VIRTRA SYSTEMS INC
Form 10QSB
November 14, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

(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, 2003

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 000-28381

VIRTRA SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Texas	93-1207631
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
440 North Center, Arlington, TX	76011
(Address of principal executive offices)	(Zip Code)

(817) 261-4269
(Registrant's telephone number, including area code)

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 |_|

As of November 4, 2003, the Registrant had outstanding 47,618,629 shares of common stock, par value $.005 per share.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

Balance Sheet as of September 30, 2003 and December 31, 2002
Statement of Operations for the three months and nine months ended September 30, 2003 and 2002
Statement of Changes in Stockholders' Deficit for the nine months ended September 30, 2003
Statement of Cash Flows for the nine months ended September 30, 2003 and 2002
Selected Notes to Financial Statements

VIRTRA SYSTEMS, INC.
BALANCE SHEET
September 30, 2003 and December 31, 2002

	September 30, 2003 (Unaudited)	December 31, 2002 (Note)
ASSETS		

Current assets:		
Cash and cash equivalents	$ -	$ 98,442
Accounts receivable	31,620	93,929
Costs and estimated earnings in excess of billings on uncompleted contracts	-	17,342
Total current assets	31,620	209,713
Property and equipment, net	172,901	158,237
Assets of discontinued operations	-	187,877
Note receivable-related party	67,885	67,885
Intangible assets, net	22,665	36,261
Total assets	$ 295,071	$ 659,973

LIABILITIES AND STOCKHOLDERS' DEFICIT

Current liabilities:		
Notes payable	$ 817,313	$ 889,324
Obligations under product financing arrangements	5,842,724	5,240,418
Notes payable-stockholders	910,031	910,031
Convertible debentures	88,634	308,262
Book overdraft	7,266	-
Accounts payable	1,089,496	1,201,849
Accrued liabilities	683,105	643,879
Billings in excess of costs and estimated earnings on uncompleted contracts	69,720	82,613
Total current liabilities	9,508,289	9,276,376
Redeemable common stock, 490,760 shares at $.005 par value	2,454	3,891
Stockholders' deficit:		
Common stock, $.005 par value, 100,000,000 shares authorized, 46,575,511 and 37,331,448 shares issued and outstanding at September 30, 2003 and December 31, 2002, respectively	232,878	186,658
Additional paid-in capital	3,611,401	2,922,833
Accumulated deficit	(13,061,388)	(11,729,785)
Total stockholders' deficit	(9,217,109)	(8,620,294)

Total liabilities and stockholders' deficit	$ 295,071	$ 659,973

Note: The balance sheet at December 31, 2002 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

See accompanying notes.

VIRTRA SYSTEMS, INC.
STATEMENT OF OPERATIONS
for the three months and nine months ended September 30, 2003 and 2002

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	**2002**	**2003**	**2002**
Revenue:				
Custom applications	$ 218,911	$ 97,314	$ 644,435	$ 235,201
Arcades and other	-	20,856	17,080	78,251
Total revenue	218,911	118,170	661,515	313,452
Cost of sales and services	122,014	58,890	296,115	139,192
Gross margin (loss)	96,897	59,280	365,400	174,260
General and administrative expenses	393,730	265,856	944,344	1,177,868
Loss from operations	(296,833)	(206,576)	(578,944)	(1,003,608)
Other income (expenses):				
Interest income	-	130	-	130
Interest expense and finance charges	(242,698)	(381,129)	(720,189)	(1,067,584)
Gain (loss) on sale of asset	18,908	-	(16,281)	-
Other income	37,264	-	37,264	6,872
Total other income (expenses)	(186,526)	(380,999)	(699,206)	(1,060,582)
Net loss from continuing operations	(483,359)	(587,575)	(1,278,150)	(2,064,190)
Income (loss) from discontinued operations	-	28,541	(53,453)	(54,859)
Net loss	$ (483,359)	$ (559,034)	$(1,331,603)	$(2,119,049)

Weighted average shares outstanding	44,413,497	35,745,265	40,574,782	34,819,486
Basic and diluted net loss per common share	$ (0.01)	$ (0.02)	$ (0.03)	$ (0.06)

See accompanying notes.

VIRTRA SYSTEMS, INC.
STATEMENT OF STOCKHOLDERS' DEFICIT
for the nine months ended September 30, 2003

(Unaudited)

	Common Stock		Additional Paid-In	Accumulated	
	Shares	**Amount**	**Capital**	**Deficit**	**Total**
Balance at December 31, 2002	37,331,448	$ 186,658	$2,922,833	$(11,729,785)	$(8,620,294)
Common stock issued upon conversion of debentures	2,710,600	13,553	191,045	-	204,598
Common stock issued for payment of interest	106,232	531	7,255	-	7,786
Common stock issued for cash	5,427,231	27,136	425,268	-	452,404
Common stock issued for services	1,000,000	5,000	65,000	-	70,000
Net loss	-	-	-	(1,331,603)	(1,331,603)
Balance at September 30, 2003 (unaudited)	46,575,511	$ 232,878	$3,611,401	$(13,061,388)	$(9,217,109)

See accompanying notes.

VIRTRA SYSTEMS, INC.

STATEMENT OF CASH FLOWS

for the nine months ended September 30, 2003 and 2002

(Unaudited)

	Nine Months Ended September 30, 2003	2002
Cash flows from operating activities:		
Net loss	$(1,331,603)	$(2,119,049)
Less: net loss from discontinued operations	(53,453)	(54,859)
Net loss from continuing operations	(1,278,150)	(2,064,190)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	66,809	51,247
Loss on sale of assets	16,281	-
Effect of beneficial conversion feature and warrant costs	-	156,900
Bad debt expense	-	16,967
Amortization of debt issuance costs and increase in obligation under product financing arrangements	602,306	524,685
Stock issued for interest and financing fees	7,786	234,602
Stock issued as compensation for services	70,000	279,775
Change in operating assets and liabilities	(21,398)	312,332

Net cash used in operating activities	(536,366)	(487,682)
Cash flows from investing activities:		
Purchase of property and equipment	(48,970)	-
Proceeds from sale of assets	120,000	-
Net cash provided by investing activities	71,030	-
Cash flows from financing activities:		
Proceeds from notes payable	35,000	35,000
Payments on notes payable	(107,012)	(141,068)
Proceeds from convertible debentures	-	450,000
Proceeds from notes payable to stockholders	-	199,500
Increase (decrease) in book overdraft	7,266	(33,172)
Payments on obligations under product financing arrangements	-	(15,000)
Proceeds from issuance of common stock	452,404	25,000
Net cash provided by financing activities	387,658	520,260
Net cash provided by (used in) discontinued operations	(20,764)	303,270
Net increase (decrease) in cash and cash equivalents	(98,442)	335,848
Cash and cash equivalents at beginning of period	98,442	-
Cash and cash equivalents at end of period	$ -	$ 335,848
Supplemental disclosure of cash flow information:		
Interest paid	$ 30,607	$ 39,914
Income taxes paid	$ -	$ -
Non-cash investing and financing activities:		
Common stock issued upon conversion of debentures	$ 204,598	$ 11,690

See accompanying notes.

VIRTRA SYSTEMS, INC.
NOTES TO FINANCIAL STATEMENTS

1. Basis of Presentation

The accompanying unaudited interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and the rules of the U.S. Securities and Exchange Commission, and should be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 2002. They do not include all information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. However, except as disclosed herein, there has been no material change in the information disclosed in the notes to the financial statements for the year ended December 31, 2002 included in the Company's Form 10-KSB and Form DEF 14A filed with the Securities and Exchange Commission. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of financial position and the results of operations for the interim periods presented have been included. Operating results for the interim periods are not necessarily indicative of the results that may be expected for the respective full year.

2. 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 reported amounts and related disclosures. Actual results could differ from those estimates.

3. Income Taxes

The difference between the 34% federal statutory income tax rate and amounts shown in the accompanying interim financial statements is primarily attributable to an increase in the valuation allowance applied against the tax benefit from the future utilization of net operating loss carryforwards.

4. Discontinued Operations

On April 30, 2003, VirTra Systems, Inc. (the "Company") entered into an agreement to sell its contracts and the assets used in its theme park operations for $120,000, payable in four equal installments of $30,000 upon signing of the term sheet; $30,000 on April 30, 2003; $30,000 on May 31, 2003; and $30,000 on June 30, 2003. The transaction resulted in a loss on sale of assets of $16,281.

The financial statements have been presented to reflect the sale of the Company's assets related to its theme park operations. Accordingly, the financial statements reflect the theme park operations as discontinued operations for each of the periods presented.

Total revenues included in discontinued operations was $-0- and $32,060 for the three and nine months ended September 30, 2003, respectively, and $713,139 and $1,019,921 for the three and nine months ended September 30, 2002, respectively. There was no effect on basic and diluted net loss per common share, reported in the accompanying statement of operations, from the results of the discontinued operations.

5. Reclassification

Certain amounts reported in the prior period financial statements have been reclassified to the current period presentation.

6. Common Stock

In July 2002, the Company entered into an agreement for up to a maximum $5,000,000 sale of its common stock to Dutchess Private Equities Fund, LP ("Dutchess"). Under this investment agreement the Company has the right to issue a "put notice" to Dutchess to purchase the Company's common stock. Put notices cannot be issued more frequently than every seven days. The required purchase price is equal to 92% of the average of the four lowest closing bid prices of the common stock during the five-day period immediately following the issuance of the put notice. Each individual put notice is subject to a maximum amount equal to 175% of the daily average volume of the common stock for the 40 trading days before the issuance of the put notice multiplied by the average of the closing bid prices of the common stock for the three trading days immediately preceding the put notice date. Regardless of the amount stated in a put notice, the maximum amount that Dutchess is required to purchase is the lesser of the amount stated in the put notice

or an amount equal to 20% of the aggregate trading volume of the common stock during the five days immediately following the date of the put notice times 92% of the average of the four lowest closing bid prices of the common stock during this five-day period. During the nine months ended September 30, 2003 the Company sold 5,427,231 shares of its common stock for $452,404 under this agreement.
In connection with this investment agreement the Company issued $450,000 in convertible debentures. The debentures bear interest at 5% per year payable in cash or registered common stock at the Company's option. The debentures mature in September 2005 and are convertible, at the option of the holder, to shares of the Company's common stock at a conversion price per share equal to the lower of (i) 85% of the average of any four or five closing bid prices for the common stock for the five days prior to the conversion date; or (ii) 125% of the volume weighted average price on the closing date. During the nine months ended September 30, 2003 the Company issued 2,710,600 shares of its common stock upon conversion of $204,598 of this debenture and issued 106,232 shares of its common stock as payment of $7,786 of interest on the debentures.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The statements contained in this Report that are not historical are forward-looking statements, including statements regarding our expectations, intentions, beliefs or strategies regarding the future. Forward-looking statements include our statements regarding liquidity, anticipated cash needs, and availability and anticipated expense levels. All forward-looking statements included in this Report are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statement. It is important to note that our actual results could differ materially from those in such forward-looking statements. The following discussion and analysis should be read in conjunction with the financial statements and notes thereto appearing elsewhere in this Report.

Overview

Effective May 6, 2002, our name was changed from "GameCom, Inc." to "VirTra Systems, Inc.," pursuant to authority granted to the board of directors by the shareholders at its September, 2001 meeting.

Effective September, 2001, we completed the acquisition of Ferris Industries, Inc., a leading developer and operator of virtual reality devices. Ferris designed, developed, and distributed technically-advanced products for the entertainment, simulation, promotion, and education markets. Its virtual reality (VR) devices are computer-based and allow people to view and manipulate graphical representations of physical reality. The acquisition provided us with a wider array of products within our industry, an experienced management team, an existing revenue stream, and established distribution channels. Until we acquired Ferris, we had devoted substantially all of our efforts to implementing our `Net GameLink™ product, an interactive entertainment system designed to allow a number of players to compete with one another in a game via an intranet or the Internet.

The Ferris acquisition was accounted for as a pooling of interests. Ferris was much larger than GameCom in terms of assets, and had substantial revenues whereas GameCom had essentially no revenues at the time of the acquisition. We recently sold our theme park operations, so that substantially all our revenue on an ongoing basis is expected to be in custom applications and other sources.

Future revenues and profits will depend upon various factors, including market acceptance of our two advanced training systems, and the success of our continued sales to the advertising/promotion market. Our anticipated entry into the training/simulation market was advanced by the aftermath of September 11, 2001. We unveiled our initial product in this market, the IVR-p™ advanced training simulator, in December of 2002, and we publicly announced the other more advanced training simulator, the IVR-360™, in July. We recently announced the initial two sales of our advanced training simulators in September and October, respectively. We have conducted demonstrations of both the IVR-p™ and the IVR-360™ in Washington, D.C. and at our Phoenix production facility, and numerous demonstrations are scheduled within the next few months. We remain in advanced discussions with representatives of the Department of Homeland Security, various federal and foreign agencies, and various law enforcement agencies regarding our

technology, and our capabilities in situational awareness and judgmental use-of-force training.
We face all of the risks, expenses, and difficulties frequently encountered in connection with the expansion and development of a business, difficulties in maintaining delivery schedules if and when volume increases, the need to develop support arrangements for systems at widely dispersed physical locations, and the need to control operating and general and administrative expenses. While the Ferris acquisition provided an established stream of revenues and historically favorable gross margins, Ferris had not yet generated a profit, and substantial additional capital, or major highly-profitable custom applications, will be needed if those operations are to become profitable.

Results of Operations

Three Months Ended September 30, 2003 Compared to Three Months Ended September 30, 2002

Three major factors affected our results of operations for the three months ended September 30, 2003, compared to the corresponding period of 2002. First, revenue increased. Second, general and administrative expenses increased. Third, interest expense and finance charges decreased.

Revenues from our virtual reality product lines are somewhat unpredictable. Custom applications tend to consist of a few large projects at any time, and the stage of completion of any particular project can significantly affect revenue. We had revenue of $218,911 for the three months ended September 30, 2003, compared to $118,170 for the corresponding three months of 2002. Revenue from custom applications and other sources increased. The main component of this item is revenue from the recently completed contract with Cameo Marketing for the *Red Baron® 3-D Flying Adventure*™, from a promotional helicopter project for an undisclosed customer, and from Schwan’s (Red Baron™ Pizza) for a promotional experience at its new flight museum. Cost of sales and services increased proportionally.

General and administrative expenses of $393,730 for the three months ended September 30, 2003, compared to $265,856 for the three months ended September 30, 2002, increased primarily due to an increase in consulting fees. .

Interest expense and finance charges decreased to $242,698 for the three months ended September 30, 2003 compared to $381,129 for the corresponding period of 2002 largely because of a significant reduction in common shares issued as interest or financing fees, and because the debt issuance costs on a majority of the product-financing arrangements have now been fully amortized.

Nine months Ended September 30, 2003 Compared to Nine Months Ended September 30, 2002

Three major factors affected our results of operations for the nine months ended September 30, 2003, compared to the corresponding period of 2002. First, revenues increased. Second, general and administrative expenses decreased. Finally, interest expense and finance charges also decreased.

We had revenue of $661,515 for the nine months ended September 30, 2003, compared to $313,452 for the corresponding nine months of 2002. The main components of this item are revenue from the Shell/Pennzoil *Vroom Tour* promotional virtual reality project, the recently-completed *Red Baron® 3-D Flying Adventure*™ promotional project, a promotional helicopter experience for an undisclosed customer, and the Schwan’s (Red Baron™ Pizza) promotional experience at its new flight museum. Cost of sales and services increased to $296,115, which is relatively proportionate to the increase in revenue.

General and administrative expenses of $944,344 for the nine months ended September 30, 2003, compared to $1,177,868 for the nine months ended September 30, 2002, decreased primarily due to a reduction in professional and consulting fees, and management’s efforts to reduce general overhead expense.

Interest expense and finance charges decreased to $720,189 for the nine months ended September 30, 2003, compared to $1,067,584 for the corresponding period of 2002, largely because of a significant reduction in common shares issued as interest or financing fees, and because the debt issuance costs on a majority of the product-financing arrangements have now been fully amortized.

Liquidity and Plan of Operations

As of September 30, 2003 our liquidity position remained precarious. However, our recent increase in revenue from custom applications for the advertising/promotional market has given us some breathing room. As of September 30, 2003 we had current liabilities of $9,508,289, including $5,842,313 in obligations under lease financing arrangements for the virtual reality systems formerly utilized in our amusement applications, $1,089,496 in accounts payable, and short-term notes payable of $817,313, some of which were either demand indebtedness or were payable at an earlier date and were in default. As of September 30, 2003 there were only $31,620 in current assets available to meet those liabilities. We will be able to continue operations only if holders of our short-term notes and lease obligations continue to forebear enforcement of those obligations.

On July 12, 2002, we entered into an agreement with Dutchess Private Equities, L.P., pursuant to which Dutchess and other investors participated in the private placement of $450,000.00 in convertible debentures, as well as a private equity line of $5,000,000.00 over the next two years. Registration of the shares to be issued under the terms of the agreement was accomplished pursuant to the terms of an SB-2 filed with the Securities and Exchange Commission on August 12, 2002, and which became effective on September 2, 2002. Dutchess has fully funded the debentures. As of September 30, 2003, the balance owed on the debentures to Dutchess had been reduced to $88,634.

The Dutchess private equity line may not in the future be a viable funding mechanism, as the price and volume of trading in our shares may become too low to make that source of financing attractive. To date we have met our capital requirements by acquiring needed equipment under non-cancelable leasing arrangements, through capital contributions, loans from principal shareholders and officers, certain private placement offerings, the Dutchess convertible debentures, and the Dutchess private equity line.

For the nine months ended September 30, 2003, net cash used in operating expenses was $536,366. To fund our operations for the nine months ended September 30, 2003, we received $120,000 from the sale of assets used in our theme park operations, issued $35,000 in notes to non-stockholders, utilized our cash on hand in the sum of $98,442, increased our book overdraft by $7266, and drew down $452,404 under our equity line of credit.

The opinion of our independent auditor for each of the last two fiscal years expressed substantial doubt as to our ability to continue as a going concern. We will either need substantial additional capital, or to be successful with lucrative custom application projects in the promotional/advertising markets, or for our entry into the training/simulation market to be successful so as to generate profits to fund the company. We may need additional financing in order to carry out our expansion plans. Based upon the increase in the stock's trading volume and price following our entry into the training/simulation market, management believes that the Dutchess financing will allow us to continue our operations for at least the next 12 months, provided holders of our short-term notes and equipment lease obligations continue to give us the breathing room necessary for our new applications to make significant contributions to revenue.

Item 3. Controls and Procedures

Based upon an evaluation performed within 90 days of this report, our CEO and CFO has concluded that our disclosure controls and procedures are effective to ensure that material information relating to our company is made known to management, including the CEO and CFO, particularly during the period when our periodic reports are being prepared, and that our internal controls are effective to provide reasonable assurance that our financial statements are fairly presented in conformity with generally accepted accounting principles.

In accord with SEC requirements, the CEO and CFO notes that, since the date of his evaluation to the date of this Quarterly Report, there have been no significant changes in internal controls or in other factors that could significantly affect internal controls, including any corrective actions with regard to significant deficiencies and material weaknesses.

PART II - OTHER INFORMATION

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

N/A

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

(a) Exhibits

31 Chief Executive Officer and Chief Financial Officer - Rule 13a-14(a) Certification

32 Chief Executive Officer and Chief Financial Officer - Sarbanes-Oxley Act Section 906 Certification

(b) We have not filed any reports on Form 8-K during the last quarter of the period covered by this report.

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

VIRTRA SYSTEMS, INC.

Date: November 14, 2003	/s/ L. Kelly Jones
	L. Kelly Jones
	Chief Executive Officer and Chief Financial Officer