400	53
Compensation cost relating to options granted to consultants	-	69
Non-cash interest and financing costs	285,500	83
Changes in operating assets and liabilities:		
Accounts receivable	-	76
Inventories	33,100	(20
Prepaid expenses and other assets	204,700	(16
Accrued interest on senior convertible debentures	-	52
Accounts payable and accrued expenses	1,840,300	26
Net cash flows from continuing operating activities	(2,365,800)	(5,78
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capitalized patent costs	-	(33
Net cash used for investment in subsidiary	-	(1,93
Purchase of property and equipment	(5,500)	(7
Net cash flows from investing activities	(5,500)	(2,35
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of subscribed stock, net of related costs	190,000	3,67
Proceeds (payments) of notes payable and warrants	960,000	(25
Net proceeds from the issuance of preferred stock and warrants, net of costs	-	3,61
Net cash flows from financing activities	1,150,000	7,02
NET CHANGE IN CASH AND EQUIVALENTS	(1,221,300)	(1,11
CASH AND EQUIVALENTS, BEGINNING OF PERIOD	1,379,000	2,79
CASH AND EQUIVALENTS, END OF PERIOD	$ 157,700	$ 1,67
SUPPLEMENTAL CASH FLOW INFORMATION		
Interest paid	$ -	$ 2
Issuance of debt to pay accrued expenses	$ 300,000	$
Issuance of stock to pay Gordon liability	$ 653,000	$
Deemed dividends	$ 834,000	$ 1,25
Subscribed stock	$ 310,000	$

See accompanying notes to consolidated financial statements

CHROMATICS COLOR SCIENCES INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Basis of Presentation:

Nature of Report - The consolidated balance sheet at the end of the preceding fiscal year has been derived from the audited consolidated balance sheet contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000 and is presented for comparative purposes. All other financial statements are unaudited. In the opinion of management, all adjustments, which include only normal recurring adjustments necessary to present fairly the financial position, results of operations and changes in cash flows, for all periods presented have been made. The results of operations for interim periods are not necessarily indicative of the operating results for the full year.

Footnotes - Certain footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted in accordance with the published rules and regulations of the Securities and Exchange Commission. These consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000.

Note 2 - Commitments and Contingencies:

Business Risks - Since its formation in 1984, the Company has been principally engaged in color science technology research and development and licensing activities, seeking mass market applications for its proprietary technology and instrumentation. The Company's business encompasses all of the risks inherent in the establishment of a new business enterprise, including a limited operating history with significant competition possessing substantially greater resources. Current and future operations also depend upon the continued employment of certain key executives, the ability to further commercialize its proprietary technology and products and the Company's ability to obtain sufficient revenues and outside financing.

Operating Difficulties - Since 1989, the Company has incurred losses from operations and net cash outflows from operations. The Company expects to license its patents and proprietary technology, sell its equipment and market its related services and products to ultimately overcome these difficulties.

Although the Company has taken steps to substantially reduce personnel and ongoing operating expenses, the Company expects that it will continue to incur costs in connection with the required research and development on its new LED instrument and technology, complete filings, administration and maintenance for certain intellectual properties and regulatory requirements; supply updated products and sales support to its medical distributor; complete FDA filings for upgrades to its medical products, and explore the possibility of either renegotiating its current distribution agreement for its medical products or selling the exclusive rights to its medical products and technology. There can be no assurance the Company will not continue to incur such losses or will ever generate revenues at levels sufficient to support profitable operations.

The Company anticipates that it will continue to incur net losses for the foreseeable future as expenses are incurred in implementing its long-term business plan.

The Company is currently taking steps to improve operating results and has initiated a plan to significantly reduce operating costs. The Company is experiencing a major liquidity crisis and requires an immediate infusion of cash to continue operations. The Company is seeking additional capital to facilitate liquidity and is currently reviewing various financing proposals. If the Company is unable to obtain such financing, or sell its assets to obtain a cash infusion, it may be forced to seek protection from its creditors in bankruptcy.

Even if the Company is successful in obtaining this cash infusion, the Company will require additional future financing to further execute its long range business plan. If the Company is not able to attract additional future financing, generate significant revenue from operations and/or successfully market its products and technologies, it may have to significantly curtail and/or cease operations and be forced to seek protection from its creditors in bankruptcy.

The Company has previously received notifications from NASDAQ that its common stock failed to comply with the $1.00 minimum bid price and $2,000,000 minimum net tangible asset conditions required for coninued listing of the common stock on the NASDAQ SmallCap Market. A hearing on the proposed delisting of the Company's common stock was held on August 16, 2001. At that hearing the NASDAQ Hearing Committee requested additional information regarding the Company's plans to achieve compliance with the minimum net tangible asset requirement. To date, NASDAQ has publicly announced a temporary suspension of all delisting proceedings regarding the listing requirement for a $1 minimum per share price in the aftermath of the September 11th attacks on the World Trade Center and the Pentagon. Additionally, on October 30, 2001, NASDAQ has granted a temporary exception to the Company to remain listed until November 30, 2001, pending the Company's ability to be in compliance with the terms of the exception, including the Net Tangible Asset requirement. There can be no assurance that the Company will be in compliance with the terms of the exception and the Net Tangible Asset requirement by November 30, 2001 or at any later date. If the Company is not in compliance by November 30, 2001, then it's securities will be delisted from the NASDAQ SmallCap Market. If the Company's securities should cease to be listed on the NASDAQ SmallCap Market, they may continue to be listed on the OTC Bulletin Board. The Company has requested that the Listing Council review this decision. However the institution of a review will not operate as a stay of delisting based on this decision.

Legal Proceedings - On January 16, 2001, a lawsuit was commenced against the Company and Darby Macfarlane in the federal district court for the Southern District of New York entitled Richard Sommers and Linda Sommers v. Chromatics Color Sciences International, Inc. and Darby S. Macfarlane. The plaintiffs allege that certain statements purportedly made by or on behalf of the Company concerning the Company's success, the extent of use of the ColorMate (Registered Trademark) System and the Company's cash flow constituted violations of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 promulgated thereunder and Section 12(a)(2) of the Securities Act of 1933 as well as common law claims alleging fraudulent misrepresentation, concealment and nondisclosure and seek unspecified damages in an amount to be proven at trial. On March 1, 2001, the defendants moved to dismiss the complaint for failure to state a claim upon which relief can be granted, for failure to plead fraud with requisite particularity and for failure to comply with the statutory requirements for federal securities fraud claims. No decision has been rendered by the court on this motion. The defendants believe that the allegations of the complaint are without merit and intend to vigorously defend this action.

Note 3 - Discontinued Operations:

On June 2, 2000, the Company purchased Gordon Laboratories, Inc. ("Gordon"). Due to the recent financial results of Gordon and CCSI's inability to continue funding Gordon, the Company decided to sell Gordon in the first quarter of 2001. On July 3, 2001 the Company completed the sale of Gordon (see below). The Company retains the right to repurchase Gordon within the one year anniversary of July 3,

2001. Accordingly, results of this operation have been classified as discontinued, and prior periods have been restated. The net assets of Gordon were written-down to zero as of March 31, 2001.

In connection with the purchase of Gordon, the Company was required to issue additional shares of its common stock to certain Gordon options holders on June 2, 2001 at a price of $6.29 per share. In accordance with this provision, the Company issued 22,894 shares on July 3, 2001. The financial statements reflect these shares as if they had been fully issued on June 2, 2001.

Net sales and loss from the discontinued operation are as follows:

	Three Months ended Sep. 30, 2001	Nine Months ended Sep. 30, 2001	Three Mo ended Sep. 30,
Net Sales	$ 0	$ 2,590,000	$ 1,7
Loss from discontinued operation	$ 0	$ 1,000,000	$ 3
Impairment cost (gain)	$ 0	$ 0	$
Net Loss from discontinued operation	$ 0	$ 1,000,000	$ 3

* Note - Gordon's net assets were written-down to zero at March 31, 2001. Losses subsequent to March 31, 2001 at Gordon had no effect on the Company's financial statements. Results for 2001 are through June 30, 2001 and do not reflect results after the sale of Gordon.

Assets and liabilities from the discontinued operation were as follows:

	December 31, 2000
Current assets	$ 1,821,500

Property and equipment/other assets	$	3,261,100
Current liabilities	$	4,082,600
Long-term liabilities	$	0
Net assets of discontinued operation	$	1,000,000

Sale of Gordon

On July 3, 2001, pursuant to the Share Subscription and Redemption Agreement, dated as of June 19, 2001 (the "Purchase Agreement"), among the Company, Abilene Investments Corp. ("Abilene"), GAC- Labs, LLC ("GAC- Labs" and collectively with Abilene, the "Purchasers") and Gordon Acquisition Corp., a wholly-owned subsidiary of the Company ("Gordon"), Gordon issued 200 shares of common stock, par value $.001 per share, of Gordon ("Gordon Stock") to Abilene and 800 shares of Gordon

Stock to GAC-Labs for an aggregate purchase price of $1,000,000. Simultaneously, the shares of Gordon Stock that were outstanding immediately prior to the closing of this transaction, all of which were owned by the Company, were redeemed for one dollar. In addition, the Company assigned to the Purchasers its right, title and interest in the indebtedness of Gordon and/or H.B. Gordon Manufacturing Co., Inc., its wholly-owned subsidiary, owed to the Company in the ratio of 20% to Abilene and 80% to GAC-Labs.

As part of the same transaction, pursuant to the Purchase Option Agreement, dated as of July 3, 2001 (the "Option Agreement"), among the Company, Abilene and GAC-Labs, the Company was granted the option to purchase from the Purchasers the shares of Gordon Stock issued to them and the indebtedness assigned to them under the Purchase Agreement within one year for an aggregate purchase price of $1,000,000 plus interest thereon at the rate of 14% per annum, subject to reduction under certain conditions, as described below.

Furthermore, the Company granted to the Purchasers one-year warrants (the "Warrants") to purchase (i) an aggregate of 2,000,000 shares of common stock, par value $.001 per share, of the Company ("CCSI Stock") at the exercise price of $.50 per share, if the Company does not consummate a rights offering/ private placement by the Company of its securities prior to the one year expiration of such warrants, or alternatively (ii) an aggregate of 11,200,000 shares of CCSI Stock at the exercise price of $.10 per share and 4.8 million shares at $0.001 per share, subject to price adjustment, if the Company consummates a rights offering/private placement by the Company of its securities prior to the one year expiration of such warrants and obtains shareholder approval with respect to such rights offering/private placement by the Company of its securities and such increase in warrants. The fair market value of the 2 million warrants was immaterial. If the alternative additional warrants are issued at a later date, the fair market value of such warrants will be recorded as a further loss on the disposal of Gordon.

If (i) pursuant to the Option Agreement the Company exercises its option to purchase from the Purchasers the shares of Gordon Stock issued to them and the indebtedness assigned to them under the Purchase Agreement, (ii) the Company has not effected a reverse stock split of the CCSI Stock in a ratio greater than ten to one, (iii) the Company has consummated a rights offering/private placement by the Company of its securities and (iv) the market price of CCSI Stock exceeds $1.00 per share for at least ten consecutive trading days from and after the date of exercise under the Option Agreement, the Warrants will be subject to mandatory exercise. In the event of such a mandatory exercise, the Company will accept as payment of the aggregate exercise price the shares of Gordon Stock that the Purchasers acquired under the Purchase Agreement, and the exercise price under the Option Agreement will be reduced to one dollar. The Warrants are also subject to mandatory exercise if (i) a registration statement filed by the Company with respect to the shares of CCSI Stock issuable upon exercise of the Warrants has been declared effective by the Securities and Exchange Commission, (ii) the Company has not effected a reverse stock split of the CCSI Stock in a ratio greater than ten to one, (iii) the Company has consummated a rights offering/private placement by the Company of its securities and (iv) the market price of CCSI Stock exceeds $1.00 per share for at least ten consecutive trading days from and after the effective date of such registration statement. In the event of such a mandatory exercise, the Company will accept payment of the aggregate exercise price through the means of a broker's cashless exercise transaction.

Note 4 - Issuance of Common Stock:

In connection with an "adjustable warrant" granted to a private investor in 2000, the Company issued 935,750 shares of its common stock to such investor as a result of the first adjustment of such warrant which occurred on March 31, 2001.

In connection with the purchase of Gordon, the Company issued 22,894 of its common shares in July 2001. See Note 3.

Note 5 - Employee termination payments

Since March 2001, the Company terminated many of its employees or has been unable to pay many of its existing employees. Some of these employees have employment contracts that provide for severance and other payments upon the termination of employment or breach in such contracts. Accordingly, the Company has recorded a $1,000,000 provision for the estimated exposure to these employees for additional amounts due to them. As of September 30, 2001, $300,000 of this provision has been utilized via payments by an officer of the Company. The Company believes the remaining $700,000 accrual is reasonable.

Note 6 - Notes payable

During the nine months ended September 30, 2001 the Company received $1,260,000 through the issuance of bridge notes ($300,000 resulted from the payment by an officer of Company liabilities). The notes bear interest at a fixed rate of 10% and are due in one year. In connection with the debt, the Company issued an aggregate of 13 million warrants to investors and an additional 4 million warrants to the finder. All of the warrants have a five year life and are exercisable at $0.10 per share upon registration of the underlying shares. The fair market value of these warrants amounted to $966,000 determined using the Black-Scholes option pricing model. The fair market value of these warrants issued in connection with debt has been recorded as deferred financing costs, is included in current assets, and is being amortized over the life of the relative debt. For the nine months ended September 30, 2001, approximately $285,500 was charged to non-cash financing costs relating to the amortization of the deferred financing costs.

Note 7 - Stock subscriptions

In August 2001, the Company retained Janssen Partners, Inc. to serve as its placement agent in connection with an offering of 10,333,333 shares of common stock and warrants to raise $620,000 in proceeds. Attached to each share is a Series A Common Stock Purchase Warrant which vests immediately, has a five year life and is exercisable at $0.10 per share after registration of the underlying shares. Upon the exercise of each Series A Common Stock Purchase Warrant, the holder will receive a Series B Common Stock Purchase Warrant which vests immediately, has a five year life from date of issuance and is exercisable at $0.15 per share after registration of the underlying shares. The offering will expire upon the earlier of November 30, 2001 or the full subscription of the offering. As of September 30, 2001, 8,333,334 shares of common stock have been subscribed for in an aggregate amount of $500,000, of which $190,000 was received in September 2001 and $310,000 included in

current assets as these amounts were received in October 2001 after required shareholder approval for additional authorized shares was obtained October 31, 2001. In addition, 12,500,000 Series A Common Stock Purchase Warrants and 12,500,000 Series B Common Stock Purchase Warrant are issuable in connection with the offering.

The Company is in the process of completing documentation including an additional proxy to obtain stockholder approval for an additional proposed private placement by the Company involving potential issuance of additional shares of common stock by the Company in an aggregate amount in excess of 20% of the Company's common stock outstanding immediately prior to such private placement at a price per share less than the market value of the common stock. On October 31, 2001, at a special shareholder meeting an amendment to the Company's Certificate of Incorporation to increase the number of authorized shares of common stock, $.001 par value per share, from 50,000,000 to 550,000,000 was approved by the following votes: 18,110,383 for; 1,033,794 against; and 71,069 abstained. Additionally, an amendment to the Company's Certificate of Incorporation to effect a one share for up to forty shares reverse stock split of the Company's issued and outstanding shares of common stock, as determined by the Company's Board of Directors was approved by the following votes: 18,078,117 for; 1,052,519 against; and 84,550 abstained. Due to NASDAQ's temporary suspension of all delisting proceedings regarding the listing requirement for a $1.00 minimum per share price, the Company's Board of Directors does not see the necessity to execute a reverse split in the Company's common stock at this time, but reserves the right to reconsider this action at a later date within time frames proposed in the Proxy which were approved by the Company's shareholders at the October 31, 2001 Special Meeting of the Shareholders.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

The Company incurred losses from continuing operations of $1,056,800 and $2,690,000 for the three months ended September 30, 2001 and 2000, respectively. For the nine months ended September 30, 2001 and 2000, the Company incurred losses from continuing operations of $5,082,800 and $9,036,700, respectively. Loss per share from continuing operations for the three months ended September 30, 2001 and 2000 were ($.07) and ($.17), respectively. Loss per share from continuing operations for the nine months ended September 30, 2001 and 2000 were ($.30) and ($.63), respectively. The reduction in losses incurred from continuing operations is primarily attributable to the Company's ability to reduce its operating costs in accordance with its business plan.

The Company incurred losses from Discontinued Operations of $1,000,000 or ($.05) per share for the nine months ended September 30, 2001 and $374,400 or ($.02) per share for the nine months ended September 30, 2000 due to the decision to dispose of the Gordon operation (See Note 3).

Sales, marketing and trade show costs were $28,100 and $281,500 for the three and nine months ended September 30, 2001 as compared to $496,400 and $1,667,100 in the prior periods as the Company has substantially reduced its medical sales force in 2001. Medical regulatory expenses were $26,000 and $304,300 for the three and nine months ended September 30, 2001 as compared to $193,400 and $617,000 in the prior periods due to significant reductions in the second quarter of 2001 in FDA filing costs relating to medical products and other regulatory requirements.

Research and development costs were $142,500 for the three months ended September 30, 2001 as compared to $283,400 for the three months ended September 30, 2000. The decrease in research and development costs in the current period is primarily a result of completion of certain milestones in development of the Company's medical product. Research and development costs were $597,200 for the nine months ended September 30, 2001 as compared to $958,300 for the nine months ended September 30, 2000. The decreased research and development costs for the nine months ended September 30,2001 are primarily a result of the above-mentioned completion of milestones.

The Company recorded a provision for estimated payments for terminated employees of $1,000,000 at March 31, 2001.

Compensation costs - Officers, employees and consultants were $198,900 for the three months ended September 30, 2001 as compared to $519,100 for the three months ended September 30, 2000. The decrease in these costs in the current period is a result of the Company's significant decreases in personnel in 2001. Officers, employees and consultants were $853,200 for the nine months ended September 30, 2001 as compared to $1,258,800 for the nine months ended September 30, 2000. The decreases were caused by the same reasons.

Total General and administrative costs were $647,400 and $2,419,100 for the three and nine months ended September 30, 2001 as compared to $1,266,400 and $3,673,700 in the prior periods. The decrease is primarily a result of cost reductions initiated by the Company in 2001.

Interest and non-cash financing costs were $210,900 and $309,900 in the three and nine months ended September 30, 2001 as compared to $181,800 and $1,379,200 in the prior periods. The nine month decrease is primarily due to amortization of original issue discount on senior convertible debentures, which was fully amortized in prior periods.

Deemed dividends on preferred stock were $278,000 and $834,000 in the three and nine months ended September 30, 2001 as compared to $278,000 and $1,259,000 in the prior periods. The decrease for the nine month period is due to an additional deemed dividend from a new financing in the prior period, which did not occur in the current period.

Although the Company has substantially reduced personnel and ongoing operating expenses, the Company expects that if it is successful in raising the necessary financing to continue operations, it will continue to incur costs in connection

with the required research and development for different market applications of its new LED instrument and technology, complete filings, administration and maintenance for certain intellectual properties and regulatory requirements; supply updated products and sales support to its medical distributor; complete FDA filings for further upgrades to its medical products, and explore the possibility of either renegotiating its current distribution agreement for its medical products or selling the exclusive rights to its medical products and technology.

The Company anticipates that it will continue to incur net losses for the foreseeable future as expenses are incurred in implementing its long-term business plan.

LIQUIDITY AND CAPITAL RESOURCES

Current Assets were $2,002,400 at September 30, 2001 as compared to $2,495,900 at December 31, 2000. This decrease is primarily attributable to a decrease in cash due to the operating losses.

As indicated in the Consolidated Statement of Cash Flows, the Company continues to experience significant negative net cash flows from operating activities. The 2001 net cash outflow from operating activities is primarily attributed to the Company's net loss partially offset by depreciation and amortization expense and increases in accounts payable.

The Company lacks funds to continue material aspects of its operations and business plan, including funds and necessary personnel to complete research and development on its new LED instrument and technology recently required during its first mass manufacturing process; complete filings, administration and maintenance for certain intellectual properties and regulatory requirements; supply upgraded products and sales support to its medical distributor; and complete FDA regulatory filings for upgrades to its medical products.

The Company's current objective with regard to its medical business is to arrive at acceptable revised terms of the existing agreement with the distributor or to identify a strategic partner in the medical industry to whom the Company could sell, for an up-front fee and ongoing royalty, the exclusive market rights to the ColorMate(R) TLc-BiliTest(R) System.

The Independent Accountants' Report on the December 31, 2000 financial statements indicates the Company has incurred recurring losses for the last several years, including $19,464,400 in 2000 and has experienced significant problems and delays exploiting its primary technology (medical equipment). In addition, the Company's subsidiary, Gordon, defaulted on its debt services obligations and the lender demanded payment of the entire debt, which totaled $2,714,700 at December 31, 2000. The Independent Accountants' Report states that these matters raise substantial doubt about the Company's ability to continue as a going concern. Gordon has subsequently been sold. See Note 3.

The Company is experiencing a major liquidity crisis and requires an immediate infusion of cash to continue operations. The Company is seeking additional capital to facilitate liquidity and is currently reviewing various financing proposals and has taken steps to significantly reduce costs. If the Company is unable to obtain such financing, or sell its assets to obtain a cash infusion, it may be forced to seek protection from its creditors in bankruptcy.

Even if the Company is successful in obtaining this cash infusion, the Company will require additional future financing to further execute its long range business plan. If the Company is not able to attract additional future financing, generate significant revenue from operations and/or successfully market its products and technologies, it may have to significantly curtail and/or cease operations and be forced to seek protection from its creditors in bankruptcy.

The Company is currently negotiating proposals for financing the Company. Such proposals require negotiation of warrants to purchase the Company's stock and are subject to satisfactory completion of due diligence, negotiation, execution and delivery of definitive agreements by and between the parties, and compliance with NASDAQ listing requirements.

In August 2001, the Company retained Janssen Partners, Inc. to serve as its placement agent in connection with an offering of 10,333,333 shares of common stock and warrants to raise $620,000 in proceeds. Attached to each share is a Series A Common Stock Purchase Warrant which vests immediately, has a five year life and is exercisable at $0.10 per share after registration of the underlying shares. Upon the exercise of each Series A Common Stock Purchase Warrant, the holder will receive a Series B Common Stock Purchase Warrant which vests immediately, has a five year life from date of issuance and is exercisable at $0.15 per share after registration of the underlying shares. The offering will expire upon the earlier of November 30, 2001 or the full subscription of the offering. As of September 30, 2001, 8,333,334 shares of common stock have been subscribed for in an aggregate amount of $500,000, of which $190,000 was received in September 2001 and $310,000 included in current assets as these amounts were received in October 2001 after required shareholder approval for additional authorized shares was obtained October 31, 2001. In addition, 12,500,000 Series A Common Stock Purchase Warrants and 12,500,000 Series B Common Stock Purchase Warrant are issuable in connection with the offering.

The Company is in the process of completing documentation including an additional proxy to obtain stockholder approval for an additional proposed private placement by the Company involving potential issuance of additional shares of common stock by the Company in an aggregate amount in excess of 20% of the Company's common stock outstanding immediately prior to such private placement at a price per share less than the market value of the common stock. On October 31, 2001, at a special shareholder meeting an amendment to the Company's Certificate of Incorporation to increase the number of authorized shares of common stock, $.001 par value per share, from 50,000,000 to 550,000,000 was approved by the following votes: 18,110,383 for; 1,033,794 against; and 71,069 abstained. Additionally, an amendment to the Company's Certificate of Incorporation to effect a one share for up to forty shares reverse stock split of the Company's issued and outstanding shares of common stock, as determined by the Company's Board of Directors was approved by the

following votes: 18,078,117 for; 1,052,519 against; and 84,550 abstained. Due to NASDAQ's temporary suspension of all delisting proceedings regarding the listing requirement for a $1.00 minimum per share price, the Company's Board of Directors does not see the necessity to execute a reverse split in the Company's common stock at this time, but reserves the right to reconsider this action at a later date within time frames proposed in the Proxy which were approved by the Company's shareholders at the October 31, 2001 Special Meeting of the

Shareholders.

Some of the information presented in or incorporated by reference in this report constitutes "forward- looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Although the Company believes that its expectations are based on reasonable assumptions, within the bounds of its knowledge of its business and operations, there can be no assurance that actual results will not differ materially from its expectations. Factors that could cause actual results to differ from expectations include, among other things: (i) the inability of the Company to resolve the current liquidity crisis, (ii) the inability of the Company to secure additional financing, (iii) the failure of the Company to implement its business plan for various applications of its technologies, including medical and industrial technologies, (iv) government regulation and (v) the loss of key personnel.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

No disclosure is required under this Item 3.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On January 16, 2001, a lawsuit was commenced against the Company and Darby Macfarlane in the federal district court for the Southern District of New York entitled Richard Sommers and Linda Sommers v. Chromatics Color Sciences International, Inc. and Darby S. Macfarlane. The plaintiffs allege that certain statements purportedly made by or on behalf of the Company concerning the Company's success, the extent of use of the ColorMate (Registered Trademark) System and the Company's cash flow constituted violations of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 promulgated thereunder and Section 12(a)(2) of the Securities Act of 1933 as well as common law claims alleging fraudulent misrepresentation, concealment and nondisclosure and seek unspecified damages in an amount to be proven at trial. On March 1, 2001, the defendants moved to dismiss the complaint for failure to state a claim upon which relief can be granted, for failure to plead fraud with requisite particularity and for failure to comply with the statutory requirements for federal securities fraud claims. No decision has been rendered by the court on this motion. The defendants believe that the allegations of the complaint are without merit and intend to vigorously defend this action.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None.

ITEM 5. OTHER INFORMATION.

On September 13, 2001, the Company received Food and Drug Administration (FDA) clearance of its 510(k) premarket application to commercially market its upgraded Colormate(R) TLco BiliTest(R) System for non-invasive monitoring of infant jaundice. The TLco BiliTest(R) System upgrade includes faster, more user friendly test programs with many new or improved features requested by healthcare providers, such as test result transfer capability to a central server via the internet. This most recent FDA clearance also confirmed the safety and effectiveness of the TLco BiliTest(R) System for infants of all races and gestational ages before, during and after phototherapy, other than infants with discoloration at a required measurement site. The Company believes these features will provide a state-of-the art monitoring system for aiding physicians and healthcare providers in monitoring bilirubin for newborn infants.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

Reports on Form 8-K:

None.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CHROMATICS COLOR SCIENCES
INTERNATIONAL, INC.

Date: November 14, 2001 By: /s/ Darby S. Macfarlane

Darby S. Macfarlane
Chairman and Chief Technology Officer

Date: November 14, 2001 By: /s/ Leslie Foglesong

Leslie Foglesong
Asst. Treasurer and principal
accounting officer